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Personal tax

BBC presenters and IR35 (Lecture P1161 – 16.36 minutes)

Summary - On a split decision, the work done by three BBC presenters was held to fall foul of the IR35 rules so tax and NIC were due on payments made to them by their personal service companies.

Joanna Gosling, Tim Willcox and David Eades worked for the BBC through their personal service companies: Paya Ltd, Tim Willcox Ltd, and Allday Media Ltd. HMRC challenged the companies, arguing that the presenters' earnings for 2006/07 to 2013/14 were caught by the IR35 rules, making the companies responsible for tax and National insurance on those earnings.

Interestingly, prior to setting up their companies in 2003 and 2004, Tim Willcox and Joanna Gosling had worked as freelancers for the BBC, and David Eades had been an employee for a number of years before taking voluntary redundancy. It seems that around 2003 or 2004, news presenters were given little choice; they could either go on to the BBC payroll as employees or provide their services through a personal service company.

Each of the three personal service companies entered into a number of contracts with the BBC to provide the services of the presenters. During the tax years concerned, all three presenters undertook some other work to varying degrees. Interestingly, in 2014 all three presenters ceased working through their personal service companies to become employees of the BBC.

The appeal followed the normal pattern of events whereby the Tribunal looked at mutuality, control and other provisions within the contracts to see if they were consistent with them being contracts of service. The decision, however, was not clear cut.

Decision

The First Tier Tribunal concluded that the BBC was looking to shift the employment tax risk to the presenters through their personal service companies. The individuals had little choice but to contract with the BBC through personal service companies as the BBC considered that this was the only acceptable way of contracting with the presenters to reduce their tax risk. The only alternative was to accept a substantial pay cut and become an employee.

Considering a hypothetical contract, Judge Morgan concluded that IR35 applied to most of the contracts:

- Mutuality of obligation: Even though the presenters had the option to refuse to work on some dates, all three presenters were required to work for a minimum number of days if asked to do so, with the BBC being required to pay for that minimum number of days, regardless of whether work was actually provided. This was held to be a sufficient mutuality of obligation;

- Control: Before taking on other client work, the presenters needed to obtain the BBC's consent before accepting. Additionally, the BBC had ultimate control over the productions, with limited autonomy allowed when the presenters were presenting and interviewing. This was seen to be evidence of employment.

Interestingly, the second judge agreed with the finding of facts, but disagreed with final conclusion reached by Judge Morgan. He concluded that there was no guarantee that their contracts would be renewed, there was a significant degree of flexibility to their work pattern that allowed them to refuse work and use their journalism skills elsewhere; although the editorial guidelines provided a framework as to what needed doing the news readers did have a significant amount of autonomy as to how they worked. In addition the newsreaders had no holiday pay, sick pay or pension provision.

The final decision rested with Judge Morgan's casting vote with the final decision going in HMRC's favour. However, the judges agreed that the presenters and their advisers had acted in good faith, and had not been careless in their decision to disapply the IR35 rules. This meant that the enquiry period was limited to four years, and so some of the determinations were invalid as they were issued out of time.

Point to note: If these presenters had been investigated today, the new off-payroll rules contained in Chapter 10 ITEPA 2003 would have applied. This would have resulted in the BBC picking up the bill. With the BBC giving the presenters little choice over the use of their personal service companies, some might say that this would have been a fairer outcome.

Paya Ltd, Tim Willcox Ltd, Allday Media Ltd v HMRC (TC07377)

STOP PRESS: Christa Ackroyd, the Look North presenter, has failed in her appeal to have her deemed employment status under the IR35 legislation overturned. The Upper Tribunal has found that the First Tier Tribunal had not erred in law when they concluded that the BBC had the ultimate right of control over her actions. We will provide a detailed summary of this case in next month's release.

GP's money – salary or compensation? (Lecture P1161 – 16.36 minutes)

Summary – Payments made by South Kent Coast CCG to the taxpayer's practice, for his services, constituted a salary and not compensation for the cost of engaging a locum.

Bruce Cawdron practiced as a GP and was the sole shareholder and director of Warehorne Consultants Limited that traded as the Martello Medical Practice. Prior to April 2013, he was the sole GP practicing from this practice, working five days each week for the practice.

In late 2012 he was appointed as a GP member of the South Kent Coast CCG Board with the appointment running from 1 April 2013 to 31 March 2015 with him agreeing to work one day a week. However, he left the role early on 31 May 2014. During this time his Practice received payments totalling £51,519.80 from the South Kent Coast Clinical Commissioning Group ("CCG").

The issue to be decided was how the sum paid of £51,519.80 was to be treated for tax:

- Dr Cawdron argued that the payments were made by the board to the Martello Medical Practice and were made to compensate the practice for the cost of engaging a locum one day a week when he worked for the South Kent Coast CCG;
- HMRC considered that the contract was between the South Kent Coast CCG and Dr Cawdron and that the payments were remuneration for his services.

Decision

The First Tier Tribunal found that the contract was between South Kent Coast CCG and Dr Cawdron as an individual. Martello Medical Practice was not a party to the contract. Dr Cawdron was paid monthly in arrears for the work he carried out as an office holder and should be taxed as employment income.

As far as South Kent Coast CCG were concerned, the fee paid related only to the time Dr Cawdron spent working for them, and that it was unrelated to the costs of employing a locum. The contract made no reference to compensation for the loss of engaging a locum.

The Tribunal accepted that the cost to the practice of providing medical services five days a week had become more expensive when Dr Cawdron had started working a day a week for the board. It did not matter that Dr Cawdron requested for his payments to be made to the Martello Medical Practice rather than his personal bank account. This did not change the nature of the contract, nor the nature of the payments. The Tribunal agreed with HMRC that the amounts were the income of Dr Cawdron and, as advised on the P60, should have been included on his personal tax return. The appeal was dismissed.

Bruce Cawdron v HMRC (TC07295)

Taxable car benefits and CO_2 emissions (Lecture P1162 – 8.12 minutes)

As announced by the previous Chancellor in 2017, the CO_2 emissions figure for the purposes of company car tax (and related charges) will be based on the Worldwide Harmonised Light Vehicle Test Procedure (WLTP) methodology in respect of new cars registered on or after 6 April 2020. This measure is included in the draft Finance Bill clauses published on 11 July 2019.

For cars assessed under the WLTP rules, the majority of the taxable benefit percentages will be reduced by 2% in 2020/21 compared to cars with CO_2 emissions measured under the normal New European Driving Cycle (NEDC). For example, CO_2 emissions generating an appropriate percentage of 23% by virtue of the latter arrangement would be given a reduced percentage of 21%. This figure will then be increased by one percentage point in 2021/22 (i.e. to 22%) and by a further percentage point in 2022/23 (i.e.. to 23%).

Where cars are classified as zero-emission vehicles, the relevant percentage will be taken as 0% in 2020/21, rising to 1% for 2021/22 and 2% for 2022/23.

For cars first registered on or after 1 October 1999 but before 6 April 2020, the draft Finance Bill makes it clear that the CO_2 emission figures will continue to be based on the NEDC regime. The legislation is unchanged for cars first registered before 1 October 1999.

The policy objective behind the move is explained by HMRC as follows:

‘As WLTP is more representative of real-world driving conditions, this measure ensures that company car tax . . . (is) based on a more robust regime for measuring CO_2 emissions.

The introduction of WLTP allows motorists to make more informed purchasing decisions when considering the CO_2 impact of their new car. WLTP results in different CO_2 values in comparison to the NEDC procedure and the changes to the appropriate percentages for cars measured under the WLTP procedure support its introduction. The changes to appropriate percentage figures for all zero-emission vehicles support the Government's climate change objectives by encouraging take-up of zero-emission vehicles.'

The company car tax system is currently based on a vehicle's CO_2 emission figure calculated under the NEDC test procedure. WLTP testing standards were introduced for new registrations made on or after 1 September 2017. With effect from that date, legislation requires manufacturers to report the CO_2 emission figures for both NEDC and WLTP test procedures. However, where more than one emission figure is recorded on the car's log book, the NEDC figure should be used for all tax years up to and including 2019/20.

For 2020/21, S139 ITEPA 2003 sets out the following car benefit figures for cars registered before 6 April 2020:

Appropriate CO_2 emissions	*Percentage*
0	0%
1 – 50:	
Car with electric range figure of 130 miles or more	2%
Car with electric range figure of 70 – 129 miles	5%
Car with electric range figure of 40 – 69 miles	8%
Car with electric range figure of 30 – 39 miles	12%
Car with electric range figure of less than 30 miles	14%
51 – 54	15%
55 – 59	16%
60 – 64	17%
65 – 69	18%
70 – 74	19%
75 – 79	20%
80 – 84	21%
85 – 89	22%
90 – 94	23%
95 – 99	24%
100 – 104	25%
105 – 109	26%
110 – 114	27%
115 – 119	28%
120 – 124	29%
125 – 129	30%
130 – 134	31%
135 – 139	32%
140 – 144	33%
145 – 149	34%
150 – 154	35%
155 – 159	36%
160 or over	37%

For 2020/21, S139A ITEPA 2003 sets out the following car benefit figures for cars registered on or after 6 April 2020:

Appropriate CO2 emissions		*Percentage*
0		0%
1 – 50:		
	Car with electric range figure of 130 miles or more	0%
	Car with electric range figure of 70 – 129 miles	3%
	Car with electric range figure of 40 – 69 miles	6%
	Car with electric range figure of 30 – 39 miles	10%
	Car with electric range figure of less than 30 miles	12%
51 – 54		13%
55 – 59		14%
60 – 64		15%
65 – 69		16%
70 – 74		17%
75 – 79		18%
80 – 84		19%
85 – 89		20%
90 – 94		21%
95 – 99		22%
100 – 104		23%
105 – 109		24%
110 – 114		25%
115 – 119		26%
120 – 124		27%
125 – 129		28%
130 – 134		29%
135 – 139		30%
140 – 144		31%
145 – 149		32%
150 – 154		33%
155 – 159		34%
160 – 164		35%
165 – 169		36%
170 or over		37%

Further adjustments, as previously mentioned, have been made for the tax years 2021/22 and subsequently.

Contributed by Robert Jamieson

Festivities – Let's celebrate! (Lecture P1163 - 15.01 minutes)

Many employers celebrate festive dates with employees by organising company events or making gifts to their employees. In this article we consider what tax and national insurance will be due and whether there is anything that employers can do to make these tax free.

Taxable party or gift

If the event is taxable then the taxable amount will need to be reported on the employees' P11Ds as well as tax becoming payable by the employee, collected by amending their PAYE code. In addition, the employer will need to account for Class 1A NIC on the benefit and reported on the P11D(b) form.

To avoid the employee suffering the tax bill, the employer can agree to pay the tax due by including the amount in their PAYE settlement agreement. The employer then becomes responsible for paying the tax at each employee's marginal rate of tax as well as the employers' Class 1B NIC due, calculated on the tax inclusive benefit, at a rate of 13.8%.

