Tolley®CPD

November 2018

Disclaimer

Tolley CPD takes every care when preparing this material. However, no responsibility can be accepted for any losses arising to any person acting or refraining from acting as a result of the material contained in these notes.

CONTENTS

Budget 2018: Personal Tax (Lecture P1101 – 22.04 minutes)

Income Tax

Rates and allowances

For 2019/20, the personal allowance is increased from £11,850 to £12,500 and the basic rate limit from £34,500 to £37,500, so that the level of income at which an individual comes within the charge to income tax is extended from £46,350 in 2018/19 to £50,000 in 2019/20. The 2019/20 figures will remain the same for 2020/21. After that they will rise with the annual increase in the Consumer Price Index.

The higher rate limit and the personal allowance income limit remain unchanged at £150,000 and £100,000 respectively for 2019/20. The basic, higher and additional rates are all unchanged, as are the rates on dividends and savings income. The dividend allowance, personal savings allowance, starting rate for savings and starting rate limit all stay at their 2018/19 levels. The transferable tax allowance for married persons (aka the marriage allowance) automatically becomes £1,250 for 2019/20. Other income tax personal reliefs are increased in line with inflation, as is the capital gains tax annual exempt amount which becomes £12,000 from 6 April 2019. Rates of capital gains tax are unchanged, as are income tax rates for trustees.

Property businesses — rent-a-room relief

It had previously been announced that Finance Bill 2019 would introduce a shared occupancy test for rent-a-room relief for 2019/20 onwards. The potential claimant (or a member of his household) would have to use the residence as sleeping accommodation for at least part of the period of the tenancy in order to qualify for rent-a-room relief on the rents. It is now announced that this test will *not* be introduced by Finance Bill 2019.

ISAs and Child Trust Funds

The ISA annual subscription limit will remain at £20,000 for 2019/20. The annual subscription limits for Junior ISAs and Child Trust Funds are increased in line with inflation to £4,368 from 6 April 2019.

Voluntary tax returns

A number of cases before the tribunal have made it clear that HMRC's powers are limited with regard to self-assessment tax returns submitted voluntarily, i.e. in a case where notice to file a return has not been given or has been given but not properly served. For example, HRMC cannot enquire into such a return and neither can they charge a penalty for late filing. With retrospective effect to 1996/97 (the first year of income tax self-assessment), the same rules apply to these unsolicited returns as to any other self-assessment returns.

Brexit

Legislation will be introduced in Finance Bill 2019 to provide a power to make minor consequential amendments pursuant to Brexit. The Government intend to use the power to make such minor amendments to tax law as to keep it working in the same way as it does now if the UK leaves the EU without a deal.

Employment Tax

Car and van benefits

The amount to which the appropriate percentage is applied in determining the taxable benefit of company car fuel is £24,100 for 2019/20 (£23,400 for 2018/19). The cash equivalent of the benefit of a company van for 2019/20 is £3,430 (£3,350 for 2018/19). The cash equivalent of the benefit of van fuel for 2019/20 is £655 (£633 for 2018/19).

Off-payroll working in the private sector

Responsibility for operating the off-payroll working rules (IR35) in the private sector, and deducting any tax and national insurance contributions due, will move from the individual to the organisation, agency or other third party paying the individual's personal service company. Small organisations will be exempt. This change will bring private sector organisations into line with public sector bodies and agencies, and will have effect from 6 April 2020.

National insurance contributions (NICs)

Reforms to the NICs treatment of termination payments and income from sporting testimonials, which were originally to be introduced from 6 April 2018 but were then deferred until 6 April 2019, are still further delayed, this time until 6 April 2020.

Employment allowance

Most employers can currently claim an employment allowance of up to £3,000 to offset against their liability to employer Class 1 NICs. The Government are to restrict the allowance to employers with an employer NICs liability of less than £100,000 in the preceding tax year. Where employers are connected, the £100,000 threshold will apply to their aggregated liability. This change will take effect from 2020.

Self-funded work-related training costs

Following consultation, the Government are maintaining, but not widening, the scope of tax relief currently available to employees and the self-employed for work-related training costs.

Short Term Business Visitors (STBVs)

Following consultation on the tax and administrative treatment of STBVs from overseas branches of UK headquartered companies, the Government will widen eligibility for the STBV PAYE special arrangement and extend its deadlines for reporting and paying tax. This will have effect from April 2020.

Abuse of insolvency rules

The Government are to introduce legislation in Finance Bill 2020 to enable HMRC to make directors and other persons involved in tax avoidance, evasion or phoenixism jointly and severally liable for company tax liabilities, where there is a risk that the company may deliberately enter insolvency. This will have effect from Royal Assent of Finance Bill 2020.

Other measures

There are no changes to the following previously announced employment tax measures:

- amendment to salary sacrifice rules for taxable cars and vans;
- relief from benefit rules for employer provided electricity for electric vehicles;
- changes to benefit rules on emergency vehicles;
- widening the scope of the benefit exemption for employer pension contributions;
- abolition of receipt checking for subsistence benchmark scale rates;
- legislating existing overseas scale rates for accommodation and subsistence.

Pensions Tax

The much-predicted changes to pensions tax (reduction of annual allowance and/or taper limit, restriction of relief to basic rate etc.) have *not* materialised. The lifetime allowance is increased with inflation to £1,055,000.

Capital Gains Tax

Entrepreneurs' relief

With effect for disposals on or after 29 October 2018, a new test will be added to existing tests that determine if a company is an individual's personal company for entrepreneurs' relief. The new condition requires the individual to be beneficially entitled to at least 5% of the company's distributable profits and 5% of its assets available for distribution to equity holders in a winding-up.

The minimum period throughout which certain conditions must be met to qualify for entrepreneurs' relief, for example the period a business must be carried on immediately prior to a disposal, is to be increased from one year to two years. This will apply to disposals on or after 6 April 2019, except that where the claimant's business ceased, or his personal company ceased to be a trading company (or the holding company of a trading group), before 29 October 2018, the pre-existing one-year qualifying period will continue to apply.

As previously announced, the Government will legislate to allow individuals whose shareholding is diluted below the 5% qualifying threshold for entrepreneurs' relief as a result of a new share issue to obtain relief for gains up to that time, subject to conditions. The change will apply where a company ceases to be the individual's personal company as a result of its issuing shares on or after 6 April 2019. Following consultation, changes are being made to clarify and improve the computational and qualifying rules in the draft legislation.

Private residence relief

From April 2020, two changes will be made to private residence relief as follows.

The fraction of the gain that is exempt is given by dividing the length of the part period of ownership during which the dwelling-house was the individual's only or main residence, but inclusive of the last 18 months of the period of ownership in any event (36 months for certain disposals by disabled persons and long-term residents in a care home) by the length of the period of ownership. The 18-month period is to be reduced to 9 months, but the 36-month period, where it applies, will be unchanged.

Where the dwelling-house in question has at any time in the period of ownership been let as residential accommodation, the part of the gain, if any, which would otherwise be a chargeable gain by reason of the letting is exempt to the extent of the lower of £40,000 and the amount of the gain otherwise exempt. This lettings relief will be reformed so that it applies only in circumstances where the owner of the property is in shared-occupancy with a tenant.

Taxing gains made by non-UK residents on UK immovable property

As announced at Autumn Budget 2017, the Government will legislate in Finance Bill 2019 to broaden the UK's tax base to include disposals of all forms of UK land made by non-residents. This will include both direct disposals of UK land, and indirect disposals of entities that predominantly derive their value from UK land. The changes will take effect for disposals made on or after 6 April 2019.

Capital gains tax payment window

Also as announced at Autumn Budget 2017, the Government will legislate in Finance Bill 2019 to introduce a requirement for UK residents to make a payment on account of capital gains tax following the completion of a residential property disposal. This will apply to disposals by non-UK residents on or after 6 April 2019 and by UK residents on or after 6 April 2020. Following consultation, the legislation has been changed to allow reasonable estimates of valuations and apportionments needed to compute the gain, where this information is not available before the payment deadline and to remove disposals by UK residents of non-UK properties from the rules.

Inheritance Tax

Residence nil rate band

Some minor technical amendments are being made to the operation of the residence nil rate band. These will have effect from 29 October 2018.

Stamp Duty Land Tax

Extension of first-time buyers relief

First-time buyers relief will be extended to include qualifying shared ownership property purchases in England and Northern Ireland. The first £300,000 on an initial share purchased will not be liable to SDLT. This is whether or not the purchaser elects to pay SDLT on the market value of the property. The balance of the initial share purchased will be chargeable at 5% on amounts over £300,000 with no SDLT chargeable on the lease. There will be no relief on any further shares purchased. This change will apply to relevant transactions with an effective date on or after 29 October 2018 and will also be backdated to 22 November 2017 when the relief for first time buyers was introduced.

SDLT higher rates

The Government will extend the time allowed to amend a tax return relating to higher rates for additional dwellings from three months to twelve months for those who sell their old homes more than 12 months after they buy a new home.

SDLT for non-UK residents

A consultation will be published in January 2019 on an SDLT surcharge of 1% for non-residents buying residential property in England and Northern Ireland.

Stamp duty (SD) and Stamp duty reserve tax (SDRT)

A targeted market value rule will come into force on 29 October 2019 for SD and SDRT will be introduced for listed securities transferred to connected companies. The transfer will be chargeable based on the higher of the amount or value of the consideration, if any, for the transfer or the market value of the securities.

The Government will also consult on aligning the Stamp Duty and SDRT consideration rules and introducing a general connected party market value rule.

Budget 2018: Business Tax (Lecture B1101 – 19.34 minutes)

Capital allowances

The annual investment allowance will temporarily increase from £200,000 to £1 million for the two-year period from 1 January 2019 to 31 December 2020. This does mean there will once again be complex rules for periods of account spanning those dates, and businesses will need to take care that they do not inadvertently spend too much at the wrong time in the accounting period.

For 2019 and 2020, an update to items on the energy technology list and the water technology list which qualify for enhanced 100% capital allowances to reflect developments in eligible technologies;

The 100% first-year allowances for energy saving plant and machinery and environmentally beneficial plant and machinery will come to an end on 5 April 2020. The current 100% first-year allowance for expenditure incurred on electric charge-point equipment, which was to have expired on 5 April 2019, is extended to 5 April 2023.

The special rate of writing-down allowance will reduce from 8% to 6% from 6 April 2019. The special rate applies to cars (other than certain low emission cars), long-life assets, thermal insulation and integral features. For periods of account spanning 6 April 2019, expenditure in the special rate pool will be relieved at a hybrid rate somewhere between 6% and 8%.

A new Structures and Buildings Allowance (SBA) is to be introduced for new non-residential structures and buildings. Relief will be provided on eligible construction costs incurred on or after 29 October 2018, at an annual rate of 2% on a straight-line basis. There will not be a system of balancing charges or balancing allowances on a subsequent disposal of the asset. Instead, a purchaser will continue to claim the annual allowance of 2% of original cost. The amount eligible for relief will not be increased where a structure or building is purchased, or where it has appreciated in value, as this does not represent the cost of construction.

Relief will be available for UK and overseas structures and buildings, where the business is within the charge to UK tax. The cost of land or rights over land, and the costs of obtaining planning permission, will not be eligible for relief. Relief will not be available for structures or buildings where a contract for the physical construction works is entered into before 29 October 2018.

For speculative building and those structures or buildings constructed ‘in house’, relief will not be available where the construction activity began before that date. SBA expenditure will not qualify for the annual investment allowance.

The Government will legislate in Finance Bill 2019 to clarify when expenditure on altering land for the purposes of installing plant or machinery can qualify for capital allowances. The intention is to put beyond doubt that the land alteration expenditure qualifies for plant or machinery capital allowances only where the plant or machinery itself so qualifies. This takes effect for capital allowances claims made on or after 29 October 2018.

Corporation Tax

Digital services tax (DST)

Tackling the tax treatment of digital business is part of the OECD's base erosion and profit shifting (BEPS) project and the Chancellor has confirmed he remains committed to this process but has proposed the introduction of a digital services tax whilst the BEPS project is finalised.

The DST will be 2% tax on revenues generated from search engines, social media platforms and online marketplaces where those activities are linked to the participation of UK users. There will be a £25 million per annum allowance and the DST will only apply to groups that generate global yearly revenues of more than £500 million. A tax on revenue can have a higher impact on loss-making and start-up companies but there will be a safe harbour provision that exempts loss-makers and reduces the effective rate of tax for business with very low profit margins. The tax will be introduced in April 2020 but the Government will consult on the detail.

The UK proposal contrasts with a proposal from the European Commission for an interim DST of a 3% tax that the Committee on Economic and Monetary Affairs of the European Parliament has suggested should be set at 5%.

Capital losses

From 1 April 2020, the Government will bring the treatment of capital losses in line with other corporate income losses. Therefore, the utilisation of brought forward capital losses will be restricted to 50% of annual capital gains. This aligns with the restrictions on other corporate tax losses that were introduced from 1 April 2017. The current £5 million allowance that applies for corporate income tax losses will therefore be extended to capital losses. There will be a consultation on the detail of the proposals and also the introduction of anti-avoidance measures.