Annual social functions

Under s264 ITEPA 2003, social events can be tax-free provided the following conditions are satisfied:

- The event is an annual party/parties for employees that happens on a recurring basis:
    - A one off event would not qualify;
    - Director only events do not qualify;
    - Available to all employees/ employees at one site if business has several;
- The cost of all events must not exceed £150 per head attending. If the total cost is greater than £150, you need to look at each event to see which is taxable

The £150 covers a number of things including:

- VAT;
- Free bar before the event;
- The dinner and any entertainment;
- Gifts given at the event;
- Free bar after the event;
- Transport to and from the venue;
- Overnight accommodation.

Example 1

An employer has two annual events. The Christmas party costs £100 per head and the summer BBQ that costs £45 per head.

As the total is below the £150 limit, both events are tax free.

Example 2

An employer has two annual functions. The first costs £130 and the second £50 per head.

The first falls within the “annual parties” exemption but the second takes the total over £150 limit and is taxable. The employees P11D would show £50 as a taxable benefit, or £100 if they took a partner. If they only attended the first event, there is no taxable benefit. Somewhat bizarrely, for any employee that only attended the second event, there would be a taxable benefit £50

Trivial benefits

Where there is a taxable amount on the second event, it worth checking to see whether this could be tax free as a trivial benefit.

A benefit is trivial if:

- It costs the employer £50 or less to provide (including VAT);
- It is NOT paid in cash or a voucher exchangeable for cash;
- It is NOT a reward for services, employment or performance;
- It is not in the contract of employment.

Example 3

An employer has two annual functions. The first cost £130 and is covered by the annual events exemption. The second costs £45 per head and takes the total over £150 and so cannot be treated as tax free as a second annual event. However, it does satisfy the conditions to be an exempt trivial benefit.

The trivial exemption could also apply if the employer decides to gift a hamper, wine or store vouchers that cost less than £50.

Article created from seminar recorded by Alexandra Durrant

Pension Annual Allowance **(Lecture P1164 – 16.23 minutes)**

The pension annual allowance charge is causing some fun for accountants who act for high net worth individuals who are making significant pension contributions or who participate in final salary schemes (now mainly those within the public sector). There has been a lot of publicity in the normal press recently about doctors who are having problems with their pension contributions.

Contributions can be made up to the annual allowance each year, with both personal and employer contributions being taken into account.

Where a final salary scheme is involved, there is a mechanism for calculating the pension input and the pension fund trustees should supply this each year. Very broadly, you take the difference between the pension entitlement at the beginning and end of the tax year (after the value at the beginning has been uprated by CPI for the previous September) with annual pension amounts being multiplied by 16 to get the valuation.

Example

Ahmed belongs to a pension scheme where he gets 1/80th of his final salary for each year of pensionable service and a separate lump sum of three time his pension. At the start of the year, his pay is £75,000 and he has been a member of the scheme for 20 years. He has a promotion during the year that sees his salary increase to £90,000. Assume CPI is 3%.

<u>Opening value</u>

Amount of pension = 20/80 x £75,000 = £18,750 x 16 = £300,000

Lump sum = 3 x £18,750 = £56,250

Total = £356,250 x 1.03 = **£366,937**

<u>Closing value</u>

Amount of pension = 21/80 x £90,000 = £23,625 x 16 = £378,000

Lump sum = 3 x £23,625 = £70,875

Total = **£448,875**

<u>Pension input amount</u>

The difference between these amounts is £81,938.

The annual allowance is now tapered away but even that is not straightforward. Net income (basically the income after pension contributions have been deducted) has to be more than £110,000 and adjusted income (basically the income plus both employers and pension contributions) has to be more than £150,000 for the taper to apply. The annual allowance is then reduced by £1 for every £2 adjusted income exceeds £150,000 although it cannot go below £10,000.

Finally, you can carry forward unused contributions for up to three years. Current year allowance is used first then brought forward on a first in first out basis. Note also that 2015/16 was a strange year as the year was split although the impact of that year is not relevant for 2019/20 onwards other than determining use of brought forward amounts.

Example

An individual has contributions as follows:

2011/12	32,867
2012/13	35,048
2013/14	12,505
2014/15	68,152
6 April 2015 to 8 July 2015	17,644
9 July 2015 to 5 April 2016	48,476
2016/17	49,943
2017/18	42,404

Annual allowance for all years up to 2013/14 was £50,000 and then reduced to £40,000. In 2015/16 the annual allowance was £80,000 but only £40,000 could be made after 8th July.

The analysis for the above employee is as follows:

2011/12: within annual allowance, surplus of £17,133 (NB this is used in 2014/15)

2012/13: within annual allowance, surplus of £14,952 (NB £11,019 utilised in 2014/15 and then the balance lost)

2013/14: within annual allowance, surplus of £37,495 (NB £8,476 used in 2014/15 and £9,943 in 2016/17 with the balance lost)

2014/15: contributions in excess of annual allowance but £17,133 used from 2011/12 and £11,019 from 2012/13

2015/16: apparent surplus over £80,000 but total amounts after 8 July more than £40,000 so no surplus

2016/17: contributions in excess of annual allowance but utilise £9,943 from 2013/14

2017/18: contributions in excess of annual allowance and no brought forward amounts to cover the excess.

The above assumes that there is no tapering of the allowance. What if the income in 2017/18 was £125,000? In that case, the net income is more than £110,000 and the adjusted income is £167,404. The annual allowance therefore reduces by (167,404 – 150,000)/2 = £8,702 so the revised annual allowance is £31,298 and the problem is exacerbated.

One final point to note is that if the annual allowance charge is more than £2,000 the pension member can ask the pension fund to pay the charge. You have until July following the normal self-assessment filing date to do this.

The tax charge is the marginal rate of tax paid by the individual on their top slice of income.

Reduced annual allowance

It is also important to acknowledge that there are other situations where there is a reduced annual allowance. Since April 2015 it has been possible for those aged over 55 to get full access to their pensions but taking income from a pension can mean that the money purchase annual allowance kicks in so that the amount which can be saved reduces to £4,000 per year (£10,000 from 6 April 2015 to 5 April 2017). It should be noted that just taking a cash-free lump sum will not trigger the MPAA but anything more than the cash-free amount would also push someone into this regime.

This is largely a problem with defined contribution schemes since the receipt of a pension from a defined benefit (final salary) scheme would not trigger the MPAA. Carry forward also applies, albeit of a much-reduced figure.

If you trigger an event that brings the MPAA into play, the pension provider should send a 'flexible access' statement within 31 days but evidence suggests this letter is often ignored or misunderstood. Whilst pension provider issuing the letter may not allow higher premiums to continue to be paid but other pension providers (and it is increasingly common for individuals to have more than one pension pot) will not be aware of the issue at all. If you receive such a letter, the individual must inform all other money purchase pension plans within 91 days that they are subject to the MPAA with fines being levied on those who fail to do this, as well as the additional tax charges.

Contributed by Ros Martin

Capital Taxes

Entrepreneurs' relief and trading (Lecture P1161 – 16.36 minutes)

Summary – Entrepreneurs' relief was available when the company was liquidated as it had been trading for a number of years after the issue of its last invoice. The company was seeking new business for the purpose of a trade that it was preparing to carry on.

The Potters owned all the shares in Gatebright Ltd, which had traded successfully on the London Metal Exchange with Neil Potter being an 'introducing broker' and dealer.

Following the financial crash in 2008 the company:

- sought to safeguard its reserves by purchasing investment bonds paying £35,000 of interest annually from 2009 to 2015;

- issued its last invoice in March 2009, after which the Potters continued to attempt to revive the company's trade, but without success.

Gatebright Ltd was eventually put in voluntary liquidation in November 2015, resulting in a capital gain arising on the deemed disposal of their shares, against which the Potters claimed entrepreneurs' relief.

HMRC disallowed the claim, putting forward two arguments:

1. Gatebright Ltd had ceased trading. Under s169 TGCA 1992, to be eligible for entrepreneurs' relief, Gatebright Ltd needed to have been a trading company throughout a period of one year, ending either on the date of the disposal (in November 2015) or on any other date in the previous three years; or

2. The company was not a trading company. The investment in bonds meant that the company's activities had become, to a substantial extent, investment activities and not trading activities.

Decision

The First-tier Tribunal said the key question was whether Gatebright Ltd was a trading company after March 2009, when it issued its last invoice. The Tribunal concluded that the company was trying to find new business to be able to continue its old trade, once the market had improved. During this time, Mr Potter was telephoning and meeting contacts, trying to find business, but he was unable to make any deals. The Tribunal concluded that in November 2012 it was still reasonable to believe that they would ultimately find new business. There were still attempts to do deals until June 2014 when activity decreased.

The First Tier Tribunal highlighted that holding bonds and earning interest seemed to imply investment activities but they stated that, having invested in bonds, the company could not do anything else with those funds until the bonds had matured in 2015.

The Tribunal concluded that the company was not carrying out investment activities. There was no time or money spent on investment activities. Its activities did not include, to a substantial extent, activities other than trading. Indeed, its activities were entirely directed at reviving its trade.

The taxpayers' appeal was allowed.

Jacqueline and Neil Potter v HMRC (TC07348)

Goodwill or land disposal **(Lecture P1161 – 16.36 minutes)**

The Leeds Cricket, Football & Athletic Company Ltd (Leeds CFA) owned the freehold to Headingley cricket ground (the Property) that it leased to Yorkshire County Cricket Club (YCCC) in order that YCCC could play cricket there. In December 2005 Leeds CFA sold the Property to YCCC.

On 30 December 2005 Leeds CFA entered into a contract with YCCC for the sale and purchase of freehold property at Headingley Cricket Stadium. The question before the FTT was whether the sale was a disposal of:

- land with attached income streams that would be treated as a capital gain; or
- a business with attached goodwill.

Although the ground prior to the sale was leased to YCCC, Leeds CFA maintained the right to carry out hospitality, catering and advertising in the ground. This included selling corporate hospitality packages, selling advertising on the boards around the ground and providing meals and refreshments to visitors to the stadium on cricket days. The case called these activities the "cricket business". On the sale of the ground to YCCC, Leeds CFA provided details of customer lists and transferred third party agreements to YCCC and the catering business was licensed back by YCCC to Leeds CFA.

HMRC argued that these activities were ancillary to the land and could not exist without having the land and also that it was a passive income stream arising from the land which did not require anything to be done by Leeds CFA.

Decision

The First Tier Tribunal dismissed both arguments on the facts provided in that Leeds CFA did have to organise activities to support the cricket business and this business could exist without the land. It was not land with income streams attached.

The next question was whether the business had goodwill attached to it. The FTT referred to the summary of goodwill in *Balloon Promotions Ltd and others v HMRC* [2006] SpC 524 and highlighted the client base and reputation which had been built up by the cricket business over the years. They concluded that the business did have goodwill attached to it.

The last point to be raised was whether the business and associated goodwill was transferred with land. HMRC's main arguments focussed on the business not actually being transferred as Leeds CFA had licensed the catering business back and prior to the sale they had sub-contracted the hospitality functions out to another entity. HMRC therefore said that Leeds CFA had not actually transferred the cricket business.

The First Tier Tribunal dismissed these arguments stating that Leeds CFA was still engaged in those businesses but were employing standard business approaches to their operation. The Tribunal concluded that the Cricket Business, with attached goodwill, was transferred together with the Ground.

The appeal was allowed.

The Leeds Cricket Football & Athletic Company Limited v HMRC (TC07362)

Adapted from case summary provided by Joanne Houghton

BPR on shares in loan companies (Lecture B 1163 – 9.51 minutes)

BPR gives 100% relief from Inheritance Tax (IHT) on the value of shares in unlisted trading companies. Accessing BPR is therefore a crucial tool in IHT mitigation strategies for clients. Shifting non-qualifying assets and surplus cash into shares that are eligible for BPR can unlock massive IHT savings.

Before continuing, it is worth reminding you that the Pandora's Box marked BPR is only opened once the shares have been business property for two years, so this planning does not offer immediately rewards and a degree of forethought is required.

BPR is not available on shares in "investment" companies. More precisely and quoting legislation if I may, S.105(3) IHTA 1984 denies BPR where the business being operated is one which consists of "making or holding investments" or "dealing in land". The latter three words scupper the chances of BPR in property investment companies. Shares in such companies will suffer a full 40% IHT charge on death.

Quite what S.105 means by "making or holding investments" is less certain. As you can imagine, much hot air has been expended on this, but the 2006 case of Executors of Rhoda Phillips v HMRC [2006] does help clear the fog to a certain extent.

The Phillips case

Mrs Rhoda Phillips held shares in an eight separate property investment companies, all inherited from her husband, Philip Phillips, who had built up the businesses over a number of years until his death in 2000.

In 1989, one of the companies (PP Investments Ltd) sold its entire property portfolio and used the cash to extend loans to the other family property companies. On the death of Mrs Rhoda Phillips in 2001, the only assets of PP Investments Ltd were cash at the bank and amounts owned to it as largely unsecured debt (mainly from its related "sister" companies).

PP Investments Ltd had applied for and obtained a standard licence under the Consumer Credit Act and was therefore authorised to make loans to independent third parties (as well as its related companies). There were a handful of such loans.

PP Investments Ltd had amended its Director's Reports within its annual accounts and recorded its principal activity as being "property investment and providing finance". In reality its only activity was providing finance.

HMRC accepted that the company's activities had changed and reclassified it as a trading company for Corporation Tax (instead of a close investment-holding company which it had been before). [While this looks helpful 'on paper', the Courts will not necessarily be persuaded by this as Corporation Tax and IHT are entirely different animals.]

Mrs Phillips died in June 2001 triggering the question as to whether her shares in PP Investments Ltd qualified for BPR. The traditional dance took its natural course with HMRC denying BPR on the grounds that the company's business consisted "'wholly or mainly of... making or holding investments", and the case finished up in the in-tray of the Special Commissioners. [Incidentally, the HMRC Capital Taxes Officer commented that he would have taken a different view if PP Investments Ltd had lent more widely in which case it could be analogous to a bank which is clearly a trading business.]

In reaching their decision, the Commissioners made a number of points.

- They were required to look at the activity of the business in the two years before Mrs Phillips' death and not the activity undertaken by the business in the past. The fact that the company had been a property investment business until 1989 was not relevant;

- They could not take a "blanket" approach and categorise lending as either "investment" or "non-investment" as the treatment depended on the nature of the lending activity. For example, the activity of money-lending is not normally regarded as an investment whereas other forms of lending (for example, holding debentures or investment bonds) would be more likely to be. They therefore needed to distinguish between "making loans" (which banks did) and "investing in loans" (which investors did);

- The fact that the loans were mainly used by the borrowers to make investments did not necessarily make the loans themselves investments. It was not relevant to the activities of PP Investments Ltd what the borrowers used the funds for. PP Investments Ltd was not entitled to any profit generated from the investments made by its sister companies (thereby bolstering the argument that the loans were not investments themselves).

The Commissioners decided that, on balance, PP Investments Ltd was in the business of making loans and not in the business of investing in loans. The loans were not investments for their own sake but were instead the provision of a finance facility to the other companies. Consequently the business of PP Investments Ltd did not consist wholly or mainly of making or holding investments, and 100% BPR was available in relation to the shares.

The Green Light?

HMRC did not appeal the Phillips decision and have thus far not taken any steps to counter this position.

The door therefore remains open for BPR planning along the following lines:

- Where a family company is carrying on an investment business (for example, property dealing), a money-lending business could be held alongside to provide finance. The shares in the money-lending company will qualify for BPR after two years. The associated debt in the property dealing company would reduce the value of its shares for IHT;

- Trading companies with surplus cash could establish an in-house money-lending subsidiary to provide cash to either other family companies or individual family members. In essence this is creating a “banking-arm” for in-house transactions. This would prevent significant cash balances within the trading company from becoming “excepted assets” (thereby avoiding any dilution of IHT within the structure);

- Family members with surplus cash (or non-BPR qualifying investments which could be turned into cash) could establish a new company or partnership to make commercial loans to family businesses or family members.

When set up correctly, the value of the loan-making company will be covered by BPR after 2 years and will not be chargeable to IHT on death.

Attending to the detail…

As will all successful planning, I’s and T’s must be dotted and crossed.

The company’s Articles must be altered so as to allow it to operate as a money-lending business.

It is crucial that the business qualifies as a trade of making loans, rather than investing in loans. The good old “badges of trade” tests must therefore be applied.

According to our friends at HMRC: “Lending money at interest is normally an investment and any interest received is taxable as savings income. Whether the making of loans amounts to trade is essentially a question of fact and there has to be sufficient evidence of trading to displace the investment presumption”. [BIM62201]

Money-lending is only usually regarded as a trade in cases where it is an integral part of the business operations to employ capital to produce such income.

So boxes need to be systematically ticked here such as:

1. A high degree of organisation – for example, making advances, collecting repayments, pursuing late payers and producing related documents in a similar way to a bank or finance house. Ideally this means that the terms of any in-house loans should be similar to loans made on commercial terms between third parties. For example, a commercial rate of interest, bearing in mind any specific circumstances, should be charged and paid by the creditor company. Security is always good to have but (on the back of Phillips), the fact that some loans may be unsecured should not jeopardise the BPR position.

2. The number of lending transactions is significant to help ensure that profits on performing loans can cover losses on non-performing loans. I'm not saying that a practitioner cannot win an argument that Company A, which exists solely for the purpose of providing finance on commercial terms to its sister Company B, is not in business as a money-lender. But it certainly strengthens one's hand if Company A has a few other clients.

3. Whether an application for authorisation under the Consumer Credit Act 1974 has been made to the Financial Conduct Authority (FCA). You must check if the proposed business requires FCA authorisation to carry out regulated consumer credit activities. I am not a financial adviser (and this should not therefore be seen in any way as financial advice). However it is my understanding (from the oracle that is Gov.uk) that business-to-business lending does not require FCA authorisation unless your customer is either:

   - An individual (e.g., sole trader);
   - A partnership with fewer than 4 partners; or
   - An unincorporated association.

   Either way, this will need to be researched and any relevant paperwork put in order before lending commences. A trawl through www.fca.org.uk is time well-spent.

Once the badges of trade boxes are ticked, the money-lending business should report its income on its tax return as trading income rather than as loan relationship non-trade credits. The company's accounts should also record its trading status.

As mentioned above, the fact that the Corp Tax arm of HMRC accepts that we have a money-lending trade cannot always be regarded as 100% persuasive to those in the Capital Taxes Office who are looking at this through their IHT-tinted glasses. But it certainly helps and one is automatically on the back foot if the trading wrapper isn't there.

Contributed by Steve Sanders

3% supplementary rate for SDLT (Lecture P1165 – 15.19 minutes)

The normal rates for residential property transactions are shown below but for transactions where completion takes place on or after 1 April 2016, there is a 3% supplement when buying a second residential property unless one of the narrow exceptions applies. The 3% is added to all rate bands (including the 0% band) other than the 15% anti-avoidance rate.

Relevant consideration	Normal rate	Supplement rate
Up to £125,000	0%	3%
> £125,000 but ≤ £250,000	2%	5%
> £250,000 but ≤ £925,000	5%	8%
> £925,000 but ≤ £1.5 million	10%	13%
The remainder	12%	15%
> £500,000 and acquired by a non-natural person (subject to exemptions)	15% (on whole consideration)	15%

The higher rate will apply to the purchase of a major interest in one or more dwellings where the conditions are met. A major interest is, broadly, a freehold or leasehold interest in land but the new legislation explicitly excludes a leasehold interest if the lease was originally granted for a period of 7 years or less. It is not the amount of lease which is left; it is the original length of the lease.

For the purposes of the higher rates a dwelling is defined as 'a building or part of a building that is used or suitable for use as a single dwelling, or in the process of being constructed or adapted for use as a dwelling'.

The gardens and grounds of the dwelling or land that is to be enjoyed with the dwelling (including buildings), for example, a detached garage, are taken to be part of the dwelling as is land that subsists (or is to subsist) for the benefit of a dwelling, but a transaction in such a building or land without the purchase of the actual dwelling will not be liable to the higher rates. This does mean that land without a dwelling on it (even if there is planning permission to build a house on it) will not normally attract the higher rates.

'Dwelling' takes its everyday meaning. This means it is any building, or a part of a building that affords those who use it the facilities required for day-to-day private domestic existence. In most cases there should be little difficulty in deciding whether or not particular premises are a dwelling. Holiday homes and furnished holiday lettings clearly fall within the definition of a dwelling.

For the purposes of the higher rates an off-plan purchase will also count as dwelling where the following conditions are met:

- contracts have been exchanged for the purchase of a building, or part of building, which is to be constructed or adapted for use as a single dwelling,
- the contract is substantially performed, and
- at the time of substantial performance the construction or adaptation of the building has not yet begun.

It will be important in some cases to determine whether a premises consists of one or more than one dwelling. This will always be a question of fact.

The original legislation contained no relief in situations where 'granny flats' were part of a bigger overall dwelling but an announcement was made whilst the legislation was going through Parliament that the provisions would be amended. A property will form part of a 'single sale transaction' where:

- the annexe is in the same grounds as the main property
- will have all the facilities of a main home
- is not worth more than one third of the total cost of the transaction value

The higher rate will not apply to purchases of non-residential or mixed-use properties; transactions where the consideration is less than £40,000 and caravans, houseboats and mobile homes. The 15% rate for enveloped dwellings will take priority too.

Conditions

The higher rate will apply to a major interest in a single dwelling by an individual if at the end of the day of the purchase Conditions A to D are met:

- Condition A is that the consideration is £40,000 or more. This is not a nil rate band; if the consideration is more than £40,000 the higher rate applies to the whole of the consideration.
- Condition B is that the dwelling is not subject to a lease which has more than 21 years to run on the date of purchase.
- Condition C is that the purchaser owns a major interest in another dwelling which has a market value of £40,000 or more and is not subject to a lease which has more than 21 years to run at the date of purchase of the new dwelling.
- Condition D is that the dwelling being purchased is not replacing the purchaser's only or main residence.