Intangible assets

Following consultation on the treatment of intangible fixed assets in spring 2018, the Government intend to reform the intangibles regime. This reform will partially reinstate relief for acquired goodwill in the acquisition of businesses with eligible intellectual property from April 2019. This relief was completely removed for goodwill acquired on or after 8 July 2015.

In addition, the de-grouping charge rules will be amended for de-groupings occurring on or after 7 November 2018 so that a charge will not arise where the de-grouping is the result of a share disposal that qualifies for substantial shareholding exemption. A de-grouping charge applies when a company leaves a group after the transfer of an asset on a tax neutral basis. Further details will be released on 7 November 2018.

As announced in the Autumn Budget 2017, a UK income tax charge will apply to amounts received in a low tax jurisdiction in respect of intangible property where those amounts are referable to the sales of goods or services in the UK. This measure will apply to income from both related and unrelated parties.

There will be a £10 million de minimis UK sales threshold and exemptions for income that is taxed at appropriate levels or which relates to intangible property that is supported by sufficient local substance. The income tax charge will apply regardless of whether there is a UK taxable presence. This measure will apply from 6 April 2019.

Research and development (R&D) tax credit

An SME with a trading loss that has incurred qualifying R&D expenditure can surrender all or part of the loss for a tax credit that is currently 14.5% of the surrenderable loss. For accounting periods beginning on or after 1 April 2020, there will be a limit on the amount of tax credit that a company can claim under the R&D SME tax relief scheme. The limit will be set at three times the total PAYE and NICs payment for the period. Consultation is expected.

Definition of a permanent establishment

A company not resident in the UK will be chargeable to corporation tax if it carries on a trade in the UK through a permanent establishment (PE). However some companies avoid establishing a PE by fragmenting their activities.

From 1 January 2019, a non-UK resident company will be denied this PE exemption where that company or group carries on a business operation in the UK, one of the companies has a PE where complementary functions are carried out and the activities would create a PE if they were in a single company.

This legislative change puts into UK domestic law the proposals of the OECD in their base erosion and profit-shifting (BEPS) project.

Diverted profits tax

Amendments will be made to the diverted profits tax rules to close planning opportunities and modify the mechanics of the legislation.

Charities and charitable giving

The Government will legislate to increase the charities' small trading exemption limits. These limits apply to trading that does not relate to the charities' primary purpose. The main limit is 25% of the charity's income, but it is currently £5,000 if total income is under £20,000, and is currently £50,000 if total income is over £200,000. In future the limits will be £8,000 if total income is under £32,000 and £80,000 if total income is over £320,000. The changes will have effect on and after 6 April 2019 for unincorporated charities and from 1 April 2019 for incorporated charities.

The Gift Aid Small Donations Scheme currently applies to donations of £20 or less made by individuals in cash or by contactless payment. This will increase to £30. Parliamentary timetable permitting, the increase will take effect from 6 April 2019.

The previously announced simplification of Gift Aid donor benefit rules will go ahead from 6 April 2019 as expected.

Other measures

The following measures have been previously announced and remain largely unchanged:

- amendments to the corporate interest restriction to ensure that it works as intended and takes account of the impact of IFRS 16;
- non-UK resident companies that carry on a UK property business or have UK property income to be within the charge to corporation tax rather than income tax, from 6 April 2020;
- certain UK residential property gains for non-UK resident companies will come into charge to corporation tax from 6 April 2019;
- amendments to relief for carried-forward losses for companies to ensure that legislation works as intended;
- amendments to the controlled foreign company legislation and amendments to the hybrid mismatch rules to comply with the EU directive on anti-tax avoidance

VAT

VAT registration and deregistration thresholds

The current VAT registration threshold of £85,000 and the deregistration threshold of £83,000 will be maintained. The threshold will stay at its existing amount until April 2022.

Vouchers

Legislation will be implemented that ensures that the correct amount of VAT is levied on the amount paid by the customer, regardless of whether the customer pays with a voucher or other means of payment.

VAT fraud in labour provision in the construction sector

The Government will extend the scope of the domestic reverse charge mechanism to include labour provision in the construction sector.

VAT and higher education

The Government have stated that they will amend VAT law to ensure continuity of VAT treatment of English education providers under the Higher Education and Research Act.

Split payment (alternative method of collecting VAT)

The Government have announced that they will publish a response to their previous consultation on the introduction of a split payment method under which businesses would pay the VAT collected from the customer directly to HMRC.

VAT grouping

The Government announced that legislation will extend the eligibility to join a VAT group to certain non-corporate entities, and revised VAT grouping guidance will be issued to clarify certain areas.

VAT — adjustments to Regulation 38

Stricter rules will be introduced regarding how and when adjustments to VAT should be made following a retrospective reduction in the price of goods or services.

Personal tax

Welsh taxpayer technical guidance

From 6 April 2019, new Welsh rates of income tax will apply. In readiness for this, HMRC has added a new internal manual 'Welsh taxpayer technical guidance' which covers:

- who will be a Welsh taxpayer for the purposes of the new Welsh rates of income tax;
- information on an individual's place of residence;
- tests for Welsh taxpayer status;
- evidence used to establish a person's status.

www.gov.uk/hmrc-internal-manuals/welsh-taxpayer-technical-guidance

Employment related expenses (Lecture B1103 – 15.35 minutes)

Normally, payments for expenses, including sums put at the employee's disposal and paid away by them, are assessable to income tax as taxable benefits. However, provided the expense is a qualifying expense, a deduction can be claimed and no tax paid. To qualify, the expenses must satisfy s336 ITEPA2003 whereby the employee must incur or pay the expense due to employment, and the expense must be incurred "wholly, exclusively and necessarily in the performance of the duties of employment".

Qualifying business expenses

Historically, an employer could apply for a dispensation for certain expenses to be paid tax free and not reported. Today, no such dispensation applies but instead, provided that the expenses satisfy s336 ITEPA 2003, they are 'qualifying expenses' and are neither taxed nor reported.

The employer must not assume that all expenses incurred by an employee are qualifying expenses; they must always check that s336 applies by carefully reviewing any claims and payments. They must consider all expenses, principally travel, subsistence and entertainment but there may be other expenses that are incurred such payment for use of home phone or broadband

Travel expenses

Travel costs are probably the most widely claimed expenses. 100% tax relief is given for allowable travel expenses that include travelling in the performance of duties, or to or from a temporary place of work.

For travel to qualify as business travel in performance of their duties, the travel must be required as part of the job. This could be to visit a customer or supplier, to attend a training session or wok related exhibition. Remember that HMRC would not expect normal home to work travel to be deducted from these travels expenses, but they would expect the employer to check that the employee is taking a direct route for the business travel and is not going via friends and family or visiting the gym.

Permanent place of work

The contract of employment will normally state the permanent place of work that will be where the employee regularly works to carry out duties, whether from an office, depot, site or for a salesperson that could be a defined geographical area. Journeys within a geographical area would be qualifying business travel.

An employee could have a temporary workplace, in which case travel to and from home to this temporary workplace would qualify as business travel and not be taxable. A temporary workplace can last as long as 24 months or up until the point that the employer knows that the workplace becomes permanent. So an 18-month placement to Leeds would be a temporary workplace with business travel being paid tax-free. If after 12 months it is agreed that the employee will continue to work in Leeds for the foreseeable future, Leeds becomes the employee's permanent workplace and travel costs become taxable from that date.

Dual purposes expenses

Where an expense is wholly business related, no reporting is required. However, where an expense is partly business and partly private, the non-business element should be reported through PAYE.

If an expense is reported through payroll, the employee can still make a s336 claim for any business element.

Business trip example

Joe is based in London and he travels to Manchester for a 3-day training course. He stops on route with friends and takes them out for a meal to thank them for putting him up. He claims mileage for driving from home to Manchester and back. He buys sandwiches for lunch each day. His hotel bill includes his room, breakfast and evening meal, mini bar and drinks at the bar and a morning newspaper. On the last day he plays a round of golf.How are these expenses treated?

- Meal to say thank you is a taxable benefit as it is not wholly, exclusively and necessarily incurred in the performance of his duties;

- The mileage is a business expense and can be claimed tax free at 45p per mile (25p if business miles have exceeded 10,000 for the tax year);

- Sandwiches are paid tax free subsistence as the amount spent is a modest amount;

- The cost his hotel room, breakfast and evening meal would all be tax free business expenses; the drinks from the mini bar and bar would be taxable as they are not qualifying business expenses;

- The newspaper is a personal expense and taxable; The employee can claim incidental expenses tax free of up to £5 per night when staying away from home in the UK or £10 if abroad. This allowance would cover the newspaper cost and could be used to cover the cost of his bar drinks. We will cover this allowance in more detail in a future session.

- The round of golf would be taxable unless it was entertaining a client, in which case it would be claimable as a business expense.

Where the employee reimburses the cost of taxable items, they are no longer taxable. Failing to reimburse, means that the employer must report these expenses and collect tax and NIC through PAYE.

HMRC guidance for salary sacrifice

On 9 October 2018, HMRC published updated guidance to incorporate recent changes relating to salary sacrifice arrangements made available by employers. This would seem like a good time to remind ourselves of how tax and national insurance works under such schemes.

What is a salary sacrifice arrangement?

This is an agreement whereby an employee's entitlement to cash pay is reduced, usually in return for a non-cash benefit. Clearly an employee must agree to any such change and the employer must update the employee's contract with each change that is made.

Remember, a salary sacrifice arrangement cannot reduce an employee's cash earnings below the National Minimum Wage rates.

Historically, a salary sacrifice arrangement was used to reduce tax and National Insurance Contributions payable. An employee would be taxed on the benefit received using the benefit in kind rules that typically would give a lower taxable amount than the amount of salary given up. If the benefit was exempt, there would be no tax charge. As a result, employees paid less income tax and both employees and employers paid less National Insurance Contributions (NICs) than would have been the case if the employee had been remunerated solely in cash.

FA 2017 introduced "optional remuneration arrangements" which largely withdrew the Income Tax and NICs advantages. From 6 April 2017:

- Any cash element, including salaries and bonuses, are processed through PAYE;
- Typically, non-cash benefits are taxed on the higher of the:
    1. amount of the salary given up;
    2. earnings charge under the normal benefit in kind rules.

However, for cars with CO_2 emissions of no more than 75g/km, employers must always use the earnings charge under the normal benefit in kind rules.

Exemptions on non-cash benefits

The only benefits that are not valued, and therefore not taxable, for a salary sacrifice arrangement are:

- payments into pension schemes;
- employer provided pensions advice;
- workplace nurseries;

- childcare vouchers and directly contracted employer provided childcare started before 4 October 2018;

- bicycles and cycling safety equipment (including cycle to work).

Old arrangements

Most existing arrangements set up before 6 April 2017 are automatically subject to the new rules from 6 April 2018. This date is extended to April 2021 for arrangements for individual employees relating to:

- cars with CO_2 emissions of more than 75g/km;

- accommodation;

- school fees (even if varied, renewed or modified for same child and school).

The new rules apply if the arrangement is varied, renewed or modified unless the change is:

- connected to an employee’s statutory sick pay;

- connected to an employee’s maternity, paternity, adoption or shared parental pay;

- out of the control of the employee and employer (like a damaged contract).

Earnings related benefits

Salary sacrifice can affect an employee’s entitlement to earnings related benefits such as Maternity Allowance and Additional State Pension. The amount they receive may be less than the full standard rate or they may lose the entitlement altogether.

Contribution based benefits

Salary sacrifice may affect an employee’s entitlement to contribution-based benefits such as Incapacity Benefit and State Pension. Salary sacrifice may reduce the cash earnings on which National Insurance contributions are charged. Employees may therefore pay – or be treated as paying – less or no National Insurance contributions.

Workplace pension schemes

As stated above, employer payments into a pension scheme are not taxable but how do salary sacrifice arrangements affect contributions?

Often, employers will use a notional level of pay to calculate employer and employee pension contributions, so that employees who participate in salary sacrifice arrangements are not put at a disadvantage.

Where an employee opts out of a workplace pension scheme, it is possible that they will have received reduced earnings under the salary sacrifice arrangement. If the employer ‘makes good’ that shortfall to the employee then the payment should be made subject to tax and National Insurance contributions.

www.gov.uk/guidance/salary-sacrifice-and-the-effects-on-paye

HMRC webinars for NMW and NLW

HMRC have developed a series of bite-sized webinars aimed to help employers avoid common errors.

The first three in the series, each under 10 minutes long, cover particular types of error:

1. Interns, Work Placements and the NMW: clarity is provided around what has, in the past, been a confusing area for some employers. Just by calling a worker 'unpaid' or 'a volunteer', even if the individual agrees to this, it doesn't prevent them from qualifying for the minimum wage if they are entitled.

2. Apprentices and the NMW: outlines the correct approach to be taken when applying the apprenticeship rate of pay. It's not enough to just call somebody an apprentice. Apprenticeships must equip a worker with the skills and ability to enable them to do a trade. Workers who are 19 or over and have completed the first year of their apprenticeship are entitled to the higher minimum wage rate for their age.

3. Payments, Deductions and the NMW: explains the deductions an employer makes from a worker's pay, or payments made by a worker to their employer, that reduce pay for minimum wage purposes. It also covers statutory deductions.

Each of the short presentations aims to make it easier for employers to understand their minimum wage obligations.