A new exception was introduced by FA2018 where the purchaser had a major interest in the dwelling immediately before the effective date of the transaction and the property had been the only or main residence throughout the period of three years ending with the effective date of the transaction. Effectively this means that the supplementary charge is not relevant where a person is increasing their interest in a property as long as that is their main residence. It does not apply where the purchaser is a joint tenant and there are more than three other joint tenants or if they are entitled to less than a quarter of the prior interest as a tenant in common.

Also, where a person (A) has a major interest in land but a property adjustment order has been made in respect of the interest for the benefit of another person (B) which is B's main residence (and not A's) then A is not treated as having that interest for the purposes of this Schedule. There is a specific definition of what constitutes a property adjustment order. It covers such things as Mesher orders or similar to enable a spouse to remain in property after a divorce, often to protect the position of minor children.

Points to note:

- In Condition C, the £40,000 is the value of the interest owned by the purchaser and not the total value of the dwelling but also includes a valuation of any associated land. If there is more than one interest all valued at less than £40,000 the condition is not met even if the total exceeds £40,000. It includes land outside the UK.
- Condition D is that the purchased dwelling is not a replacement of the purchaser's only or main residence. There are two parts to a replacement of a purchaser's main residence: there must be a disposal of the purchaser's or their spouse or civil partner's previous main residence, and the dwelling acquired must be intended to be occupied as the individual's only or main residence.
- There are two situations in which a purchase of a dwelling will be a replacement of a main residence. The first is where the disposal occurred before, or on the day of the purchase. The second is where the purchase happens first and then the disposal happens later.

- There is a replacement of a main residence if, in the three years ending with the purchase, the purchaser disposed of a major interest in another dwelling and that other dwelling was, at some time in the three-year period, the only or main residence of the purchaser.

- There is also a replacement of a main residence if in the three years ending with the purchase, the purchaser's spouse or civil partner disposed of a major interest in another dwelling and that other dwelling was, at some time in the three-year period, the only or main residence of the purchaser. Changes in FA2018 mean that you cannot meet this condition by selling to your spouse or civil partner.

- The three-year period for this test will not be applied for purchases on or before 26 November 2018. This is a transitional provision so as not to disadvantage those whose last disposal of a main residence was before the announcement of the higher rates on 25 November 2015. It is only the first acquisition of a new main residence that is treated as a replacement, so if two purchase transactions are entered into within three years of a disposal (or on or before 26 November 2018), only the first acquisition of a new main residence is a replacement.

- Renting a new main residence in the time between disposal and purchase will not prevent the purchase from being a replacement of a main residence unless the period of the tenancy agreed is more than seven years.

- Where an individual is a legal and beneficial owner of an interest they will own that interest for the purposes of Condition C, but there are a number of other situations in which an individual will be treated as owning an interest in another dwelling including:

- Where an individual has absolute beneficial ownership of an interest in land but legal ownership is held by another person (as in a bare trust or nominee arrangement)

- Where the beneficiary of the trust would be absolutely entitled but for being under age or disabled in a way that prevents them from being legally capable of owning property

- Where a minor child would be treated as owning an interest in land because they are the absolute beneficiary of a trust, the parents of that child (and, if the parents are not married to one another, the spouses or civil partners, if any, of those parents) are treated for the purposes of Condition C as owners of the interest

- Where a dwelling is owned by another person subject to a trust that gives the individual a right to occupy the dwelling for life or the right to the income earned in respect of the dwelling, the individual is treated as owning the interest. This treatment will not apply to interests in dwellings that are trust property of a trust that gives the trustee a discretion to apply income between a class of beneficiaries or a trust which accumulates income.

Joint purchases and spouses/civil partners

Where a transaction is entered into by joint purchasers, the higher rates will apply if the transaction would be a higher rate transaction for any of the purchasers considered individually. So if there are two individual purchasers and Conditions A to D are all met for one of them only, the transaction will be charged at the higher rates. This rules applies whether an interest in a dwelling is purchased as joint tenants or tenants in common. It does not matter how small the interest of a particular purchaser is, the test is applied in the same manner.

Where an individual with a spouse or civil partner purchases an interest in a dwelling and their spouse or civil partner is not a joint purchaser, the spouse or civil partner will be treated as a joint purchaser in respect of the transaction. This means that where a purchaser is married or in a civil partnership, if Conditions A to D are met by either spouse or civil partner, the transaction will be a higher rates transaction.

The transaction will not be a higher rate transaction if there is one purchaser and one vendor and they are married or civil partners (as long as they are living together). Also, where there are two purchasers and one of them (P) is also the vendor, then P is to be treated as if they are not a purchaser (and vice versa if there are two vendors and one purchaser). However, you cannot sell the property to your spouse to trigger a disposal for the purposes of the main residence relief.

Inherited interests

Following the death of an individual, the beneficiaries of their estate may become entitled to a major interest in a dwelling. Where a person becomes entitled to such an interest in the three years before a chargeable transaction, the interest can be ignored provided that:

- the beneficiary became a joint owner of the interest by inheritance,

- the beneficiary and any spouse or civil partner’s combined interest has not exceeded half of the major interest in the three years before the effective date of the chargeable transaction.

The date of inheritance for these purposes is the date that the individual becomes entitled to the interest that is normally the date when the interest is transferred to them although it could be the date that the residue is ascertained if earlier. Note this might be different if the property is another jurisdiction.

Purchases of two or more dwellings

Where an individual purchaser purchases two or more dwellings in the same transaction, different tests determine whether the transaction is liable to the higher rates of tax. A transaction involving more than one dwelling will either be liable to the higher rates of tax or it won’t, the rules do not allow for a single transaction to be a combination of higher and normal residential rates.

The same basic conditions have to be considered but in a slightly different way. Condition A is also modified so that it says that the consideration attributable to the dwelling on a just and reasonable basis is £40,000 or more.

Firstly if none of the interests in dwellings purchased meet both conditions A and B the higher rates will not be applicable (with joint purchasers then you consider the tests in the context of both of them). The example of a situation where this might apply is the purchase of a freehold over a block of flats where all flats are subject to long leases.

If two or more dwellings purchased in the same transaction meet conditions A and B then it will be a higher rate transaction.

If only one dwelling meets conditions A and B, then the transaction is a higher rate transaction if the dwelling meets conditions C and D.

Purchases by companies and trusts

The higher rates will apply to the purchase of major interests in one or more dwellings by a company, if Conditions A and B are met in respect of at least one of the dwellings:

- Condition A - the dwelling purchased is worth £40,000 or more;
- Condition B - the dwelling is not subject to lease which has more than 21 years to run on the date of purchase;

Purchases by trustees are treated differently depending whether the trustee is the trustee of a bare trust, a trust with life or income interests or any other trust.

Where there is a bare trust or an individual has a life interest, it is the position of the beneficiary which needs to be considered when determining if the conditions are met. For a discretionary trust, it is the trustees and they are treated as if they are a company i.e. conditions A and B have to be met.

Examples

Individual who is married and been living in rented accommodation while wife has rental property in Glasgow but has not lived there for 10 years. Buying property and this will be liable to the 3% supplement.

Married couple who own a flat as their main residence. They are wanting to buy the flat above which they will then integrate into their main residence to make a bigger property. This will be liable to the 3% supplement.

Individual bought property with the intention of living in it and paid higher rate as she had not sold her main residence, although that was what she planned. She sold her main residence but did not apply for a refund. She has now jointly purchased a property with her new partner and paid the higher rate and they are going to live in it as their main residence. She could claim a refund for the higher rate on the new property purchased.

Contributed by Ros Martin

Administration

Mistaken belief and employer's error (Lecture P1161 – 16.36 minutes)

Summary – Relying on unqualified third parties was not a reasonable excuse for failing to submit a tax return on time but receiving no mail from HMRC through no fault of his own, meant that the taxpayer had special circumstances.

Janis Locmelis had poor English and was not familiar with the UK tax system, relying on a friend to do his returns. He ceased self-employment in 2014/15 when he became an employee and provided details to a secretary to complete an online form notifying HMRC that he was no longer self employed. Mistakenly, he believed that no further action regarding his former self-employment was needed. He thought his self-employed status would close automatically when his employer started to pay taxes.

In September 2015, he advised HMRC of his new address. He claimed that he had not received anything from HMRC requiring a tax return to be submitted nor had he received reminders that he was late.

Consequently, Janis Locmelis filed his 2014/15 return late resulting in penalties being charged by HMRC. He did not dispute that his paper return had been filed late on 17 January 2019; he had tried to sort matters out as soon as he found out that the return was late. On investigating, it was clear that correspondence from November 2015 to October 2018 had been sent in error to his old address due to his employer's incorrect updating of his address on HMRC's systems when completing a PAYE form.

Decision

The First Tier Tribunal accepted that Janis Locmelis had kept HMRC up to date with his address. The delays in filing had arisen because of his:

- incorrect belief that he did not need to complete a tax return
- employer's incorrect updating of his address on HMRC's systems.

The First-tier Tribunal stated that a reasonable taxpayer would have checked the position with either a qualified adviser or directly with HMRC. Relying on unqualified third parties for help was not enough to amount to a reasonable excuse for the late returns. Although a genuine mistake, his incorrect belief was a genuine mistake but the legislation did not provide shelter for mistakes.

The Tribunal acknowledged that, through no fault of his own, he received no mail from HMRC, and so was not aware of the problem and could not correct the position. In their view, this amounted to special circumstances and so the penalties were quashed.

The appeal was allowed.

Janis Locmelis v HMRC (TC07300)

12 years of assessments cancelled **(Lecture P1161 – 16.36 minutes)**

Summary – Inferences used were so unreasonable that 12 years of assessments were cancelled.

HMRC claimed have made a discovery that the taxpayer had failed to declare trading profits from his second-hand car business for 2004/05 to 2015/16. They relied upon information from Worldpay (the payment processing company) showing a heading "Waltham Cars," with Sebastian Cussens described as the "principal".

When Sebastian Cussens failed to answer questions from HMRC at the start of its investigation, or at any other time prior to the hearing, HMRC inferred that Sebastian Cussens was a second hand car trader. Based on estimated sales for 2015/16, and with an assumed profit of 50%, HMRC raised 12 years of assessments plus penalties totalling some £340,000.

Sebastian Cussens appealed. His 81- year old father explained at the appeal that his son had permanent ill health that prevented him working. He received enhanced employment and support allowance from the DWP which is paid to persons who are unfit to work due to physical or mental impairments. He also explained that all vehicle trading took place through his company, Waltham Builders Ltd, and that vehicles were purchased at auction and sold on at a minimum profit.

Decision

The First Tier Tribunal identified that they should follow a two-stage process:

1. Consider if the assessment was made according to the best judgment of the assessing officer. If not, the assessment fails and stage 2 does not arise;

2. Consider whether the amount of the assessment should be reduced by reference to further evidence available to the tribunal.

The First-tier Tribunal concluded that Sebastian Cussens 'was less than co-operative' and failed to produce adequate documentation on which HMRC could reply prior to appeal.

However, the Tribunal was concerned with how HMRC's had handled the case. In particular, they were unable to find that Sebastian Cussens had bought and sold second-hand cars and believed that HMRC had simply "plucked from the air"' the 50% profit margin. They believed that HMRC issued the assessments to frighten Sebastian Cussens to engage properly in the review. The First Tier Tribunal formed the opinion that the assessments raised were 'so wild, extravagant and unreasonable that they were not raised for the purpose of making good to the Crown a loss of tax and so were not authorised by s29 TMA.' They were invalid as best judgment had not been used.

The appeal against the assessment and their related penalties was allowed.

The Tribunal also concluded that it was not for them to try to re-work these assessments. It is for HMRC to decide if they want to revisit the situation, making any appropriate adjustment for Sebastian Cussens' medical condition.

Sebastian Cussens was also criticised for failing to deal with the HMRC correspondence or explain his ill health prior to the appeal If HMRC decided to revisit the matter, he was advised ‘not to behave ostrich-like and to bury his head in the sand any further, but to respond, to the best of his ability’.

Sebastian Cussens v HMRC (TC07337)

Deadlines

1 November 2019

- Corporation tax for periods to 31 January 2019 for SMEs not liable to instalments

7 November 2019

- Payment and filing deadline for 30 September 2019 VAT quarter (electronic)

14 November 2019

- Quarterly corporation tax instalment for large companies
- Monthly EC sales list if paper return used

19 November 2019

- PAYE, NIC, CIS and student loan liabilities for month to 5 November 2019
- File monthly CIS return

21 November 2019

- File online monthly EC sales list
- Submit supplementary intrastat declarations for October 2019

22 November 2019

- PAYE, NIC, CIS and student loan liabilities cleared into HMRC bank account

30 November 2019

- File private company accounts with 28 February 2019 year end at Companies House
- File public company accounts with 31 May 2019 year end at Companies House
- CTSA returns filed for companies with accounting periods ended 30 November 2018

News

No Budget

On 14 October, the Chancellor of the Exchequer, Sajid Javid, announced he was planning to hold the Budget on Wednesday 6 November 2019. The government was committed to securing a deal and leaving on 31 October and, in the event of no deal, the government planned to take early action to support the economy, businesses and households. However, as we all know, this did not happen and the deadline to leave the EU has moved to 31 January 2020.

Due to the proposed general election, the Budget will now not go ahead on 6th November but, as yet, no alternative date for a Budget Statement has been given.

www.gov.uk/government/news/budget-2019-date-announced

Simplifying tax for individuals

In a recent report, the OTS has made 15 recommendations aimed at simplifying tax for individuals. The report aims to help to help tackle complex tax issues that can arise in relation to events such as having children, entering work, saving for or drawing a pension, and helping others who need support.

Family life

1. The government should review the administrative arrangements linked to the operation of child benefit, making clear the consequences of not claiming the benefit, with a view to ensuring that people cannot lose out on national insurance entitlements.

2. The government should consider the potential for enabling national insurance credits to be restored to those people who have lost out through not claiming child benefit.

3. The government should consider how to ease the process of enabling children of those who have not claimed child benefit to receive their National Insurance number.

4. HMRC should work to improve the visibility of guidance for non-commercial employers and maintain the Basic PAYE Tools to meet their needs.

Being in work

5. HMRC should incorporate consideration of practical issues arising in connection with starting work, changing jobs, taking on additional jobs and claiming expenses into its ongoing work to improve the operation of the PAYE system.

Saving for a pension

6. The government should consider the potential for reducing or removing the differences in outcomes between net pay and relief at source schemes for people whose income is below the personal allowance, without making it more complicated for those affected.

7. HMRC should play a full part in helping to ensure that guidance on the tax consequences of particular pension arrangements and choices is available and clear to all concerned.

8. The government should continue to review the annual allowance and lifetime allowances and how, in combination, they deliver against their policy objectives, taking account of the distortions (such as those affecting the National Health Service) they sometimes produce.

9. The government should review the operation of the Money Purchase Annual Allowance, considering whether it meets its policy objectives, is set at the right level and is sufficiently understood, given the present potential for disproportionate outcomes.

Later life

10. HMRC should improve the explanatory notes provided with tax coding notices issued when people first receive the state pension, or another pension.

11. HMRC should explore the potential for developing automated checks or other tools for 'designing out' errors such as the allocation of 'K-codes' to smaller PAYE sources.

12. HMRC should review the current series of forms issued once a death has been notified through 'Tell Us Once' and consider how they could work more effectively with personal representatives to gain a complete view of the tax affairs of the deceased person, and the survivor, rapidly and sensitively.

Helping others

13. HMRC should integrate and improve its various sources of guidance for those helping others, including agents and those with powers of attorney, to help make it easier for suitable people (whether paid or not) to take on such roles.

Tax education and awareness

14. HMRC should collaborate more with relevant external bodies, including schools and in further and higher education, seeking to improve the public's understanding of tax and finance, when seeking to extend the reach of its own tax education materials.

15. HMRC should extend its collaboration with academic researchers to quantify the effect of HMRC's tax education programme and explore the potential for a cost/benefit measure to allow HMRC to prioritise and target its tax education resources.

www.gov.uk/government/publications/ots-life-events-review-simplifying-tax-for-individuals

Cancellation of probate fee increase

Following significant pressure from various groups, the Government has done a U-turn and decided to cancel the proposed increase to probate fees.

Theses fees will for now be kept the same, but will be reviewed as part of the annual review of court fees by the Ministry of Justice.

A Ministry of Justice spokesperson stated that:

> "Fees are necessary to properly fund our world-leading courts system, but we have listened carefully to concerns around changes to those charged for probate and will look at them again as part of a wider review to make sure all fees are fair and proportionate."

https://www.ftadviser.com/pensions/2019/10/14/govt-u-turns-on-probate-fee-hike/

Business Taxation

Incorporating a buy to let portfolio update (Lecture B1162 – 18.12 minutes)

Income tax or corporation tax?

Remember that from 2017/18, relief for interest paid by an individual on a loan to purchase a residential buy to let property is being restricted with the aim that by 2020/21, taxpayers will only receive relief at the basic rate of tax. Clearly higher rate taxpayers are worse off under the new system, but how much so depends on how geared their property business is. Clients with significant gearing might be uncomfortable with the new rules and may be considering incorporating their property portfolio to avoid the increases. But will this be worthwhile?

In theory, incorporating should make them better off but corporate interest rates are higher, typically between 3% and 3.5% compared to rates for individuals of around 2%. By the time borrowing fees are also factored in, corporate borrowing rates are significantly higher. This means that for many, incorporation will not be worthwhile. This is especially so if they rely on the rental income to live on day to day basis.

Example

A high rate client with a portfolio worth £2m yielding 4.25% that they need to live off as income, has borrowings of £1.5m and is currently paying interest at 2%. Their income tax position is as follows and shows a £6,000 reduction as a result of these new rules:

	2016/17	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Rental income (4.25%)	£85,000	£85,000	£85,000	£85,000	£85,000
Finance costs 100/75/50/25%	(£30,000)	(£22,500)	(£15,000)	(£7,500)	Nil
Rental profits	**£55,000**	**£62,500**	**£70,000**	**£77,500**	**£85,000**
Tax at 40%	(£22,000)	(£25,000)	(£28,000)	(£31,000)	(£34,000)
Tax reducer	0	£1,500	£3,000	£4,500	£6,000
Post tax income	**£33,000**	**£31,500**	**£30,000**	**£28,500**	**£27,000**

If they incorporate, let's say that their interest rate will rise to 3%, a very optimistic rate.

Reworking the figures shows the following

	2016/17	2017/18	2018/19	2019/20	2020/21
Rental income (4.25%)	£85,000	£85,000	£85,000	£85,000	£85,000
Finance costs	(£45,000)	(£45,000)	(£45,000)	(£45,000)	(£45,000)
Rental profits	**£40,000**	**£40,000**	**£40,000**	**£40,000**	**£40,000**
Corporation tax	(£8,000)	(£7,600)	(£7,600)	(£7,600)	(£6,800)
Dividend (100%)	£32,000	£32,400	£32,400	£32,400	£33,200
Post tax dividend	**£21,600**	**£21,870**	**£21,870**	**£21,870**	**£22,410**
Worse off by…	**(£11,400)**	**(£9,630)**	**£(8,130)**	**£(6,630)**	**£(4,590)**

Once the new finance rules have transitioned in fully, the individual would be worse off by incorporating by £4,590. Clearly this would be worse if the corporate borrowing rate exceeds 3%. The rate is likely to be nearer 4% once fees are factored in.

If the client is not drawing the rental income as dividends, then a company does offer increased post tax profit. However, clients who need to draw the profit should stay exactly as they are and try to reduce borrowings, perhaps by selling some property to reduce their gearing. Additionally they might consider whether some of their properties could be rented as furnished holiday lets, where the new finance rules to not apply.

Inheritance tax

Although some geared clients may benefit from incorporation, at present, inheritance tax is a key incorporation driver.

Let's use an example to explain why. Consider a couple in their 70s with a residential portfolio of around 40 properties, and worth some £12 million, that they actively manage themselves. Currently they have mortgages outstanding of £4 million. The net value of their portfolio is therefore £8 million, meaning that they are currently exposed to £3.2 million (£8m x 40%) of inheritance tax. A very big bill! With capital gains tax base costs totalling some £5 million, lifetime planning is likely to trigger disposals and chargeable gains taxable at 28%. So what else could they do?

IHT can be saved by securing 100% BPR on the value of the property business. This could be achieved by forming a company owned by the couple. The properties would be transferred into the company, CGT and SDLT free, with a tax-free uplift to market value for corporation tax purposes, enabling the company to sell some properties tax free.

This cash can then be put into trading use such as hotels, rest homes or property development. Gradually, over a period of years, the company moves from letting to become a trading company.

To qualify for 100% BPR, the company needs to be at least 50% trading in the two years up to the second death of husband or wife. (Remember if one spouse leaves assets to the other these would be exempt on the first death).

Key issue 1 – SDLT

SDLT would normally be due on the market value of the properties transferred unless they are transferring from a partnership. In this case, the sum of the lower proportions is mandatorily applied to them. Where the partners are connected, as is the case with a husband and wife, this results in £nil consideration for SDLT purposes and so no SDLT is payable.

This does not necessitate a formal partnership agreement, partnership tax returns or the production of partnership accounts but simply owning property jointly will not be enough. If the couples main activity is managing their sizeable buy to let portfolio and sharing the resulting profits equally then it is quite likely that they can be treated as a partnership. In this instance SDLT should not be a problem but they would be advised to get a formal opinion as to whether an SDLT lawyer would sign this off as a partnership.

If the property is owned in joint names but is unlikely to be treated as a partnership, couples have been transferring their properties into an LLP, prior to incorporation. In doing so, they need to watch the anti-avoidance rules contained within s75A FA 2003. Ideally they should wait at least three years before considering incorporating the LLP, possibly longer. The incorporation cannot be pre-ordained! Anything less than three years and they definitely risk a challenge from HMRC.

Key issue 2 - Loan finance

Loans should be novated to the company and then repaid on the day of transfer by new corporate borrowings.

Let’s assume that the market value of properties is £12 million and the total loans novated are £4 million. The £8 million business is transferred in exchange for shares worth £8 million. Assuming that the properties have a CGT base cost of £5 million, this transfer triggers a gain of £7 million (£12 million - £5 million). As all of the net assets have been transferred into the company, this gain is automatically set against the £8 million share value under S162 TCGA 1992. On the same day as the transfer the novated loans are repaid by new corporate borrowing. This avoids any ‘consideration’ argument when considering s162 TCGA 1992.