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

Increase in Student Loan Plan 1 and Plan 2 thresholds

The current thresholds for the tax year 2018/19 are:

- Plan 1 - £18,330
- Plan 2 - £25,000.

The Department for Education (DfE) has confirmed that from 6 April 2019 the thresholds will increase to:

- Plan 1 - £18,935
- Plan 2 - £25,725.

DfE has confirmed the student loan threshold for Post Graduate Loans for England and Wales will be £21,000, with deductions being taken at 6%.

Capital Taxes

Holdover relief and non-resident associates

Summary - Holdover relief applied to the disposal of an interest in an LLP by a US resident individual.

Mr Reeves was one of two founders of the hedge fund business carried on by BlueCrest LLP. From 2007 he moved back to the US, where upon he and his family ceased to be UK resident.

In late 2009, BlueCrest began planning to move its business out of the UK to Guernsey, where it would be non-UK resident for tax purposes. Under s25 TCGA 1992, if BlueCrest emigrated from being a UK resident LLP to being non-resident at a time when Mr Reeves still held his interest in it, then even though he was non-resident he would be deemed to have disposed of and immediately re-acquired his 7.4% interest and would be chargeable to tax on any gain.

However, under s25(7), an asset is only a chargeable asset if any chargeable gain accruing to the non-resident person on the disposal would be chargeable to capital gains tax under s10(1) TCGA 1992. So, in an attempt to avoid this charge, on 1 April 2010 Mr Reeves gifted his interest in BlueCrest to WHR Ltd, a UK resident company, of which he was the sole shareholder and director. A gain of £33.6 million arose on the disposal. Mr Reeves and WHR Ltd made a joint claim for holdover relief on the disposal to defer the gain. With BlueCrest LLP now being owned by WHR Ltd, a UK resident company, s10 did not apply and there would be no deemed disposal on the emigration of BlueCrest to Guernsey.

Both parties agreed that on a literal interpretation of s167(2) TCGA 1992, HMRC was correct in saying that the disposal does not benefit from holdover relief under s165(4) because it fell within s167(2).

They agreed that Mr Reeves’ 100% shareholding in the transferee company WHR Ltd did not bring it within s167(2) because although he clearly controlled it and he was neither resident nor ordinarily resident in the UK, he was not a person “connected with” himself - rather he is himself;

However, although Mrs Reeves had no shareholding or other direct link with WHR Ltd of a kind falling within s416(2), Mr Reeves was an associate of hers for the purposes of that subsection and one can attribute to her all the rights and powers of Mr Reeves and those rights and powers clearly include rights and powers in WHR falling within subsection (2).

Mr Reeves argued that it was wrong to expand s 167(2) by reference to s 416 to attribute his rights and powers to his non-resident wife. This led to an absurd result as it would make the application of s 167(2) dependent on whether the transferor has non-resident associates.

Decision

The Upper Tribunal could not be sure about Parliament's intention but they were satisfied that it could not have been Parliament’s intention that holdover relief should be withheld merely because there was someone who was connected to the transferor but was non-resident, even if they had no interest in the transferee company.

They therefore held that the context in which the word ‘control’ is used in s167(2) required some modification of s416, under s288, when the definition is imported into TCGA 1992 for the purposes of section 167(2).

They held that the attributions of interests between associates within s416 are limited to connected persons who control the transferee by virtue of holding assets relating to that or any other company. It followed that Mr Reeves was not precluded from benefiting from holdover relief because his wife and children, who have no interest in WHR, are non-resident and connected with him.

Finally, in the event that it was wrong on s 167(2), the Tribunal found that the taxpayer's appeal would have succeeded because the legislation infringed his rights under Art 1 Protocol 1 of the European Convention on Human Rights.

The appeal was allowed.

William Reeves v HMRC: [2018] UKUT 0293 (TCC) (CGT)

Enhancement expenditure or director’s loan?

Summary - The taxpayers, as joint landowners, did not incur enhancement expenditure deductible for CGT purposes. Rather, a loss arose on the director’s loan account generating its own form of relief.

In July 2002 Silurian Mill was bought for £170,000. Initially the purchase was in Mr Sidebottom’s name but shortly afterwards it was transferred into the joint ownership of Mr Sidebottom’s and Ms Pickett, his wife at the time.

The plan was to redevelop the land or at least obtain planning permission and sell it at a profit. The couple were persuaded that it would be better if a company sought the planning consent and that expenses passed through this company, keeping them separate from Mr Sidebottom’s other businesses. A new company, Mainstone Properties Limited, was established in June 2003 with the taxpayers each as equal shareholders but Mr Sidebottom as sole director. The couple and Mainstone Properties Limited entered into a Development Agreement for Mainstone Properties Limited to develop the property for residential use. Mr Sidebottom advanced lump sums to the company’s bank account. The company then used the money to cover all the costs of contractors, advisers and so on required to carry out the business ventures and planning applications made in respect of the property. The advances made, totalling £283,227, were treated in the accounts as a director's loan.

Mainstone Properties Limited’s fee under the Development Agreement was payable once planning permission was obtained in April 2007. However, Mainstone Properties Limited never charged the taxpayers for the work under the agreement and no loan advances were ever repaid by the company.

In March 2011, receivers were appointed and sold the property for approximately £400,000. Neither taxpayer disclosed the disposal of that or any other properties in their tax returns. In February 2017, HMRC issued notices of assessment in respect of the disposals of part of a farm and the sale by receivers of the property, the amount of tax payable by Mr Sidebottom being £26,036.54 and by Ms Pickett £36,640.20.

HMRC's assessments as regards the property were based on the expenditure incurred in respect of obtaining planning and other improvement work was not incurred by the appellants and so did not qualify as enhancement expenditure for capital gains tax purposes.

In May, the original decisions were upheld on review, but the amount of tax payable by Mr Sidebottom increased to £46,996.78 and the amount payable by Ms Pickett reduced to £15,705.16 on the basis that the officer believed that Mr Sidebottom was the sole owner of the property. The taxpayers appealed those decisions.

Decision

The First Tier Tribunal found that Mainstone Properties Limited had never charged the taxpayers for the work under the Development Agreement. Although there was a loss, it was a loss on a Mr Sidebottom's loan account that accrued to him as director. This was not enhancement expenditure for capital gains tax purposes.

At the hearing, HMRC conceded that the property had been owned jointly. As a result, the assessments as adjusted in May 2017 were wrong and the original assessments of February 2017, based on an assumption of joint ownership, were the correct numbers. The Tribunal found that Mr Sidebottom's assessment was excessive and Ms Pickett's too low. Mr Sidebottom's appeal was allowed in part to reduce the tax chargeable to £26,036.54, the original February 2017 assessment

However, Ms Pickett had been under assessed and the amount she appealed to this Tribunal was too low. But did the Tribunal have the power to increase the tax payable on appeal and if it did, whether it should do so? Having considered the circumstances, the power to increase the tax payable by the Ms Pickett beyond that calculated in the May 2017 review, would not be exercised. HMRC had made a mistake and had decided, contrary to the appellants' arguments, that they had not owned the property jointly. On that basis, HMRC had wrongly increased the first appellant's assessment and had reduced the second appellant's. Had HMRC wished to preserve its position on that point, it was assumed that it could have done so. This issue was ultimately no more than the relatively common circumstance where HMRC took a view as to the correct amount of tax and it proved to be insufficient. While it was attractive to see increasing the second appellant's tax liability as correcting the tax payable to the true amount, that would, in substance, be treating the appellants as joint taxpayers where the tax could simply be shifted from the first appellant to the second appellant. However, the second appellant's tax position should be seen independently of the first appellant's, whether they were married or not. The second appellant's appeal was dismissed, but the amount of tax payable maintained in principle at the amount in the May 2017 review

Robert David Sidebottom and Jane Elizabeth Pickett v HMRC (TC06724)

Entrepreneurs' relief – verbal agreement not enough

Summary – A verbal agreement in February 2012 was one of goodwill, binding in honour only. Voting shares had not been owned for the required 12 months and so entrepreneur's relief was denied.

Thornton & Ross Limited developed, manufactured and supplied over-the-counter medicines and healthcare products. The Thornton family owned all of the voting shares in the company, either directly or on trust for beneficiaries who were members of Mr Thornton's family. Mr Thornton was the company's chairman.

In October 2001, the company recruited Dieno George, who came with a wealth of marketing experience in the pharmaceutical and healthcare industries. In 2002, he was promoted to become the company's chief executive. Three years on, Mr Thornton offered Mr George the chance to acquire C and D non-voting shares in the company, representing 6.9% by nominal value of the company's ordinary share capital. He accepted the offer, subscribing for shares costing just under £1 million, becoming the only non-family member to own shares in the company.

With no voting rights attaching to his shares, had Mr George sold his shares, he would not have been entitled to entrepreneurs' relief on any sale. In an attempt to rectify this, Mr Thornton said he would enfranchise Mr George's shares to confer voting rights. This was discussed and confirmed at a meeting verbally in February 2012 and finally voted on under a special resolution in January 2013.

Thornton & Ross Limited was sold in August 2013, but because the shares were franchised only eight months earlier, they did not qualify for entrepreneurs' relief. In an attempt to overcome this issue, Mr George's adviser argued that Mr Thornton and the other shareholders had agreed to the enfranchisement in February 2012. This was 'legally binding and specifically enforceable'.

HMRC disagreed.

Decision

The First Tier Tribunal were not satisfied that, in reaching the verbal agreement, Mr Thornton was acting as agent for the other shareholders but rather, the agreement was between Mr George and Mr Thornton alone.

The First Tier Tribunal considered that Mr George and Mr Thornton did not believe their agreement to be legally binding at their initial meeting in February 2012. It took 11 months to finally agree terms, with Mr Thornton being particularly concerned about the potential "value shifting" risk involved in conferring voting rights. Although Mr George had agreed to bear the cost of any tax falling on the other shareholders, Mr Thornton wanted to quantify the risk, as he was concerned that Mr George should not be exposed to a disproportionate liability. Mr George's evidence was that he could see that progress was being made towards

The Tribunal said that a special resolution of the Thornton & Ross Limited shareholders would be required to amend its articles of association to enfranchise any of Mr George's shares. Mr Thornton did not, on his own, control sufficient of the Thornton & Ross Limited shares to be able to procure the passage of a special resolution alone. That resolution did not happen until January 2013.

The judge concluded that the February 2012 agreement was one of goodwill, binding in honour only.

The taxpayer's appeal was dismissed.

Dieno George v HMRC (TC06678)

Delay occupying main residence (Lecture P1103 – 13.41 minutes)

Judgment was given on 18 July 2018 in favour of the taxpayer (M) in the First-Tier Tribunal case of McHugh v HMRC (2018). This decision related to the availability of principal private residence relief and the interaction of the afore-mentioned relief with ESC D49.

The essential facts were straightforward. Between November 2004 and December 2007, M and his wife built themselves a new house. They then occupied this house as their main residence until September 2010 when the property was sold for £1,350,000 (which represented a substantial gain for M and his wife).

Neither M's tax return for 2010/11 nor his wife's contained any entry relevant to CGT. HMRC argued that they subsequently made a discovery that resulted in a CGT liability arising on the transaction above. This charge related to the operation of ESC D49.

ESC D49, which deals with the problem of short delays on the part of an owner in taking up occupation of a private residence and applies where an individual:

- has land on which he has a house built which he then uses as his only or main residence; and

- purchases an existing house and, before using it as his only or main residence, arranges for alterations or redecorations or (alternatively) completes the necessary steps for disposing of his previous residence.

In these circumstances, the period before the individual uses the house as his only or main residence will be treated as a period in which he so used it for the purposes of S223(1) and (2)(a) TCGA 1992, provided that this period is not more than one year. If there are good reasons for this period exceeding one year that are outside the individual's control, it will be extended up to a maximum of two years.

Where the individual does not use the house as his only or main residence within the period allowed, no relief will be given for the period before it is so used. Where relief is given under this concession, it will not affect any relief due on another qualifying property in respect of the same period.

M took the view that his share of the gain was entirely exempt from CGT (as was his wife's). HMRC contended that, because the construction work lasted for more than three years, ESC D49 was not in point and therefore a time-apportioned gain for the period from November 2004 to December 2007 was chargeable to tax.

The First-Tier Tribunal judges challenged HMRC's stance. Such a proposition was, they said, 'startling'. Using the example of an individual who cannot identify any good reasons for extending the relief period beyond 12 months, they argued that HMRC's interpretation penalised someone who took 366 days to renovate his newly-acquired house, whereas another individual, who spent only 364 days doing exactly the same work, would be able to backdate his relief starting-point.

It is perhaps worth reminding ourselves exactly why the concession came into being. The policy behind ESC D49 is to ensure that a landowner who has held a plot of land for, say, eight years cannot relieve the whole of the gain on an eventual sale simply because, at the end of the eight-year period, he obtained planning permission to build a dwelling which he then occupied as an only or main residence. There is a material difference between that situation and the position of an individual who purchases land on which to build a house, only to find that the process takes longer than expected because of, say, a shortage of funds.

The judges' verdict was that HMRC's example in Para CG65009 of the Capital Gains Manual was simply wrong and should be replaced. Their view was that the concession could obviously not be open-ended but that, where building or renovation work stretched over a longer time-frame than the 12-month (or, sometimes, 24-month) period allowed by the concession, relief was available for that additional specified period. The words 'provided that' in the second paragraph of ESC D49 could, they felt, be given more than one meaning. In M's case, HMRC had agreed that there were good grounds for the longer period to apply and so the First-Tier Tribunal reduced the chargeable gain from a 37-month time-apportionment to a more reasonable 13-month calculation.

It will be interesting to see whether HMRC do, in due course, rewrite that example! HMRC's attitude in this case reminded the speaker all too strongly of their similarly unrealistic standpoint in Higgins v HMRC (2017).

Contributed by Robert Jamieson

NOTE: The Higgins case has recently been heard in the Upper Tribunal and the decision has been reversed. Our analysis of this decision is discussed below.

PPR On An Off-Plan Property (Lecture P1104 – 11.52 minutes)

Following on from Robert Jamieson's article and seminar this month (P1103), we take a look at the recent Upper Tribunal decision in the case HMRC v Desmond Higgins [2018] UKUT 0280 (TCC)

The Facts

Mr Higgins wished to purchase an apartment in a development of the former St Pancras Station Hotel.

In 2004 he paid a reservation deposit of £5,000 to secure a 2-bedroom apartment.

On 2 October 2006 Mr Higgins entered into a contract with Manhattan Loft St Pancras Apartments Ltd. At that time the development works had not yet commenced. The apartment was "off-plan" – ie, identified on the development plans but not then in existence. The agreed purchase price for the apartment was £575,000.

Further deposits of the purchase consideration were paid in October 2006 and March 2007.

Mr Higgins had no right to access the building while the apartment was under construction.

After delays to the development due to funding issues, the apartment was finally finished in December 2009. The contract was legally completed on 5 January 2010 after which point Mr Higgins had a legal right of occupation.

Mr Higgins occupied the apartment from 5 January 2010 to 5 January 2012. In December 2011 he entered into a contract for sale which was completed on 5 January 2012 at which point he vacated the property. The sale price was £1,215,000 giving Mr Higgins a substantial capital gain.

Mr Higgins claimed that private residence relief was due, and in his case full relief was available as the apartment had been his only or main residence throughout his period of ownership.

Mr Higgins contended that his period of ownership started on 5 January 2010 when he was first able to occupy the apartment and finished on 5 January 2012 when he completed the disposal and vacated the property. As the period of ownership is coterminous with the period when the apartment was his main residence, private residence relief was due on the whole of the capital gain.

HMRC rejected this premise and instead argued that private residence relief should only be granted in respect of part of Mr Higgins' capital gain because the apartment was not his main residence during the whole of his period of ownership.

Under Section 28 TCGA 1992, the "period of ownership" is the period between the date of acquisition and the date of disposal.

> "…..where an asset is disposed of and acquired under a contract, the time at which disposal and acquisition is made is the time the contract is made….".

The period of ownership commenced on 2 October 2006 when Mr Higgins contracted to purchase the apartment and ended on 15 December 2011 when he contracted to sell the apartment. In the period between 2 October 2006 and 5 January 2010, the apartment was not occupied by Mr Higgins as his only or main residence as required by Section 223. As a consequence, private residence relief should be restricted leaving part of the gain on the property chargeable to CGT.

An assessment to tax was raised by HMRC against which Mr Higgins appealed.

The FTT Decision

Both parties agreed that there was no other dwelling that Mr Higgins regarded as his main residence throughout the period July 2007 to January 2010. [In this period he had been living with his parents and travelling.]

The FTT considered that the term "period of ownership" in Sections 222 and 223 should be given its ordinary meaning and should reflect a "realistic view of the facts". The FTT accepted the taxpayer's argument that a period of ownership of a dwelling house will ordinarily begin on the date the purchase of the dwelling house has been physically and legally completed and the purchaser has the right to occupy.

Only at that time does the purchaser become the full beneficial owner of the property. In the case of an off-plan purchase the case was even stronger because when contracts are exchanged for the purchase, the dwelling does not actually exist. It was not possible for it to have been anyone's main residence in this period.

The FTT accordingly found that the period of ownership for the purpose of the private residence relief rules began when Mr Higgins acquired the legal right to occupy the property (that being the legal completion date which was 5 January 2010). This subsequently meant that the period of ownership and occupation fully coincided and Mr Higgins' gain was wholly covered by private residence relief.

The taxpayer's appeal was allowed.

HMRC appealed to the UTT.

The UTT Decision

The FTT has concluded that a period of ownership cannot begin before the taxpayer has a right of occupation. The UTT found that there was nothing in the words or context of the provisions of TCGA 1992 to justify such a narrow construction and that the FTT had failed to have due regard to Section 28.

Mr Higgins' chargeable gain is the difference between his acquisition cost and his disposal proceeds. Those figures are determined when unconditional contracts for the purchase and sale are exchanged.

The acquisition cost was fixed on 2 October 2006 when unconditional contracts were signed with the developer. This is also the date of acquisition for CGT purposes by virtue of Section 28. The gain therefore accrued between October 2006 and December 2011 (being the date the purchase price was fixed and the sale price was agreed). However, the property was not Mr Higgins' main residence prior to 5 January 2010 and as such private residence relief should be restricted.

The UTT pointed out that, in the majority of house purchases, there is a delay of a few weeks between exchange of contracts and completion, with the purchaser only taking up residence at the later date. Yet HMRC does not shave a few weeks off the main residence relief under Section 223 to account for the few weeks at the start when the property was not occupied by the taxpayer.

This practical problem is dealt with by HMRC's concession ESC D49 whereby short periods of non-occupation between exchange of contracts and completion are overlooked. ESC D49 would be superfluous if the period of ownership actually started on completion of the purchase. The fact that the practice exists is acceptance that ownership starts on exchange of contracts and gains accrue from that point. [No similar practice is needed on disposal because a dwelling-house is treated as a main residence for the last 18 months of ownership.]

It should be noted here that ESC D49 allows a period up to two years to be treated as a period of occupation, but the delay in this case was well in excess of two years so the concession was not relied upon.

The UTT also rejected the FTT finding that Mr Higgins had no equitable interest in the apartment until construction was substantially completed in December 2009 because the apartment did not exist as such until that time. It was put to the UTT that the period of ownership of the apartment could not begin before an equitable interest was established. From March 2007 when the second deposit was paid, Mr Higgins had an asset which he could legally dispose of by way of sub-sale. If Mr Higgins had disposed of his interest by way of sub-sale at any time prior to completion on 5 January 2010, he would have realised a chargeable gain with no possibility of private residence relief.

HMRC’s appeal was allowed.

Conclusions

The pragmatic view of the FTT has been set-aside by the UTT taking a much stricter interpretation of the law. It is hard to see what grounds the taxpayer will have to appeal this judgement, so this now looks to be set in stone.

This decision will be somewhat worrying to those who have entered into – or are interested in pursuing - an off-plan property purchase as delays between the buyer signing the initial contract with the developer and taking-up residence are very common and are largely out of buyer’s control.

Whether this will lead to buyers seeking some sort of contractual indemnity for any additional CGT costs they incur as a result of developmental delays remains to be seen. In Mr Higgins’ case and through no fault of his own, there was a 3-year delay between him signing the contract and the apartment being built and this has ultimately cost him around £60,000 in capital gains tax. This is certainly something buyers might consider raising with a developer if an off-plan purchase of a home is to be considered.

Caveat emptor.

Contributed by Steve Sanders

Relief for relevant business property (Lecture P1105 – 25.07 minutes)

The Courts have consistently held that the letting of property represents an investment business, regardless of the extent to which the landlord provides additional services for his tenants. HMRC argue that business relief for IHT cannot apply, since S105(3) IHTA 1984 excludes entitlement to this important relief where the business ‘consists wholly or mainly of one or more of the following, that is to say, dealing in securities, stocks or shares, land or buildings or making or holding investments’.

Last year’s case of Ross v HMRC (2017) involved let holiday cottages where an impressive list of services was provided for the owners’ holidaymaker guests. The First-Tier Tribunal acknowledged that a very high level of services was offered and that these were significantly more extensive than those considered in any earlier hearing. However, all this was irrelevant because, in the First-Tier Tribunal’s view, the relief would not be available ‘however high the standard of services which were provided and whatever the level of expenditure incurred on those services’. The fact that the letting activities were run on sound business lines, and with considerable effort on the part of the owners, was irrelevant.

This decision, together with those in cases like HMRC v Pawson (2013) and Zetland v HMRC (2013), 'looked like the end of the road with this argument', as one eminent tax commentator put it. Well, as we shall see, possibly not.

In 2017, HMRC took the same view with regard to a livery stable business (which of course necessarily involves the use of land and buildings), saying that the business was nothing more than the letting or licensing of land for the use of others and was therefore an investment business. This was the Vigne case. However, the First-Tier Tribunal decided that no properly informed observer could have concluded that the livery stable business was wholly or mainly a business of holding investments. It was asserted that the Upper Tribunal judge in the Pawson case (Henderson J, as he then was) was mistaken in beginning with the preconceived idea that the business was wholly or mainly one of making or holding investments and then asking whether there were any factors which might indicate to the contrary. The First-Tier Tribunal argued that the proper starting-point is to make no assumption one way or the other, to establish the facts and only then to determine whether or not the business is wholly or mainly one of making or holding investments.

This approach has now been supported by the case of Graham v HMRC (2018) which involved the letting of holiday accommodation – four flats in a property known as 'Carnwethers' – on the Isles of Scilly and the provision of various services. The lady who owned the business (Mrs Joyce Graham) died in 2012 and for the last few years of her life she was assisted by her daughter (Louise) who returned to the Isles of Scilly in 2008 to work with her mother following the death of her father a year earlier.

Louise herself acted on behalf of the mother's estate and her impressive advocacy persuaded the First-Tier Tribunal that the services provided were of such importance that the business should not be regarded as wholly or mainly an investment business. The judges said that the provision of many of the facilities ('the pool, the sauna, the bikes and in particular the personal care lavished upon guests by Louise') distinguished it from other more mainstream actively managed holiday letting businesses. As they pointed out, 'the services provided in the package more than balanced the mere provision of a place to stay'. They went on:

> 'An intelligent businessman would in our view regard it as more like a family-run hotel than a second home let out in the holidays.'

Interestingly, it does not seem that the services provided in this case differed very much from those in Ross v HMRC (2017), where the estate was unsuccessful in its claim for business relief, and so Louise's win here is even more commendable.

An important observation in the judgment, which clients and their advisers would do well to note, is the following:

> 'We have accepted that the rent which could be obtained for a shorthold tenancy of Carnwethers was £27,500 per annum. The average income from guests was about £60,000 over a 25-week season. Together those figures may suggest that the value of the additional services provided by the business is just over half the total value. However, a more relevant comparison would have been between the total rent which could have been expected from an austerely equipped but well maintained set of cottages let without any assistance, without any cleaning or tending of the pool, with minimal garden attention, no linen or food, with receipts at Carnwethers.'

Why has such a line of argument not been used on previous occasions?

Contributed by Robert Jamieson

Administration

Failure to notify and deliver

Summary – The taxpayer had not failed to notify chargeability of his rental income, nor had he failed to register for self-assessment as a director. Finally he did a have a reasonable excuse for failing to file three year's tax returns by 9 November 2017.

Alexander Steele was a chef who was paid a monthly salary through PAYE and had never completed a tax return or been asked to before. He believed returns were filed online and he did not have the knowledge to do so.

He had a property from which he received a small amount of rental income but made very little profit after expenses were deducted. He believed that income of this sort under a certain amount did not have to be declared

HMRC computer records showed that:

- on 2 August 2017, HMRC issued paper returns for 2013/14, 2014/15 and 2015/16;
- the due date for delivering these returns was 9 November 2017;
- Alexander Steele had had the same address in Lancashire since 2004, and that this was the one they had sent the returns to;
- they issued three penalty notices for£100 on 14 November 2017 to Alexander Steele for failure to file the returns by the due date.

The three returns were filed electronically on 29 January 2018 but appealed against the penalties. From their submission, HMRC learned that Alexander Steele was a director, although he argued that he was a director of a very small restaurant in name only.

On 26 March 2018, following their review, HMRC repeated that it was the taxpayer's responsibility to keep his address details up to date or to make redirection arrangements and said that the notice to file clearly states that if you cannot file online you can print a copy of a paper return and complete that. The penalties were upheld and so in April 2018, Alexander Steele appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal found as a matter of fact that paper returns were issued as stated on the computer records. In addition, Alexander Steele had not failed to notify chargeability of his rental income as there was no requirement to report the rental results as his income and profits were below the thresholds stated on the GOV.UK website which says:

> "You must report your profits on a Self Assessment tax return if HMRC ask you.
> We're likely to do this if your income is:
>
> - £2,500 to £9,999 after allowable expenses
>
> - £10,000 or more before allowable expenses"

The Tribunal said that Alexander Steele was a person whose only contact with HMRC was as an employee whose tax was determined through the PAYE system. Why would he have been expecting to be asked to file three years' tax returns within three months of receiving them? HMRC provided no information to show why they decided in 2017 that he should be brought within the self-assessment system when they did.

The Tribunal also said that, although he was a director, his income consisted only of PAYE earnings and dividends chargeable at the ordinary rate or lower and so was under no obligation to notify HMRC of his chargeability to income tax.