Although this route will result in higher finance charges, the long term benefit is avoiding the £3.2 million IHT bill.

Key issue 3 – CGT relief

As we said above, having transferred all of the net assets into the company, the gain of £7 million is rolled into the base cost of the £8 million shares under s162 TCGA 1992.

To qualify for s162 relief, a business (not trade) must be transferred and an actively managed portfolio of properties can qualify as a business. The key to what is considered to be ‘actively’ managed will be the hours worked. Managing just one or two properties will not be enough.

Key issue 4 – Corporation tax relief

From the company’s perspective, it would be treated as acquiring each property at its value at the date of the transfer. This means that, as and when properties are sold by the company to fund projects, chargeable gains within the company structure are likely to be very low as assets effectively receive a tax free uplift to market value on transfer.

Conclusion

For clients with serious IHT exposure, transferring properties into a company could be a viable solution. As tenancy agreements come to end, clients should look to sell properties and reinvest in trading activities such as property development, buying hotels or rest homes. Remember, the trading activities do not need to be driven by the couple. They could appoint their children as directors to operate these trades in their place.

Provided that on the second spouse’s death, the company’s activities have been more than 50% trading for at least two years, then 100% BPR will be available against the value of shares held in their estate on death and the IHT liability issue disappears.

Created from the seminar by Dean Wootten

Yacht chartering losses (Lecture B1161 – 22.36 minutes)

Summary – The LLP intended to realise profits but the prospects of profits were so remote that the trade was not carried on on a commercial basis and loss relief was denied

Roulette V2 Charters LLP was a yacht chartering business that had two partners, Trevor Silver and Robert Newsholme. It conducted its trade using only one yacht, a 65 foot Oyster named Roulette V2. Trevor Silver had personally bought the yacht from the manufacturer in September 2007 with the aid of a loan. He subsequently discharged the loan and contributed the yacht to the LLP as a capital contribution in July 2008, shortly after the formation.

To generate business, the LLP stated that they had produced a business plan, produced brochures and took advantage of promotional articles in various magazines. However, costs were high, especially the depreciation of the yacht, which meant that the business struggled to be profitable. During this period, Trevor Silver made periodic capital contributions to the LLP in order to fund the losses. The partnership actually made losses from 2008/09 until 2015/16, 100% of which were allocated to Trevor Silver. He claimed to set these losses against his general income under s64 ITA 2007.

HMRC refused the claims for 2011/12 to 2015/16 on the basis that the yachting trade was not being carried on commercially with a view to profit as the business had never made a profit.

Decision

The First Tier Tribunal concluded that the business was trading even though they had:

- Significantly overestimated the likely amount of charter income;
- Failed to take account of the yacht's depreciation, making the chances of making a profit extremely remote.

The First Tier Tribunal accepted that the yacht had been acquired to carry on what they believed would be a profitable chartering trade and not simply to use it for his own private purposes. Family did use the yacht but they paid market rate. However, it should have been clear that the charter income was never likely to cover the running expenses.

The Tribunal concluded that the trade was not carried on on a commercial basis (s 66 ITA 2007). The taxpayer's appeal was dismissed.

Roulette V2 Charters LLP v HMRC (TC07331)

Buying and selling racehorses (Lecture B1161 – 22.36 minutes)

Summary – HMRC were entitled to raise discovery assessments denying the losses claimed as the taxpayer had failed to demonstrate that he was trading.

David Cliff was self-employed as a tax consultant, providing his services to racehorse trainers, jockeys, breeders and others in the equine industry.

In addition, from 1 January 2008, he considered himself to be self employed as a "dealer in thoroughbreds" buying and selling shares in racehorses and in horse racing syndicates. He did not draw up a business plan or profit forecasts. He did not train horses and he took no part in the decisions to sell the horses.

He decided to stop treating his activity as a commercial venture as at 31 December 2012, after he had incurred losses of approximately £160,000 over the preceding five years. He claimed loss relief against his other income.

HMRC issued discovery assessments denying the loss relief. They claimed that he had deliberately described himself as a 'dealer in thoroughbreds', which was inaccurate.

Decision

For an appeal which involves a claim for losses incurred, the Tribunal stated that there was a 'startling lack of evidence' to show that any losses had been incurred. As a tax consultant, he should have known what records should have been kept. The Tribunal concluded that the lack of evidence alone was sufficient to dismiss the appeal against the assessments and closure notices.

The First Tier Tribunal stated that a dealer is someone who buys and sells goods with the aim of making a profit. They concluded that David Cliff was not a "dealer in thoroughbreds" because he did not buy and sell horses, or make decisions as to which horses should be bought or sold, or when. He "bought shares in horses and in racing partnerships".

Although not necessary, the Tribunal went on to consider whether David Cliff's activities of buying and selling of shares in horses and racing partnerships could have been trading. S30 ITTOIA 2005 prevents shares in racehorses from being trading stock, so the Tribunal concluded that purchase and sale of shares in racehorses could not be a trade.

So David Cliff's appeal failed on a number of levels:

- He failed to provide any documentary evidence of the trade losses he claimed;
- S30 ITTOIA 2005 prevents shares in racehorses from being trading stock so his activity could not be a trade;
- Lack of involvement with the horses, and lack of a business plan, also indicated that could not trading.

The Tribunal concluded that David Cliff's description of his activities was deliberately inaccurate and the discovery assessment was valid.

David Cliff v HMRC (TC07358)

Agent and webmaster expenses

Summary – Webmaster and agent fees were disallowed but, based on the limited information available, £320 of the accountancy were allowable for 2014/15. Recalculations were required for the preceding and following tax year.

The First Tier Tribunal believed that it was in the best interests of the appellant's children that the appellant should remain anonymous and so is referred to as LD throughout this case.

LD became self-employed on 19 April 2012 so her first year of assessment would have been 2012/13. She had originally been a freelance make-up artist, but later became a glamour model and an entertainer on an adult TV channel.

On 24 October 2016, HMRC's Individuals and Small Business Compliance Team opened an in-time enquiry in relation to LD's 2014/15 return. On 16 January 2017, they received accounts and a revised tax computation for 2014/15, under cover of a letter from LD's then-accountant. These showed a turnover figure of £61,294 (an uplift of 129.68% on the originally declared figure) and a gross profit of £42,981 rather than £7,000 (an uplift of over 800% on the originally declared figure). As a result, on 7 April 2017, HMRC considered LD's self assessment return for the preceding and following year:

- 2013/14 (declared turnover of £37,793 expenses of £33,274, and gross profit of £4,519). Taking 2014/15 as the index year, HMRC increased the turnover to £49,012, and altered expenses to produce a gross profit of £42,100 by discovery assessment;
- 2015/16 (declared provisional figures as turnover of £62,000, expenses of £25,000 and gross profit of £37,000). Again, taking 2014/15 as the index year, HMRC altered the expenses to produce a revised gross profit of £60,500 by discovery assessment.

LD appealed against various matters for all three tax years.

Her new accountant explained that LD was escaping from a physically and mentally abusive relationship where her manager, agent and webmaster was also her ex-partner and father of her children. She changed accountants as her ex-partner used the same accountant and so this accountant did not know the full history of what had gone before but he stated:

> "...it is my contention that, because the abusive relationship with the man who was acting as her agent and webmaster... LD was misled both as regards her income, legitimate expenses and the submission of her accounts because her accountant at the time also acted for the abusive partner referred to above. It has also transpired that he had full access to her bank account and in effect raided it regularly to pay what he described as 'on going' costs. I will contend that this was all legitimately recoverable by LD as commission or services rendered as agent/webhost or manager."

At the hearing, the parties reached agreement that certain items were allowable 2014/15: stagewear; subsistence; travel; accommodation; flights; telephone; "printing, etc"; and train travel.

However, the parties remained at issue in relation to the following items claimed for 2014/15:

- Webmaster costs £16,500
- Agent fees £2,300
- Accountancy fees £1,200

Decision

The First Tier Tribunal concluded that her new accountant had no real way of knowing whether what he had been told by LD was in fact true. Indeed, in cross-examination, some of the matters that LD told him could not have been true. They were objectively falsified by documents produced at the appeal.

As LD did not have an accountant in 2014/15, there was no evidence that LD had incurred any liability to her previous accountant during 2014/15. However, they did agree that an amount of £320 that appeared in the accounts for accounts preparation was allowable. The same sum should be allowed for 2015/16 but nothing for 2013/14 and there was no accountant engaged in that year.

The Tribunal were not satisfied that the evidence showed that her ex-partner was LD's agent so as to permit deduction of the agent's fees. On the contrary, based on the evidence put before them, on the balance of probabilities, the ex-partner was in receipt of a significant proportion of LD's earnings because of their domestic relationship. Sadly, it did not matter whether he took the money due to coercion on his part, acquiescence or agreement on LD's part, or some mixture of the two. There was no agency contract and no oral evidence provided from either LD or her ex-partner as to this alleged contract.

The webmaster fees encountered the same difficulties. It was claimed that her ex-partner hosted (and is still said to host) an adult website, that images or videos of LD appeared on that website, and that the arrangement originally was that LD would be paid if images or videos of her were downloaded. The Tribunal concluded that there was no real evidence, oral or written, on which they could rely, not even on the balance of probabilities.

In conclusion, the Tribunal confirmed that the 2014/15 assessment should be recalculated to take account of the items upon which the parties reached agreement at the hearing as well as the Tribunal's findings in relation to the accountancy fees, agent and webmaster fees.

In addition, applying the presumption of continuity the assessments or 2013/14 and 2015/16 needed to be recalculated in accordance with the above findings.

Penalties for deliberate inaccuracy were cancelled for one return that clearly stated that the figures were provisional, making it clear that the document should not to be relied on as accurate. No similar note was made in the other returns and so the penalty was upheld but recalculated, with greater reductions for assisting HMRC.

LD v HMRC (TC07322)

Capital allowances in communal areas **(Lecture B1161 – 22.36 minutes)**

Summary - Expenditure on the common areas of houses in multiple occupation did not qualify for capital allowances as evidence supporting the expenditure relating to these areas was not supplied.

Hora Tevfik had acquired three properties for his property business that he let as houses of multiple occupancy and had incurred expenditure on communal areas which he wished to claim capital allowances.

Mr Tevfik's SA return for 2011/12 was received by HMRC showing a £50,000 Annual Investment Allowance (AIA) claim as well as a claim for 10% 'wear and tear allowance'. There were no comments/additional entries in the white space of the Return. HMRC accepted the Return without enquiry.

In April 2015, during the course of an enquiry into Mr Tevfik's 2012/13, HMRC discovered that his £50,000 AIA claim for 2011/12, related to expenditure on residential properties that were used in his property business which were let by him as houses of multiple occupancy. He had bought the properties from sellers who had not claimed any or all the capital allowances that might have been available, which therefore passed to him. He undertook a survey of the properties to identify qualifying expenditure, apportioning the purchase price for the property between plant and machinery and non-qualifying expenditure, having identified the communal parts and limited the claim to those parts. He did so on the assumption that such communal parts would not form part of a 'dwelling-house' and therefore would qualify as plant and machinery. No copy of the survey or specific identification of the communal parts was provided by him or his agent to the Tribunal.