Finally, Alexander Steele had no responsibility to tell HMRC of his address details, unless required by some other tax legislation. While obligations are placed on the employer, there is nothing in the PAYE regulations requiring an employee to inform HMRC of their address.

In conclusion the First Tier Tribunal said that there was a reasonable excuse for the failure to file the returns by 9 November 2017. Alexander Steele could have no reason to suppose that he would be required to make tax returns at all, let alone going back to 2013. Nor did he have any obligation to inform HMRC of any change of address.

The appeal was allowed and the tree penalties were cancelled.

Alexander Steele v HMRC (TC06717)

Request for statement of case and skeleton arguments

Summary –KPMG should be allowed to inspect the deconsolidated version of HMRC's statement of case, but without the annexures, and both parties' skeleton arguments in the appeal without any redactions.

KPMG applied to the First-tier Tribunal for copies of HMRC's statement of case and both parties' skeleton arguments in this appeal in which they were neither a party to the appeal nor did they represent any party. They sought the documents in order better to understand HMRC's arguments in the appeal that they said were relevant to their arguments in a different case in which they were instructed. Hastings Insurance Services and HMRC objected.

Decision

The First Tier Tribunal Rules do not expressly allow the First-tier Tribunal to allow a non-party to inspect or have access to documents relating to proceedings.

However, nothing in Rule 14 headed "Use of documents and information" suggests the existence of a general rule that documents or information relating to proceedings cannot be disclosed. On the contrary, the Tribunal considered that rule 14 indicates that, absent an order prohibiting disclosure and subject to any other statutory restriction, documents or information relating to proceedings may be disclosed on a limited basis or published more widely

Further, Rule 32(1) provides that, subject to limited exceptions that were not relevant in this case, all hearings must be held in public.

The judge said the question was whether the non-party had a legitimate interest in the documents. KPMG wished to understand better HMRC's arguments in another case and, in the judge's view, an interest in other related litigation was enough. KPMG therefore had a legitimate interest in obtaining the documents.

'It is … important for a proper understanding of the legal process, consistent with the principle of open justice, that members of the public should understand what submissions were made in the skeleton arguments even if they were modified or withdrawn during the hearing.'

They said that "If an appellant is concerned that the amount of an assessment should not become public then the appellant should apply for an order under rule 14 of the FTT Rules prohibiting the disclosure or publication of that information. As far as I am aware, no such order was sought in this case and I cannot see any grounds on which such an order would be made."

Hastings Insurance Services Ltd and HMRC and KPMG LLP (TC6656)
Adapted from Taxation (11 October 2018)

OTS' vision for HMRC guidance

The OTS has made 12 main recommendations for an overhaul of HMRC's guidance for taxpayers, in a report which addresses the challenge HMRC faces of serving a large audience with different and conflicting needs, using an 'enormous spectrum' of published material.

Key recommendations include a 'new model' for guidance that makes greater use of technology and clearly identifies three levels of complexity: simple for the majority of individual taxpayers; more advanced for businesses; and technical for tax advisers.

HMRC should consult on the extent to which taxpayers ought to be able to rely on published guidance to escape liability to interest and penalties, similar to the Australian model.

The OTS's 'new model' for guidance needs to clearly identify the level at which it is aimed. Three levels are suggested:

- level 1 — simple guidance, for the majority of individual taxpayers;
- level 2 — more advanced guidance, primarily aimed at more sophisticated taxpayers and others in business; and
- level 3 — HMRC's technical manuals, primarily for tax advisers.

The 12 key recommendations made in the report are:

1. adopt a new model for guidance, building upon the current innovative programme that uses new ways of delivery, moving the emphasis to the taxpayer's needs, away from the needs of HMRC officers;
2. appoint a senior strategic head of guidance for HMRC, with remodelling guidance as a key departmental priority in HMRC's operating plan;

3. form an HMRC 'advice and guidance panel', consisting of senior HMRC officers, respected tax specialists and academics;

4. clearly identify three levels of HMRC guidance so that users can immediately see the level of complexity of the material they are about to read;

5. use technology to direct people to enter the guidance at a point appropriate to their needs and level of understanding of tax;

6. produce a clearer statement of the respective responsibilities of HMRC and GDS, with GDS-managed guidance containing more links to HMRC's comprehensive guidance;

7. reassess GDS approach to publishing HMRC technical manuals;

8. annotate sections in manuals swiftly to record that changes will be needed to reflect amended law, or the results of a tax case;

9. introduce more feedback links into HMRC technical manuals, with dated pages, up-to-date contacts and improved links between specific parts of manuals and HMRC's other guidance material;

10. discuss and agree HMRC protocols with industry and representative bodies where these bodies are supportive of contributing to guidance, building on existing good practice;

11. consult on the circumstances in which a taxpayer can rely on published guidance and the extent to which a taxpayer will be subject to interest, penalties and the tax in dispute where guidance is found to be incorrect; and

12. indicate clearly when guidance is knowingly giving a statement of HMRC's opinion rather than something it considers to be generally accepted.

2016/17 tax computation review

According to the CIOT Tax Technical Team the 2016/17 self-assessment season proved difficult due to the significant increase in the number of returns which were subject to an exclusion.

An exclusion applies when HMRC’s tax calculator will not compute the correct tax liability. For some exclusions it is not possible to file online as HMRC’s system will not accept the return, for others it was possible to file online but the system would not calculate the tax liability correctly from the information on the return. In the latter cases individuals, particularly the unrepresented, may not have appreciated that their tax had been incorrectly calculated.

From 19 November HMRC plan to rework around 30,000 such returns, expecting to amend half of them. Where the tax position has changed the individual will:

- receive a new SA302 calculation (but not to agents!);
- will have 28 days to pay any additional tax before interest and late payment penalties apply.

Once an individual's return has been reworked in this way, it is important to note that any further amendments to the return must be submitted on paper, and should not filed electronically.

www.tax.org.uk/policy-technical/technical-news/reworking-2016-17-returns

Deadlines

1 November 2018

- CT due for periods ended 31 January 2018 for companies not liable to instalments;

2 November 2018

- Filing date for form P46 (Car) for quarter ended 5 October 2018;

5 November 2018

- Specified employment intermediaries must file return for quarter to 5 October 2018;

7 November 2018

- VAT returns and payment due for 30 September 2018 quarter (electronic payment);

14 November 2018

- Quarterly CT instalment for large companies depending on accounting year end;
- Monthly EC sales list if paper return used;

19 November 2018

- PAYE, NIC, CIS, student loan due for month ended 5 November 2018 (not electronic);
- File monthly construction industry scheme return;

21 November 2018

- File online monthly EC sales list;
- Submit supplementary intrastat declarations for October 2018;

22 November 2018

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

30 November 2018

- File private company accounts with 28 February 2018 year end at Companies House;
- File public company accounts with 31 May 2018 year end at Companies House;
- CTSA returns filed for companies with accounting periods ended 30 November 2017.

News

Withdrawal from the EU factsheet

The CIOT, ICAEW and ICAS have published a factsheet summarising the Taxation (Cross-border Trade) Act 2018, which received Royal Assent on 13 September. This is the first of a series of intended factsheets about Brexit.

Acknowledging the changing nature of Brexit legislation, the factsheet notes:

> 'it is entirely possible that new legislation may be introduced to amend/repeal some or all of the Act'.

The Act seeks to replace the current EU Union Customs Code and amend current UK VAT and excise duty laws in connection with the withdrawal of the UK from the EU.

Main provisions

Part 1 introduces a new import duty on the importation of chargeable goods into the UK. Further details covering the customs tariff, preferential rates, provisions concerning quotas, tariff suspension, certain matters concerning valuation, reliefs from import duty etc., will follow in regulations.

Part 2 states that the Treasury may introduce regulations for the charging of export duty on the export of goods from the UK.

Part 3 covers VAT confirming that all goods imported into the UK will be subject to import VAT.

Part 4 lays down general provisions for the imposition of excise duty.

There are nine schedules which contain more detailed information on customs declarations, special customs procedures, such as transit procedures, inward processing procedure, etc., HMRC powers, provisions relating to developing countries, anti-dumping customs procedures and amendments to existing VAT, excise and custom laws to reflect the UK's third country status.

What does it mean for businesses?

The Act effectively sets a standalone UK framework for a customs duty regime to be applied in accordance with the World Trade organisation (WTO) rules, but with flexibility to allow for a range of outcomes which could include the UK reaching a deal with the remaining EU member states on customs, as well as potentially allowing the UK to reach other free trade agreements. it could be seen as the 'baseline' position – any trade agreements reached with the EU or third countries will be an improvement on the baseline position. With the precise outcomes remaining highly uncertain, businesses need to plan on the basis that this regime will be the one that applies in April 2019.

www.tax.org.uk/policy-technical/technical-news/brexit-factsheet

MTD: Pilot extension and deferred start date for complex businesses

As we all know, VAT registered businesses with a taxable turnover above the VAT threshold will be required to use the Making Tax Digital (MTD) service to keep records digitally and use software to submit their VAT returns from 1 April 2019.

HMRC had been running an MTD for VAT pilot for a group of invited businesses since April. They have now extended this pilot to include around half-a-million businesses whose affairs are straightforward and up to date.

As part of planning for the VAT pilot, HMRC has continued to listen to concerns about business readiness for MTD and have now announced that businesses with more complex requirements will defer their start date by 6 months.

To defer their start date to 1 October 2019, businesses must fall into one of the following categories:

- Trusts;
- ‘Not for profit’ organisations that are not set up as a company;
- VAT divisions;
- VAT groups
- Those public sector entities required to provide additional information on their VAT return (Government departments, NHS Trusts);
- Local authorities;
- Public corporations;
- Traders based overseas;
- Those required to make payments on account
- Annual accounting scheme users.

https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital

Apprenticeship levy reform

On 1 October 2018, HM Treasury announced a package of reforms for the Apprenticeship Levy. The changes are aimed at providing flexibility for businesses so they can take full advantage of the benefits of employing apprentices, and to help as many people as possible find the right training to equip them for the new economy.

An extra £90 million of government funding will enable employers to invest a quarter of their apprenticeship funds on people working for businesses in their supply chain.

A further £5 million was announced for the Institute for Apprenticeships to introduce new standards and updating existing ones so that more courses can be offered. The government will discontinue the old frameworks so that all new apprenticeships will be on the same higher-quality standards by the start of the 2020/21 academic year.

In the coming weeks, the government will set out a process to seek views on the operation of the levy after 2020 to ensure it supports the development of the skilled workforce businesses need for the new economy.

Progress to date

The apprenticeship levy is making good progress – with 1.41 million apprenticeships started since May 2015. There were 119,500 starts reported in the first three quarters of 2017/18, more than ten-times higher than the same period the previous year

National Retraining Scheme

The government is also establishing a National Retraining Scheme to support adults across the country and equip the workforce with the skills needed for the new economy.

www.gov.uk/government/news/package-of-measures-unveiled-to-boost-apprenticeships

Call for evidence: impact of tax on businesses

The Office of Tax Simplification has opened a call for evidence and an online survey to seek views about the impacts of tax on businesses owners and managers through the company lifecycle covering:

- start-up and registration;
- calculation and payment of tax;
- closure/transfer.

The consultation closes on 7 December 2018.

Tax havens blacklist

On 2 October 2018, the Council found Liechtenstein and Peru compliant with all its commitments on tax cooperation.

It also agreed to remove Palau from the EU's list of non-cooperative tax jurisdictions. Palau has made commitments at a high political level to remedy EU concerns.

Six jurisdictions remain on the list of non-cooperative jurisdictions: American Samoa, Guam, Namibia, Samoa, Trinidad and Tobago and the US Virgin Islands.

www.consilium.europa.eu/en/press/press-releases/2018/10/02/taxation-liechtenstein-and-peru-meet-commitments-palau-removed-from-list-of-uncooperative-jurisdictions/

First ever Unexplained Wealth Order

The National Crime Agency believes there are potentially billions of pounds of laundered money invested in UK, but lack of evidence makes it extremely difficult to prove any crime.

The new Unexplained Wealth Orders (UWO) are an attempt to force property owners and their family, to disclose their wealth. If they cannot or will not demonstrate a legitimate source for their wealth, the National Crime Agency can apply to the High Court to seize the property.

During a hearing in July, the High Court learned that Mrs Hajiyeva, originally from Azerbaijan and the wife of an ex-state banker:

- had an enormous amount of disposable income and over ten years had spent more than £16m in Harrods;
- is understood to own a £15m home near Harrods, a Berkshire golf course and a $42m Gulfstream G550 jet.

Under the terms of the UK's first UWO, Mrs Hajiyeva must now provide the National Crime Agency with a clear account of how she could afford her lifestyle.

Her husband is the former chairman of the International Bank of Azerbaijan who, in 2016, was jailed for 15 years after being convicted of being part of a major fraud involving tens of millions of pounds that disappeared from the bank. Judges ordered him to repay $39m. He denies his conviction and is asking the European Court of Human Rights to intervene in his case. Mrs Hajiyeva claims that her husband was a legitimate businessman who had become independently wealthy thanks to a string of successful businesses, before becoming a chairman at the state bank.

https://www.bbc.com/news/uk-45812210

Business Taxation

Missing Class 2 NICs

Summary – Failure to pay Class 2 National Insurance Contributions between 1983 and 2010 within the prescribed time limits, was attributable to the taxpayer's ignorance but thus was not due to his failure to exercise due care and diligence.