On 17 August 2015, HMRC said that the AIA claim failed because AIA only applies to expenditure incurred on or after 6 April 2008 (s 38A CAA 2001). All of the expenditure was originally incurred before that date.

HMRC added that whilst he might have been able to claim plant and machinery allowances, the expenditure was not ‘qualifying expenditure’ as it was incurred in providing plant or machinery for use in a dwelling-house (s 35 CAA 2001). HMRC say that in an HMO, it is the totality of the property that forms the dwelling-house. It is the house as a whole that provides the facilities for day-to-day private domestic existence and hence the house as a whole that is the dwelling-house. The bedroom on its own; the kitchen on its own; the bathroom or hallways on their own do not provide the facilities, but together they are the dwelling-house.

Hora Tevfik argued that the expenditure was incurred on plant and machinery in the communal areas of the properties, which were not part of the ‘dwelling-houses’ and therefore capital allowances were due.

Decision

The first issue was whether the discovery assessment was valid for the purpose of s29 TMA 1970. The First Tier Tribunal found that the existence of the wear and tear allowance claim in the 2011/12 return was not of itself sufficient to make HMRC aware that the annual investment allowance (AIA) claim would fail.

The First Tier Tribunal confirmed that the expenditure had been incurred before 6 April 2008 so that the AIA was not allowable but writing down allowances may be claimable.

The First Tier Tribunal stated that a communal kitchen and lounge are part of a dwelling-house. However, other 'common parts' of the building are not. These include the entrance lobby, corridors, stairs or lifts and those parts of the building which do not provide any living facilities. Neither would installations to the building such as mains, gas or electrical services, nor security and communication systems.

From the information provided, the expenditure was incurred in providing plant or machinery for use in a dwelling-house and related to common parts, communal or shared areas or installations in the properties. Such expenditure would be allowed by s35(3) CAA 2001 insofar as it is an asset provided partly for use in a dwelling-house and partly for other purposes but only so far as is just and reasonable. That meant that some of the expenditure incurred was allowed by s 35(3). However, Mr Tevfik had not identified these areas so that his claim failed.

Hora Tevfik v HMRC (TC07383)

Permanent establishments – profit attribution

In *Irish Bank and Irish Nationwide*, the UT found that HMRC had been correct to deny deductions for interest paid by permanent establishments (PE) to the companies they were part of.

Both Irish Bank and Irish Nationwide (which were tax resident in Ireland) traded in the UK through PEs, so that the profits attributable to these establishments were chargeable to UK corporation tax. The issue was the computation of the profits attributable to these PEs as both appellants’ claims for deductions in relation to interest paid by the PEs to the appellants had been denied.

HMRC considered that ICTA 1988, s 11AA(3)(b) (now CTA 2009, s 21(2)(2)) precluded such deductions as the returns submitted by the appellants understated the amount of equity capital each PE was deemed to hold, and so overstated the amount of loan capital and the associated interest charges. The taxpayers did not dispute that this was the effect of the legislation, but argued that making an adjustment to the PEs' deemed levels of equity and loan capital was not permitted by the double tax treaty (DTT).

The UT agreed with the taxpayers that it was clear, both from the DTT itself and the 1963 Commentary to the OECD model treaty, that the starting point for attributing profits to a PE was the actual records of the PE's revenue and expenses. However, this was only a starting point. Even if the records are perfectly accurate, they must be adjusted if they do not reflect the assumption that the PE is a distinct and separate enterprise.

The case may be relevant for groups with UK permanent establishments and the impact of the DTT on the calculation of attributable profits.

Irish Bank Resolution Corporation Limited and Irish Nationwide Building Society v HMRC [2019] UKUT 277

Contributed by Joanne Houghton

Reliance on HMRC manuals

In *Aozora GMAC Investment* the Court of Appeal found that a Aozora had not established a legitimate expectation that it would be taxed in accordance with a statement that was published in HMRC's International Manual.

Aozora UK had set up Aozora US, which was tax resident in the US. Aozora UK made loans to Aozora US and received interest payments in respect of the funds advanced. The US imposed withholding tax on the interest payments, whilst Aozora UK was liable to corporation tax in the UK on interest received. HMRC denied unilateral credit relief so that Aozora UK was not allowed to offset US withholding tax against its liability to UK corporation tax. This was on the basis that the provisions of ICTA 1988 s 793A (now TIOPA 2010, s 11(3)) which provides, broadly, that unilateral relief is not available if a double tax treaty expressly provides that relief is not available in those circumstances.

In order to succeed in its application, the taxpayer first had to show that the statement in the Manual was a clear and unambiguous representation on which the taxpayer was entitled to rely. Both the CA and the High Court held that the taxpayer succeeded on this issue. The Manual was clear and unambiguous, and was only qualified by a general warning that it could not be relied upon for tax avoidance, which was not suggested here. The CA rejected an argument that HMRC can only create a legitimate expectation in published guidance on matters of policy, as opposed to (as was the case here) an interpretation of the law.

However, the taxpayer failed at both the High Court and CA stages on the second issue on which it needed to succeed in order to win its appeal, namely that permitting HMRC to impose tax in a manner that differed from its published guidance would result in conspicuous unfairness.

The court found that Aozora's reliance on the representation made in the manual was weak because 'the representation was merely as to HMRC's opinion about the construction of a relatively straightforward legal provision; and Aozora sought and obtained specialist advice on the meaning of the legislation and how it would apply to its particular circumstances'. As Aozora's specialist tax advisers were not at any great disadvantage compared to HMRC, when coming to their own view of the law, there was no unfairness.

The case highlights that relaying on HMRC guidance is not sufficient in circumstances where a specialist tax advisor has been engaged to interpret the tax rules.

Aozora GMAC Investment Limited v HMRC [2019] EWCA Civ 1643

UK appeal against CFC state aid decision formally published

In June 2019 the UK government made an annulment application to the EU court against the EC's decision that the financing company exemption within the CFC rules gave rise to state aid. This has now been published in the official Journal of the EU.

Broadly the finance company exemption provides an elective regime to exempt (or partially exempt) from the CFC regime certain non-trade finance profits of CFCs from the CFC charge. The aim of this regime is to enable multinational groups to have a non-UK finance company making intra-group loans to other non-UK companies without incurring a significant UK tax charge.

In summary the four pleas against the decision are:

- the financing exemption does not favour any undertaking or constitute an advantage. It is designed to set the boundaries of the corporate tax base by defining artificially diverted profit rather than providing an exemption from an already established tax base;

- an assessment of comparability should be by reference to the corporate tax framework as a whole, not the CFC rules;

- the financing exemption is not a derogation from the reference system as it does not differentiate between economic operators that are, in light of the objectives of the reference system, in a factually and legally comparable position;

- if the financing exemption does constitute a derogation from the reference system, this derogation can be justified by the basic and guiding principles of that reference system.

Official Journal of the European Union, Volume 62, 20 August 2019

Contributed by Joanne Houghton

State aid – Starbucks and Fiat

The EU General Court has published two judgements on state aid cases. The first decision involved Starbucks in the Netherlands and arose in relation to an advance pricing agreement (APA) which covered production, distribution activities and royalties. The EC had previously found that the APA constituted incompatible state aid. This decision was overturned by the EU General Court.

The other case was in relation to Fiat in Luxembourg where a tax ruling from the Luxembourg tax authorities had endorsed a method for remunerating treasury and finance services in the group. The EC also concluded that this was state aid, and this was upheld by the EU Court.

In the Fiat case the EC were able to demonstrate that the transfer pricing methodology and prices agreed resulted in a lower tax base in Luxembourg which was a selective and unjustified advantage to Fiat. However, in the Starbucks case the EC were not able to demonstrate that the APA meant an inappropriate reduction in tax payable in the Netherlands and therefore the case failed.

The details of both cases provide some clarification on how the EC Commission reviewed the transfer pricing methodologies used by Starbucks and Fiat.

T-760/15 Netherlands v Commission and T-636/16 Starbucks and Starbucks Manufacturing Emea v Commission

T-755/15 Luxembourg v Commission and T-759/15 Fiat Chrysler Finance Europe v Commission

OECD consultation on digital tax

A public consultation document has been issued by the OECD seeking views on its proposed approach to reaching agreement on ‘Pillar One’ of an international solution to taxation of multinational enterprises in the digital economy by 2020.

Pillar One covers nexus rules for determining where tax should be paid, and profit allocation rules on the portion to be taxed where customers are located. This follows the Programme of Work issued in May 2019 which included three proposals under Pillar One but highlighted that a unified approach should be outlined by January 2020. Therefore the consultation covers a proposed unified approach which builds on common aspects of the three proposals. The unified approach proposal under Pillar One grants greater taxing rights to market jurisdictions. This is intended to ensure greater taxation in jurisdictions in which significant business is conducted, even without a physical presence.

A separate consultation will be issued on Pillar Two later in the year.

OECD public consultation on unified approach under Pillar One

VAT

Pre-incorporation legal fees (Lecture B1161 – 22.36 minutes)

Summary - VAT could be claimed on legal fees invoiced to the director of a company that was incorporated after the legal services had been supplied.

Mr McKee is a skilled software programmer who used to work for Jumar Solutions Ltd. While working there, he developed software in his spare time, that was unrelated to his work at Junar, and that he intended to commercialise once he had left Jumar.

In January 2015, Mr McKee contacted a competitor of Jumar Solution Ltd, in the hope of gaining some materials that might assist with the development of his software. Jumar Solutions Ltd came to believe that he was seeking to develop a product that infringed Jumar Solution Ltd's copyright and confidential information that Mr McKee had acquired while working for Jumar. The company issued proceedings against Mr McKee for infringement of copyright, breach of confidence and breach of contract, seeking damages and an injunction.

Mr McKee successfully defended these proceedings arguing that had he not defended his position, he would not have been able to develop a business using his software. He delayed starting his business until after the judgment in case he lost the case.

Having successfully defended his case, on 8 July 2016, he incorporated Koolmove Ltd to exploit his software. Although Mr McKee had paid for the legal fees himself, he subsequently put them through his new company's books, showing in a director's loan account. He then sought to reclaim £28,876 on pre-incorporation legal fees.

HMRC denied the claim arguing that Koolmove Ltd was not incorporated at the time that the legal proceedings were instigated and the engagement letter between Mr McKee and his solicitors do not mention the company, therefore the legal costs were provided to Mr McKee in his personal capacity as the company did not exist at the time of the litigation.

The company appealed.

Decision

The First Tier Tribunal confirmed that under the rules set out in the VAT Regulations 1995, reg 111, input tax can be claimed by a company in respect of supplies of services made prior to its date of incorporation for its benefit provided the:

- supplies were made to a non taxable person who became a member or officer of the company once the incorporation had taken place;
- company pays for the expenses in question;
- services supplied were made within six months before registration;
- services have a direct link to future taxable supplies made by the company.