In 2016, Ian Chilvers reached state pension age and asked for a pension statement from the Department for Work and Pensions. Although self-employed since 1983, he had not known that he needed to pay class 2 National Insurance Contributions in order to preserve his entitlement to the state pension. Consequently, he had only 13 qualifying years rather than the full 35 years that he was expecting.

On becoming self-employed, Ian Chilvers had appointed an accountant and claimed that, had his accountant told him to register with the Department of Health and Social Security as self-employed, as it was known back in 1983, he would have done so. Mr Chilvers stated that he had "... always scrupulously maintained ..." his financial records and since 1995 he has observed the guidelines in the three booklets from HMRC which had been given to him then. He produced them and they were the Self-Assessment Guide for the self-employed and two booklets relating to record keeping for self-employed people. There was no reference to Class 2 NICs in those booklets. Mr Chilvers had always known that he had to pay National Insurance Contributions but he was not aware that there were two different types that were collected separately.

Ian Chilvers wanted to pay his missing contributions now so that he would qualify for a full State Pension on retirement but HMRC refused to allow him and so Ian Chilvers appealed.

Decision

The First Tier Tribunal said that since HMRC accepted that the failure to pay Class 2 National Insurance Contributions arose because of Mr Chilvers' ignorance, the issue for the Tribunal to decide was whether Mr Chilvers exercised due care and diligence in relation to his National Insurance Contributions.

Unsurprisingly, Mr Chilvers could not produce evidence of what his adviser had told him; he had not kept notes. The judge said that exceptionally few personal tax clients take notes at meetings with their advisors; that is why it is good practice for the advisor to write follow-up letters setting out any advice given. The Tribunal accepted Ian Chilver's statement that he was not told to register.

Although he was aware of the need to pay class 4 National Insurance Contributions, which he did, he was patently ignorant of the existence of Class 2 National Insurance Contributions and therefore he could not ask about it. It was clear Ian Chilvers had no financial or legal expertise and was aware of his limitations, which was why he employed an accountant to advise him. The Tribunal judge saw no reason for him to have researched National Insurance himself.

The taxpayer's appeal was allowed.

Ian Chilvers v HMRC (TC06686)

Extending security deposit legislation

HMRC has the power to require high-risk businesses to provide an upfront security deposit when considered necessary for the protection of the revenue. Currently this power applies to VAT, PAYE and National Insurance contributions, Insurance Premium Tax (IPT) and some environmental and gambling taxes. From 6 April 2019 this measure will give HMRC the power to also require securities in relation to Corporation Tax and CIS deductions.

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

Loan relationships (Lecture B1102 – 8.40 minutes)

In the recent case of CJ Wildbird Foods Ltd v HMRC (2018), the First-Tier Tribunal has found for the taxpayer and, in doing so, held that loans to a company, which were not being serviced or repaid, still constituted loan relationships. Accordingly, debits for impairment losses were available for corporation tax purposes.

The appeal concerned a series of inter-company loans advanced by CJ Wildbird Foods Ltd (WF) to Birdforum Ltd (BFL), in which WF held a 50% interest, over the years ended 31 March 2013, 2014 and 2015. These loans, which totalled approximately £150,000 each year, followed similar loans which had been advanced in earlier years. The issue in dispute was whether, as a result of these loans and in the light of the surrounding circumstances, the amounts advanced represented loan relationships for the purposes of Part 5 of CTA 2009 such that a deduction should be allowed to WF in respect of the write-down of these loans. BFL had no income and consequently lacked the wherewithal to pay interest and to make repayments of the sums lent. HMRC denied the debits for impairment in WF's corporation tax returns.

HMRC contended that there was no loan relationship because there was no money debt. They argued that the amounts owing did not bear the hallmarks of a loan in order to fall within the definition of a money debt. HMRC also referred to Smart v Lincolnshire Sugar Company Ltd (1937) in relation to the question of whether there was a transaction for the lending of money, given that the borrower might never be able to repay the amounts advanced. In their arguments, HMRC maintained that WF's advances of money were not arm's length transactions bearing any resemblance to the commercial reality of a loan relationship and that their preferred analysis was that the payments were akin to capital contributions and therefore disallowable for corporation tax purposes.

However, the First-Tier Tribunal decided that the advances made were, in law, repayable with interest and so the loans clearly constituted a money debt. The advances were shown in the accounts as due and owing and, while they had been provided for in full (and WF had not yet demanded repayment), they had not been legally written off, ie. formally released. The judge went on to find that there was a clear contractual agreement between the parties that interest was payable at an agreed rate on the moneys advanced. There had been no specific waiver of that arrangement – merely an agreement that there was no point in the interest actually being charged unless and until funds were available to pay it.

In relation to whether there was a transaction for the lending of money, the First-Tier Tribunal distinguished the present case from Smart v Lincolnshire Sugar Company Ltd (1937) as involving significantly different facts. Even though, at the time when the advances were made, the borrower could not repay the amounts, the judge considered that this situation had now become relatively commonplace in a number of commercial scenarios – as was the lack of a fixed repayment date – and that neither factor should prevent the loans from being treated as loan relationships. In his summing up, he said:

> 'The modern business world has many famous examples of companies, especially in the technology sector, with no cash and no immediate prospect of generating a profit which go on to be very successful. Clearly, the appellant considers BFL potentially to be such a company and is therefore prepared to subsidise its running costs by way of loan for the time being in the hope of obtaining repayment of some or all of its loans in due course, possibly with a gain on its share investment as well.'

Contributed by Robert Jamieson

HMRC guidance on S396B ITTOIA 2005 (Lecture P1102 – 15.04 minutes)

S396B ITTOIA 2005 introduced a targeted anti-avoidance rule (TAAR) with effect from 6 April 2016. It applies to certain distributions made by individuals on the winding up of a company.

Briefly, the section states that, if four conditions (known as Condition A, Condition B, Condition C and Condition D) are met, a distribution on a winding up will be treated as an income distribution. It will not be treated as capital, which would normally represent a more favourable tax outcome.

The TAAR is aimed at 'phoenixism', i.e. the practice where a profitable company deliberately 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.

The four conditions are:

Condition A: The individual receiving the distribution in respect of a winding up must hold an interest in the company of at least 5% – this is determined by reference to both ordinary share capital and voting rights;

Condition B: The company must be either a close company when it is wound up or have been a close company at some point in the two years prior to the start of the winding up .

Condition C: Within a period of two years following 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 trade or activity in his own name, through a partnership, through a 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).

Condition D: 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.

In July 2017, HMRC published what many people regard as somewhat unsatisfactory guidance, using a variety of examples to demonstrate the type of transactions to which the TAAR should and should not apply. The relevant details can be found in Paras CTM36300 – CTM36350 of the Company Taxation Manual. Recently, they have updated this guidance, with particular reference to the 'main purpose' test in Condition D.

The updated guidance, which appeared on 25 July 2018, confirms the following points:

- A decision not to make an income distribution prior to the company's winding up does not, of itself, mean that Condition D has been met.

- If the recipient of the distribution is confident that there will be enough supporting evidence for an HMRC officer to arrive at a sound conclusion that Condition D was not met, the individual should self-assess on that basis, in which case HMRC can only displace this argument where the individual's decision was not a reasonable one.

- It is less likely that Condition D will be met if the individual remains involved with the carrying on of the trade or activity as an employee (as opposed to being an owner, shareholder or partner) and has no influence over the business' direction or decision-making.

It is a pity that HMRC have not also used this updating opportunity to improve the practicality and relevance of the examples that they have provided.

Contributed by Robert Jamieson

Information to establish central management and control

Summary - Legal advice privilege applied to conveyancing documents which were the subject of a third-party notice (FA 2008 Sch 36 para 2).

In this case, three properties had been purchased in the names of three separate offshore companies. HMRC was aware, as a result of a report made to it under the Liechtenstein Disclosure Facility, of the involvement of a fourth offshore company in at least two of the purchases. They sought to establish whether that fourth company was centrally managed and controlled in the UK.

HMRC had written to DAC Beachcroft LLP, a law firm, informing them that it was intending to issue a third-party information notice. DAC Beachcroft LLP, applied for a declaration that conveyancing files, created by its predecessor firm, were privileged. It was agreed that, applying the Three Rivers No. 6 [2005] 1 AC 610 categories, only Legal advice privilege could be claimed and not litigation privilege.

Decision

The First Tier Tribunal found that:

> 'all the documents were subject to Legal advice privilege, to the extent they either sought or gave (or evidenced the seeking or giving of) legal advice or were part of the "continuum aimed at keeping both [solicitor and client] informed so

The Tribunal concluded that some of the documents did not fall within Legal advice privilege. For instance, the client care and engagement letters, a declaration of trust, a surveyor's report, and a letter from a company providing administration services for the establishment of offshore companies were not covered by Legal Advice Privilege, but details of the advice to be given should be removed from them.

The Tribunal also accepted that the identity of the recipient of these letters constituted a 'significant piece of information for HMRC' but it found, on balance, that this was not privileged information.

The Tribunal observed that routing the letter through the law firm had not given it the 'cloak' of Legal advice privilege.

DAC Beachcroft LLP v HMRC (TC06704)
Adapted from Tax Journal (21 September 2018)

EU digital services tax

In March 2018 the European Commission (EC) issued two proposals for the taxation of digital businesses in the EU. The first proposal would deem a business to have a taxable ‘digital presence’ where it meets certain criteria based on a revenue threshold, user numbers, or contract volumes. The second set out an ‘interim’ digital services tax (DST) at a rate of 3% on revenues from selling online advertising space, digital intermediary activities, and selling user-generated data and content.

On 21 September the EU Parliament economic and monetary affairs (ECON) committee published a draft report on these proposals. The committee recommended the following:

- increase the rate of the DST from 3% to 5%;
- broaden the tax by including supplies of digital content such as video, audio or text through digital interfaces, and online sales of goods or services via e-commerce platforms, within the scope of ‘taxable revenue’;
- clarify that DST should also apply to the sale and transmission of data collected through active participation of users;
- introduce a sunset clause for the DST to lapse with the adoption of proposals for a ‘digital significant presence’ or the CCCTB (including the EU Parliament position on digital permanent establishment);
- ask the Commission to review the directive after 3 years; and
- introduce a mechanism for DST returns filed with the member state of identification to be audited every three years.

The EC’s first proposal for a deemed digital presence also forms part of the common consolidated corporate tax base (CCTB) and therefore the proposal to broaden the scope of the DST follows the CCTB’s reform plans to tax the value companies create from user data.

The intention is for member states to implement the DST by 1 January 2020 although not all countries are in agreement this interim measure and support achieving consensus at a global level through the OECD BEPS Action Plan 1.

In the UK, the government supports the OECD proposals but in his speech at the Conservative Party conference in October 2018, Philip Hammond noted that the best way to tax international companies is through international agreements but if those agreements could not be reached then the UK would go it alone with its own DST.

The US Senate Finance Committee, which writes tax law in the US, also disapproves of the DST stating that the tax 'violates the long-held principle that taxes on multinationals should be profit-based, not-revenue-based' and that it would lead to double taxation of US companies.

Lastly, the EU Council legal service have issued an opinion that the tax may be unlawful on the basis that a DST would not fall within the three types of tax that can be harmonised within the EU, being turnover tax, excise duties and other forms of indirect tax.

Contributed by Joanne Houghton

Debit on derecognition of a financial asset

The case of *The Union Castle Steamship Company Ltd v HMRC* [2016] UKFTT TC526 was a lead case concerning the debits that arose from the partial derecognition of a financial asset under a disclosed tax arrangement. The Union Castle Steamship Company Ltd (Union Castle) had claimed a deduction under the derivative contracts tax regime for a £39m debit in respect of the partial derecognition of FTSE 250 related derivative contracts (put options) which it carried on its balance sheet. The debit arose because of the accounting treatment under International Accounting Standards of a bonus issue of shares by Union Castle to its parent company, Caledonia Investments plc (Caledonia). Under the bonus issue of shares 95% of the cash from the options was to be distributed to Caledonia.

The FTT denied relief for the debit because Union Castle had not incurred as loss (as defined by CTA 2009, s 595 (3)(a) prior to amendment by F(No 2) 2015, Sch 7 paras 59,62) because it was essentially entitled to receive exactly the same amounts under the put options before and after the issue of shares.

The FTT then carried on to consider what would had been the outcome had a loss actually been established. They concluded that if there had been a loss it would have arisen from the derivative contracts and the debit would have satisfied the requirement that it fairly represented the loss on the derivative. Lastly the FTT noted that the bonus issue was not a transaction within the scope of the transfer pricing rules so there would have been no adjustment under these rules to eliminate the allowable debit.

Union Castle appealed the decision that there was no loss to the Upper Tribunal and HMRC appealed the FTT decisions on the further issues that arose i.e. the loss arising from the derivative, the debit fairly representing the loss and the relevance of transfer pricing rules.

Decision

The Upper Tribunal held the following:

Issue 1: loss

The FTT was wrong to hold that the debit of £39M on the derecognition of 95% of the value of the assets was not a loss. The UT judgement was based on looking at the net worth of the company as shown in their accounts and here the value of Union Castle had gone down.

Issue 2: loss arising from the derivative

The UT held that the loss on the derecognition of the assets arose because of the issue of the bonus shares to the parent company and did not arise from the derivative contracts. The calculation of the amount of the debit is based on the valuation of the derivative contracts but does not arise from them and therefore the FTT were wrong to conclude that it did.

Issue 3: debit fairly representing the loss

The UT noted that this issue, and issue 4 on the application of transfer pricing rules, were irrelevant now as there was no loss arising from the derivative but they concluded that the debit did fairly represent the loss arising. The UT noted that the term 'fairly represents' allows HMRC to prevent a mismatch in the accounting treatment but in this case there was no mismatch. Although the term 'fairly represents' was removed from legislation for accounting period beginning on or after 1 January 2016 this decision is relevant for in other tax cases, for example GDF Suez Teeside Ltd the outcome of which is detailed below. Following amendment of the derivatives legislation, currently the amounts to be brought into account are those recognised in determining the company's profit or loss for the period in accordance with GAAP (CTA 2009, s 595(2)).

Issue 4: transfer pricing rules

The FTT found that the transfer pricing rules would not apply to the issue of bonus shares because the issue did not amount to a provision within the meaning of ICTA 1988, Sch 28AA (now TIOPA 2010, Part 4). The UT concluded that this was an error by the FTT and that such capital transactions were not excluded from the definition of provisions within the transfer pricing rules.

Contributed by Joanne Houghton

Fair value of transferred assets

In *GDF Suez Teeside Ltd v HMRC* [2018] EWCA Civ 2075, GDF Suez Teeside Ltd (then called Teeside Power Ltd (TPL)) had contingent and unrealised claims against certain insolvent companies in the Enron Group which totalled £200 million. In line with UK GAAP these claims had a nil value in the accounts of TPL due to the uncertainty of receipt. Therefore, TPL would have been taxable in full on any receipts which it received on these claims.

TPL set up a subsidiary company situated in Jersey (Teeside Recoveries and Investments Ltd (TRAIL)) to which it transferred the claims in consideration for the issue of the equivalent amount of fully paid up ordinary shares. The taxpayer claimed that this transfer did not give rise to any taxable amounts under the loan relationship rules and the shares of TRAIL in the company still had a carrying value of nil under UK GAAP.

The accounts of TRAIL, in contrast, showed that the company had acquired assets with a value of £200m for full consideration of £200m of issued share capital because these were new assets to the company. Any amounts received by TRAIL for the claims would therefore only realise a profit if they were more than the base cost of £200m. Although TRAIL was a controlled foreign company for UK tax purposes, only profits in excess of the £200m value of the assets would be treated as attributable to TPL and taxed in the UK.

Therefore, the ultimate outcome of the scheme, if it had worked, would have been that the £200m would fall permanently outside the UK tax net.

TPL had lost at the Tribunals and the appeal case rested on what amounts should be brought into account to be taxed by TPL under the loan relationship rules on the transfer of the claims. HMRC contended that the phrase ‘fairly represents’ in FA 1996, s 84(1) would include the £200m gain on the transfer of the assets to TRAIL. Whereas the taxpayer argued that ‘fairly represents’ cannot be interpreted or applied so as to override a company accounts as was confirmed in *Greene King PLC v HMRC* [2016] EWCA Civ 782, [2017] 4 WLR 190.

The Court of Appeal found for HMRC concluding that the legislation allowed a wider focus to be taken when looking at the amounts to be taken into tax and what fairly represented the profit to TPL would include the gain on the disposals of the claims and so £200m should be included as a taxable loan relationship credit.

As noted above in the Union Castle case, the term ‘fairly represents’ has been removed from the legislation, but the decision in this case could be relevant to open enquiries for earlier periods.

Schemes such as the above are now often counteracted by the loan relationship targeted anti-avoidance rule (under CTA 2009, ss 455B-455D) which makes just and reasonable adjustments to the debits and credits to be brought into account for tax where a tax advantage arises because of tax arrangements.

Contributed by Joanne Houghton

EU approves IFRIC 23

On 23 October 2018, the European Commission adopted IFRIC 23 which was issued on 7 June 2017 by the IASB. IFRIC 23 clarifies how to apply the recognition and measurement requirements in IAS 12 Income Tax when there is uncertainty over income tax treatments. IAS 12 prescribes the accounting treatment for income taxes which includes all domestic and foreign taxes that are based on taxable profits.

The interpretation in IFRIC 23 addresses:

- whether an entity considers uncertain tax treatments separately;
- the assumptions an entity makes about the examination of tax treatments by taxation authorities;
- how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- how an entity considers changes in facts and circumstances.

IFRIC 23 is applicable for EU listed companies for accounting periods commencing on or after 1 January 2019.

Contributed by Joanne Houghton

VAT

Opting tax – a two-stage process

Summary – File copy of form VAT 1614A, which could not have been backdated, was sufficient evidence of a decision to opt to tax a property.

Carol Allen, director and chief financial officer and her co-director, Graham Lake, had agreed to purchase a property in early June 2016. On 30 June 2016, at an informal board meeting this decision was confirmed and Graham Lake had asked her to deal with the "necessary paperwork".

Carol Allen explained that this was a phrase which was regularly used in the business to mean, inter alia, that an option to tax should be made if needed as the property was non-residential. In this case, the lease documentation referred to a VAT charge in relation to the premium and so she concluded that an option to tax should be made in order to be able to recover the VAT.

Carol Allen accepted that the board minutes did not expressly refer to a decision to opt to tax the property but stated that, as they would usually opt to tax non-residential buildings, it was not something which would be specifically set out. A reference to discussion of an option to tax would generally only arise where the property was not to be opted, such as where it was residential or where the vendor had not opted to tax the property.

The directors provided a copy of form VAT 1614A dated 1 July 2016. They said that this had been sent by standard untracked post and it became apparent during a VAT enquiry in October 2016 that HMRC had not received the form.

With no minutes nor proof of postage, HMRC were not convinced that the decision to opt to tax had been made and would not agree to a late notification.

Decision

The company demonstrated that when completing form VAT 1614A, it must be completed online and then printed off for posting. HMRC's systems would not allow the signature date included on the form to be backdated. An error message is shown in red on the screen, stating that 'The date must not be earlier than today', where 'today' is the date on which the form is being completed. The First Tier Tribunal concluded that HMRC had been wrong to decide that a file copy of form VAT 1614A, which could not have been backdated, was not evidence of a decision to opt.

The First-tier Tribunal concluded that HMRC's decision not to allow the late notification on the ground that there was no evidence of a positive decision to opt to tax had been unreasonable.

The appeal was allowed.

Rowhildon Ltd v HMRC (TC06669)

Legal fees on disposal of subsidiary

Summary - Legal fees incurred by a subsidiary in relation to the disposal of a subsidiary were not deductible.

As the holding company of the Arovit pet food group, C&D Foods Acquisition provided financial, management and IT support to the group's trading companies. The company had incurred legal fees on a share sale agreement for the aborted disposal of two group companies.

Under Principal VAT Directive art 135, a share disposal is an exempt transaction. The Danish Tax Authorities claimed that there was no direct and immediate link between the fees incurred and C&D's taxable activities of providing services to the subsidiaries. The company had not been allowed to deduct VAT on the legal fees.

Decision

The AG considered that if a direct and immediate link was established between the legal advice and the share disposal, the VAT incurred on the legal fees would not be deductible. This was for the national court to decide but the AG pointed out that the main purpose of the advice seemed to have been the disposal of the shares and the drafting of the share disposal agreement. The VAT was therefore unlikely to be deductible.

However, the AG added that, if there was no direct link to an exempt share sale, a possible link to the business as a whole could be explored. In this case, C&D Foods would not need to demonstrate that the legal costs were included in the management charges, but only that the costs were objectively and economically linked to its taxable activity. Some apportionment would also be possible.

C&D Foods Acquisition ApS v Skatteministeriet (Case C-502/17)
Adapted from Tax Journal (21 September 2018)

Central heating using energy saving materials

Summary – Reduced rate energy savings materials that were supplied as part of a single composite supply of heating systems could not benefit from the reduced rate.

AN Checker Heating & Service Engineers (AN Checker) installed boilers and central heating systems in residential accommodation. As part of that supply, it installed certain energy saving materials, which it argued should be charged to Vat at the reduced rate.

Both AN Checker and HMRC agreed that what needed to be decided was whether, in enacting Sch 7A Group 2 VATA 1994, Parliament had exercised its powers under the principal VAT Directive, to require the supply of an item to be charged at a reduced rate even when it was part of a composite supply.

Decision

The Upper Tribunal noted that the opening words of s29A(1) VATA 1994, which governs Sch 7A, refer to 'any supply that is of a description for the time being specified in Schedule 7A, …' In this case, the business supplied boilers and central heating systems and these supplies are not specified within Sch 7A; only components of this work are listed.

In summary, the reduced rate energy saving material was supplied only as part of a wider, composite supply. To apply the reduced rate, there needed to be a provision in legislation allowing for the apportionment of consideration received. However, the Upper Tribunal observed that no such provision existed. Additionally, they said that Parliament would have used express words if its intention had been that the reduced-rate provisions would apply to single elements of composite supplies.

The Tribunal confirmed that composite supplies, including ancillary elements, must be taxed at the rate applicable to the principal element.

The appeal was dismissed.

AN Checker Heating & Service Engineers v HMRC [2018] UKUT 0292

Reduced VAT rates on e-publications

For books, newspapers and periodicals, member states have the option of applying a ‘reduced’ VAT rate, i.e. minimum 5%. Some have been authorised to apply ‘super-reduced’ VAT rates (below 5%) or ‘zero’ rates (which involve VAT deductibility).

By contrast, under the current VAT rules (directive 2006/112/EC), electronically supplied services are taxed at the standard VAT rate.

On 2 October 2018, the Council agreed a proposal allowing member states to apply reduced, super-reduced or zero VAT rates to electronic publications, thereby allowing alignment of VAT rules for electronic and physical publications.

The new rules will apply temporarily, pending the introduction of a new, ‘definitive’ VAT system. The Commission has issued proposals for the new system, which would allow member states more flexibility than at present in setting VAT rates.

www.consilium.europa.eu/en/press/press-releases/2018/10/02/electronic-publications-council-agrees-to-allow-reduced-vat-rates/

Definitive EU VAT system proposals

The EU Parliament's economic and monetary affairs (ECON) committee has tabled its report containing amendments to the Commission's proposal for creation of a definitive EU VAT system.

The proposal is based around four fundamental principles, or 'cornerstones', to be introduced by 2022 which are:

1. tackling fraud, by charging VAT on cross-border trade between businesses inside the EU;

2. a one-stop shop, allowing traders to make declarations and payments using a single online portal in their own language and according to the same rules as in their home country;

3. the 'destination' principle, whereby the final amount of VAT is always paid to the member state of the final consumer and charged at the rate of that member state; and

4. simplified invoicing rules, allowing sellers to prepare invoices according to the rules of their own country even when trading across borders.

In addition, four short-term 'quick fixes' are proposed, aimed at improving the day-to-day functioning of the current system from 2019:

1. requiring the VAT identification number of the customer as a substantive condition for exempting intra-community supplies of goods;

2. simplifying the rules for those parts of chain transactions which do not involve the physical movement of goods;

3. simplifying the rules for suppliers in one member state who move 'call-off stock' to a warehouse in another member state for eventual sale to a known buyer; and

4. simplifying the rules on providing proof of transport for exempting intra-community supplies of goods.

Report suggestions

The report supports the anti-fraud and simplification objectives while suggesting a number of amendments including:

- 'certified taxable person' status to be clearly defined in regulations and comprehensive guidelines, and aligned as closely as possible with the criteria for authorised economic operators;

- simplified procedures for applications by SMEs;

- an appeals procedure for rejected applications to be put in place by 1 June 2020 (with applicants having to wait at least six months before making another application);

- the authorities to review certified taxable person status at least every two years;

- introduction of a VAT dispute resolution mechanism, based on the current EU VAT cross-border ruling pilot project, to operate alongside national VAT dispute mechanisms; and

- introduction of a mechanism to provide taxpayers with automatic notifications of changes to applicable VAT rates.

http://www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference=PE-627.911&format=PDF&language=EN&secondRef=01

Input Tax recovery on racing cars under the Flat Rate Scheme

Summary – Invoices in excess of £2,000 to enhance car engines was not Capital Expenditure Goods under the Flat Rate Scheme and so input VAT could not be reclaimed.

RPD Building Limited is a company that provides construction management services, largely through the services of Mr Robert Dixon, its owner and director. The company registered for VAT and approved to use the Flat Rate Scheme (FRS).

In September 2015, HMRC selected RPD Building Limited for a check of VAT returns for the periods from 03/12 to 06/15. Following their check, they concluded that input VAT reclaimed in respect of certain racing cars should not have been recovered.

Mr Dixon conceded that expenditure on fuel, coolant, oil and transport to move the vehicles was consumable in nature and therefore would not qualify as Capital Expenditure Goods (CEG). However, the remaining expenditure was on parts and labour for the creation of an asset, being an enhanced car that was transformed from a 200 to a 800 horse power engine.

Mr Dixon submitted that the expenditure was linked with his business because he was using the racing cars as promotional tools for his business, by showing and racing the cars at racing meetings and standing in the 'paddock' at racing meetings and speaking to people who might turn into potential customers.

Mr Dixon argued that although the majority of the invoices were addressed to him personally, they were paid by RPD Building Limited.

Decision

The Tribunal identified that under VAT Regulations 1995, Reg 55E(1), where invoices amounted to a value of less than £2000 (including VAT), there could be no claim for the input VAT incurred on invoices.

On invoices over £2000, they considered whether parts for rebuilding car engines and the associated labour could be CEG under the FRS?

In Sally March [2009] UKFTT 94 (TC), the Tribunal found that supplies of combined goods and labour by electrical and building suppliers in the course of constructing a riding arena were supplies of services as the goods acquired were consumed entirely in the construction of the building, being the asset ultimately purchased. Following this principle, the Tribunal agreed with HMRC that the asset in question was the car.

The costs, including labour, incurred to transform the cars into high performance racing vehicles were for services. They found that the expenditure was not CEG and therefore RPD Building Limited were not entitled to claim input tax in relation to the invoices in question.

The appeal was dismissed.

RPD Building Limited V HMRC (TC06740)

Additionally, the Tribunal confirmed that:

- The motor vehicle block in VAT (Input Tax) Order 1992 (SI 1992/3222), Article 7, did not apply as none of the input tax disputed in this case related to the supply, acquisition or importation of a car. All of the invoices related to parts, labour and consumables;

- Under the FRS, if the goods had been CEG, these rules would have overridden the general principles of input tax recovery, including the need for there to be a direct and immediate link between the supply received and the supplies made by the trader;

- The provision of bank and credit card statements showing payments being made to the relevant suppliers by the company, rather than Mr Dixon himself, might have been sufficient alternative evidence for HMRC to accept the incidence of this expenditure fell on RPD Building Limited.

VAT and food - clearing the muddy waters! (Lecture B1104 – 14.03 minutes)

The catering business is booming, with coffee shops, cafes, mobile catering units and restaurants continuing to flourish. An important issue to ensure profits are maximised is to correctly account for VAT on sales, recognising which supplies of food and drink qualify for zero-rating and those that are always standard rated.

Summary of basic rules

All supplies of food and drink consumed inside a catering establishment are standard rated. Cold food sold on a take away basis qualifies for zero-rating in many cases but there are exceptions where VAT is still payable e.g. sales of chocolate bars, crisps and fizzy drinks are all standard rated.

As a planning tip, the best approach is for your catering clients to work on the assumption that all sales are standard rated, and then specifically identify those sales of cold food and drink that qualify as zero-rated if consumed away from the premises. The challenge is to then ensure that all staff are aware of these opportunities for zero-rating. The zero-rated sales will need to be recorded separately, usually based on a multi-button till.

Defining 'the premises'

Before considering whether food is classed as hot or cold, it is important to understand the boundaries for a business as far as its premises are concerned. HMRC used to take the view that a whole site would be classed as 'premises' (e.g. a football ground) but that interpretation changed following the tribunal case of Compass Contract Services UK Ltd (CA[2006]STC1999).

It is now accepted that the premises only includes the specific area surrounding an establishment e.g. tables and chairs outside the café or a shared seating area inside a shopping centre which services the customers of a range of catering outlets (HMRC Notice 709/1, para 3.2).

A catering business that provides both on premises and take away food will need to recognise the 20% VAT difference on most cold food items for pricing purposes. Price lists should be clearly displayed so the customer is aware of the difference between take-away and on-site prices eg cheese roll (in) £2.40; cheese roll (take away) £2. The business might want to add a further charge to its 'in' prices to reflect the extra service involved e.g. £3 for cheese roll (in); £2 (take away).

Take-away food – the law

The legislation on VAT and take-away food served by cafes, sandwich bars, fish and chip shops and similar outlets is quite lengthy.

VATA1994, Sch 8, Group 1 makes an exception to zero-rating on food if it is 'a supply in the course of catering' – in other words, catering is standard rated.

Note 3 to this Group then confirms that catering includes 'any supply of hot food for consumption off those premises' i.e. take away food.

Note 3B then gives further detail about what is classed as 'hot food,' confirming it must be hot at the time it is sold i.e. either heated for that purpose, or kept hot after being heated, or provided to a customer in packaging that retains heat. Note 3B also captures supplies where the food is 'advertised or marketed in a way that indicates that it is supplied hot'.

It is important to ensure that clients do not incorrectly label food as hot when the reality might be that it is 'cooling down' after being taken out of the oven. If a product is promoted (marketed) as being hot, it will be subject to 20% VAT on take away sales but there is no problem with describing an item as 'freshly baked' (HMRC Notice 709/1, para 4.3, Test 5).

The definition of hot food – and recent tribunal case

Note 3C in the legislation confirms that food is deemed to be hot if it is served above the 'ambient air temperature' in the premises in question. It is deemed to be 'kept hot' (another phrase in Note 3B which requires a definition) if it is retained in such a way that it remains hot after it has been cooked i.e. the natural cooling process is thwarted.

The recent case of Pegasus (Manchester) Ltd (TC6382) related to an assessment for £114,122 covering a four-year period, in relation to take away sales of Afro/Caribbean food such as rice, wraps and curries, which the taxpayer claimed were zero-rated as cold food. HMRC claimed they were hot and therefore standard rated.

During preparation in a kitchen on site, the food under dispute was cooked to a temperature of 90/100C but it was then cooled in the kitchen in the pans in which it had been prepared, with a fan being used to assist the cooling process. Once cooled to 19/20C, it is placed in gastro norm containers which fit into the bain marie used in the retail unit (a bain marie is a water-based container powered by electricity). Food is kept in the bain marie for 1 to 1.5 hours, and the bain marie has an average temperature of 56C.

All parties agreed that the 'ambient room temperature' on the premises was 28C to 30C. This was quite high but accepted by HMRC because of the cooking going on from other units surrounding the client's trading area. The taxpayer claimed this was higher than the temperature of the food when it was served to customers, even though the bain marie had a temperature of 56C.

The judge dismissed the taxpayer's claim, agreeing with HMRC that the temperature of the bain marie must be reflected in the temperature of the food as well, the aim being so that it was served hot to the customer.

Exceptions to zero-rating

The legislation on the VAT liability of food is contained in VATA1994, Sch 8, Group 1. It confirms that 'food of a kind used for human consumption' is zero-rated but then contains exceptions to the zero-rating, followed by exceptions to the exceptions, and then exceptions to the exceptions to the exceptions. It is fair to say that the legislation will never win an award for 'plain English'. But to summarise, here are some of the key items that are still standard rated when sold by a business on a take-away basis:

- Ice cream and similar products but excluding frozen yoghurt that's designed to be thawed before being eaten;

- Confectionery (chocolates, sweets and candies) apart from cakes and some biscuits e.g. a biscuit partly or wholly covered in chocolate is standard rated;

- Alcoholic beverages;

- Other beverages e.g. carbonated drinks such as lemonade and cola; mixers such as tonics and sodas, as well as fruit cordials, squash and bottled water;

- Hot drinks.

Note - it is sensible for your clients to refer to HMRC Notice 701/14 to ensure they are applying the correct VAT liability to their sales of food and drink. But don't forget that all food and drink sold for consumption on the premises of a business is always standard rated.

What is 'catering'?

We have established that food and drink sold on the premises of an establishment is always classed as catering, along with hot food and drink sold on a take-away basis. But other supplies of food and drink could still be classed as catering and therefore subject to VAT.

Example

Jean runs a café and has been asked to provide a finger buffet for 20 people for a local company. The buffet will consist of a range of sandwiches, cakes, sausage rolls and pork pies (all cold food), ready for consumption as soon as it arrives at the company's office. Should she charge VAT to her customer?

Catering is "a supply involving a significant element of service" – and HMRC take the view that food and drink supplied as part of a contract is classed as catering. It would be different if Jean turned up at the office of her customer and sold sandwiches to staff from a tray but a pre-ordered buffet is classed as catering (HMRC Notice 709/1, para 2.2.2).

Contributed by Neil Warren

VAT incurred by a foreign branch

Summary - VAT incurred by a branch in relation to the activities of its head office situated in another member state was recoverable.

Morgan Stanley operated a branch in France and it was accepted that the branch constituted a fixed establishment that was not carrying out an independent economic activity.

The issue was its VAT recovery in relation to expenses incurred for its London head office activities and in relation to those affecting both activities of the French branch and activities of the London head office.

Decision

The AG considered that the combined application of the domestic provisions of the two relevant member states, France and the UK, provided the best balance between the neutrality and territoriality principles. The AG observed that under article 17 of the Sixth VAT Directive, even if a transaction gives rise to VAT recovery in the member state of the head office, recovery cannot take place in the member state of the branch unless it would also give rise to such recovery in the member state where it is claimed; the member state where the branch is established.

The AG concluded that VAT incurred in relation to expenses relating exclusively to taxable activities of the head office should be wholly recoverable. VAT relating to exempt banking activities was not recoverable. Finally, a pro rata formula should be calculated in relation to expenses incurred for both the activities of the head office and those of the branch, by reference to the total turnover of the branch (and not only its transactions with its French customers).

Morgan Stanley & Co International v Ministre de L'Économie et des Finances (Case C-165/17)
Adapted from Tax Journal (13 October 2018)

Making Tax Digital – Record-keeping **(Lecture B1105 – 12.54 minutes)**

Making Tax Digital is now only a matter of months away – it will be introduced for VAT periods beginning on or after 1 April 2019, and will be relevant to all VAT registered businesses trading above the VAT registration threshold i.e. £85,000. In my previous sessions, I considered the basic rules with MTD and in a separate session, some specific challenges for different types of business.

Spreadsheets

Many businesses use spreadsheets to produce their accounts and keep records, and the challenge here is to ensure that bridging software is in place to create a digital link between the spreadsheet totals and the VAT return process, which is then sent to HMRC. Linked cells on spreadsheets will qualify as a digital link. Many software providers have been very active in relation to this issue. In the first year until April 2020, HMRC have said that links using e.g. cut and paste will be acceptable rather than the bridging software. This has been described as ‘the soft-landing period’. It is important to always keep in mind the overall objective of MTD, which is to minimise human intervention in the accounting and tax return process. This is a key part of HMRC’s controversial conclusion that MTD will increase the tax yield by reducing human errors such as arithmetical mistakes and transposition errors.

Sales and purchase invoices

Each sales invoice needs to be recorded digitally and contain the following information:

- Time of supply – in the case of a cash accounting scheme user, this will be the date when the sales invoice is paid by the customer i.e. when output tax needs to be included on the VAT return.

- The net value of income for each rate of tax and the relevant rate of tax – so if an invoice consists of a zero-rated book for £10 and a standard rated pen for £20+VAT, then the entry on the spreadsheet must include both £10 and £20 i.e. recognising the different VAT liabilities within the sales invoice and it will clearly show that the amount of £10 is zero-rated and £20 is standard rated.

Note – the above requirement will cause additional work for many business owners. For example, you might have a client who only posts a total payment received from a customer as a single entry, even though the payment might comprise many different sales invoices.

The information needed on purchase invoices is different:

- Time of supply – as above – but the relevant date for cash accounting scheme users will be the date of payment rather than the invoice date.

- The total value of the invoice excluding VAT (there is no need to analyse a purchase invoice between different rates of VAT).

- Input tax being claimed.

Timing of keeping digital records – when must they be completed?

Many retailers keep a manual record of their daily gross takings figures and just post three months of figures to their accounting package at the time they complete their VAT return. This is fine and will meet the MTD requirement of having everything recorded digitally at the time the return is submitted to HMRC. In an ideal world, it would be great if we all did real time digital record keeping but the reality is that millions of people are still not totally clued up to the electronic world.

The key point highlighted by HMRC is that MTD is not changing the record keeping requirements of most businesses but the format in which they are kept. So as an example, flat rate scheme users only need to digitally record purchase invoices where they are claiming input tax i.e. in relation to capital expenditure goods costing more than £2,000 including VAT. The need for retailers to keep a record of their daily gross takings has been a legal requirement since the day that VAT was introduced in 1973. And the good news for margin scheme businesses, such as antique dealers, is that the second-hand stock book that records each item they buy and sell does not need to be kept digitally.

Voluntary registrations

A business that is voluntary registered for VAT can still choose to join MTD even though it is not compulsory. There is speculation that it will be compulsory for all registrations from 1 April 2020.

The challenge for voluntary registrations is to be aware of the fact that even if they exceed the threshold on a temporary basis (e.g. a one-off good order that will not be repeated) they must still join MTD and cannot withdraw if their turnover falls below the threshold again.

Penalties

The penalty system linked to MTD will be based on a points-based model. Under this model, a business would receive a point every time it failed to submit a return on time, a penalty would be charged above a certain points threshold, which will be dependent on the frequency of their submission obligations. After the threshold has been reached, a penalty will be charged for every subsequent submission failure. The specific detail of the new system has still to be finalised. It is intended that the points would be cleared to zero if the business has managed a period of full compliance.

Contributed by Neil Warren