The Tribunal stated that if HMRC insisted that input VAT could only be recovered if invoices were made out to the VAT registered business, then no pre-incorporation input tax claim would ever succeed.

The Tribunal found that Mr McKee had always intended to exploit his software through a limited company and that he incorporated the company as soon as reasonably practicable after the Jumar Solutions Ltd litigation was concluded in his favour. There was no point in him forming a company until he had won his case as he would have no business. Koolmove Ltd was formed and its future supplies were linked to the exploitation of the software developed by McKee.

The input tax on pre-incorporation legal fees could be claimed and the appeal was allowed.

Koolmove Ltd v HMRC (TC07305)

One business or two? (Lecture B1161 – 22.36 minutes)

Summary – A café and restaurant run by husband and wife were separate businesses for VAT with both trading under the registration threshold as there was a clear intention on the part of the owners to run separate entities

Charles Caton had run the Commonwealth Cafe for a number of years. In 2009, his wife opened a restaurant in adjoining premises. Both traded below the VAT registration threshold.

There were a number of factors that pointed to the idea that both businesses were run by Charles Caton:

- The lease for the restaurant, liability insurance, its alcohol licence and its bank account were all in Charles Caton's name.
- Initially the businesses operations did not share common areas but 2014 alterations were made to the premises, paid for by Charles Caton, to allow access to the toilets from both the cafe and the restaurant;
- In 2015 Chares Caton responded to an HMRC questionnaire reporting himself as the sole proprietor of the restaurant business and his wife as an employee.;
- There were reviews of both the cafe and the restaurant on TripAdvisor that were responded to by Mr Caton, calling himself the owner;
- The website for the restaurant and the cafe suggested that they are one business;

HMRC claimed that Charles Caton was the owner of both businesses and should have registered for VAT from 1 December 2009 because the combined turnover exceeded the VAT threshold.

Charles Caton claimed that they were separate businesses with the cafe run by him and the restaurant run by his.

Decision

The First Tier Tribunal found in favour of Charles Caton stating that there was a clear intention on the part of the owners to run separate entities.

- Staff were hired separately with his wife hiring her own staff;
- Mrs Caton decided on the menu for the restaurant as well as the prices;
- The cooking was done by different people using separate cooking areas;
- When the cafe sold the restaurant 'specials' they are rung up on the till with a marker that showed they were restaurant sales;
- Mrs Caton kept the cash generated from the sales in the cafe, which was not banked in Charles' account;
- Card sales were banked in Charles bank account but, Mrs Caton would transfer cash to cover her rent, rates etc, and she kept any surplus.

It was clear that the HMRC form was not filled in as diligently as it could have been. The TripAdvisor reviews replied to by Charles Caton were in 2016 when all parties agreed that Mrs Caton's English was not very strong and in both reviews the customers clearly identified Mrs Caton as the main figure in the restaurant.

The Tribunal noted that all the leases, insurance and the alcohol licence were in Charles Caton's name, and his bank account alone was used for the card takings. As Mrs Caton was not a British citizen, there were considerably more hurdles to her being able to obtain these items. In addition, with the parties being husband and wife, fully arm's length terms are not expected.

The Tribunal concluded that the facts that pointed to the businesses being run and owned as two separate operations were significantly stronger that facts that pointed to a joint ownership. In addition, without speaking to, Mrs Caton, HMRC could not be in possession of the full facts on which to base their decision.

The appeal was allowed and penalty is quashed.

Charles John Caton v HMRC (TC07343)

Cosmetic or medical treatment **(Lecture B1161 – 22.36 minutes)**

Summary – Neither the injectable nor nail fungal treatments qualified as exempt supplies but for different reasons.

Skin Rich Limited operated a skin culture and aesthetics clinic in Richmond offering a range of specialist skin treatments, including acne and rosacea treatment, non-surgical facelifts, nail fungus treatment, tattoo removal, skin peels and Injectable treatments. This case concerned the VAT treatment of botox and nail fungal treatment by the clinic.

HMRC identified that the turnover declared on the company's corporation tax return was greater than the supplies recorded on their VAT returns. On investigation it was discovered that the reason for the difference was because the company had failed to include what it considered to be exempt supplies in Box 6 of its returns. Having discovered this error, HMRC became interested in the treatments that were being accounted for as exempt medical supplies.

HMRC argued that botox and nail fungus treatment could not be considered as exempt as they are not medical treatments. HMRC argued that these services were standard-rated because clients sought treatment principally for cosmetic reasons.

Skin Rich Limited argued that both treat were exempt treatments:

- Botox is a medical procedure with treatments enhancing self-confidence and influencing quality of life. Skin Rich Limited employed members of the medical profession to administer and supervise this treatment in all instances;

- Nail fungus treatment is a medical treatment as it is carried out to restore the health of the person concerned as GPs now advise their patients to seek private practices as the NHS is over-stretched.

To be exempt the procedures needed to fall under Group 7 Schedule 9 VATA 1994 and so to qualify a medical service or treatment supplied must be carried out:

- by a registered health professional;

- in the field for which the professional is registered.

In addition the treatment must be linked to the protection, maintenance or restoration of a patient's health.

Decision

Having considered the evidence supplied, the First Tier Tribunal concluded that Skin Rich Limited had not satisfied them that the <u>principal</u> purpose of the botox or injectable treatments was to protect, restore or maintain the health of the individual rather than for cosmetic reasons. The treatment should be standard rated.

As for the nail fungal treatment this too did not qualify for exemption but for a different reason. This treatment was carried out using a medical laser process to kill the fungus but the person performing the work was not a registered medical professional.

An alternative argument put forward by Skin Rich Limited was that the premises used for the treatments was as a "hospital or state-regulated institution" (Item 4, Sch 9, Group 7, VATA1994) but this was also rejected by the Tribunal

The appeal was dismissed

Skin Rich Ltd v HMRC (TC7310)

DIY housebuilder's completion

Summary – the taxpayer's input tax claim was submitted within the appropriate time limits and so was recoverable.

In 2006 Stuart Farquharson and his wife relocated to Northern Ireland where they applied for planning permission to build a house to live in on a plot of land.

When the flat that they were renting was sold, they converted the garage of their new property to be a temporary home and moved in while the rest of the house was still being constructed.

In 2012, Stuart Farquharson was made redundant and for a while was self employed. During this time money was short so work on their property was delayed.

In 2015 he found full-time employment in Edinburgh, and with an impossible commute, in 2016 the couple decided to sell their property that was still not completed. There were seven rooms within the property that had not been completed to the original plan and would require an additional £30,000 to £40,000 to complete.

Their solicitors advised that a certificate of completion would be needed in order to sell the house. Stuart Farquharson was sceptical as to whether such a certificate would be issued as in his view the house remained unfinished. In any event, a Certificate of Completion was issued by the Council on 26 May 2017.

A valuation report commissioned in October 2008 valued the property at £350,000 as it stood at the time, and at £550,000 if it was completed to the plan. The sale of the house was finally completed on 1 July 2017 for £325,000.

On 7 August 2017, Stuart Farquharson submitted a claim for the VAT incurred in relation to the construction of the new dwelling in the sum of £15,764.48.

HMRC rejected the claim stating that it was time-barred as it should have been made within 3 months of 'completion'. In a letter to Stuart Farquharson, HMRC stated that in their view:

> "a building is normally completed when it has been finished according to its original plans. No evidence has been provided to indicate that any of the work outlined in the original plans remains outstanding and the photographic evidence that has been provided shows that the building is a fully functioning dwelling and that any remaining work is of a cosmetic or minimal nature."

They went on to say:

> "the building was completed when it was occupied, 23 December 2008, or at the very latest, 29 April 2016, the date of the last invoice that forms part of the claim. As such the DIY VAT refund claim has not been made within 3 months of the completion date and the decision to reject it, notified to you on 22 August 2017 is correct and will be upheld."

Stuart Farquharson believed that the 3 months ran from 26 May 2017, the date that the Completion Certificate was issued and so by 7 August 2017, it was within time. He appealed.

Decision

The First Tier Tribunal stated that the real issue in this appeal was to determine the meaning of ‘completion’ as provided under reg 201 of the 1995 Regulations as the 3 month time barring ran from that date.

The time limit of a valid claim is provided under reg 201(a) as:

> “ ... no later than 3 months after the completion of the building the relevant form for the purposes of the claim containing the full particulars required therein, ...’

They stated that Regulation 201(b) goes on to specify the documents that must be furnished to make a claim are:

> “ (1) a certificate of completion obtained from a local authority; or
>
> (2) such other documentary evidence of completion of the building as is satisfactory to the Commissioners. “

The Tribunal concluded that ‘completion’ should be judged by reference to the Certificate. It was only in the absence of a certificate of completion that the Commissioners would entertain a claim based on the alternative.

They went on to say:

> “There are no extraneous definitions to the meaning of ‘completion’ within reg 201 that can be extracted from the statutory wording as pertaining to the date of occupation, or to the date of the last invoice being included in the claim.”

The appeal was allowed as HMRC’s interpretations of ‘completion’ were without any basis in law.

Stuart Farquharson v HMRC (TC07240)

VAT Notice 700/22 MTD for VAT (Lecture B1161 – 22.36 minutes)

Under MTD, subject to certain exemptions, VAT registered businesses must keep and preserve certain records and accounts, with some of these records kept digitally within functional compatible software

Data transfer between software programs, applications or products that make up functional compatible software must be digital where the information continues to form part of the digital records. This cannot be performed manually. Each piece of software must be digitally linked to other pieces of software to create the digital journey.

From the start, HMRC recognised the need for a “soft landing period”, for businesses to have in place digital links between all parts of their functional compatible software. For the first year businesses will not be required to have digital links between software programs. The VAT Notice stated that businesses have until their first period starting on or after 1 April 2020 (or 1 October 2020 for deferred businesses) to get these digital links in place.

However, on 17 October 2019, HMRC announced that some businesses may qualify for an extension to this initial soft-landing period. They have acknowledged that businesses with complex or legacy IT systems may require a longer period to put digital links in place across their functional compatible software. These businesses can apply for additional time to put the required digital links in place (subject to qualifying criteria). Even if the soft landing period is extended, it will only be by 12 months.

The VAT Notice specifically mentions the possible need for more time where another business has been acquired that uses different software applications or packages.

In an article "Making Tax Digital: More time for digital links?" that appeared in AccountingWEB, Emma Rawson highlighted a number of business areas using specialist or bespoke in-house software that may benefit from this extension. Specifically she mentioned veterinary practices as well as the hotel industry and universities.

Formal application

To be considered for a specific direction, businesses will need to:

- make a formal application to HMRC for an extension by no later than the end of your soft-landing period;
- explain why it is unachievable and not reasonable for them to have digital links in place by April or October 2020;
- submit details of the systems that are unable to be digitally linked by providing a current map of existing VAT systems, highlighting the exact areas that cannot be digitally linked;
- provide a clear explanation and timetable for when and how digital links will be put in place within an extended period;
- state the controls that will be put in place to ensure any manually transferred data is moved accurately and without error.

HMRC will make their decision on a case-by-case basis, but it is worth noting that HMRC has indicated that they do not expect that any extension will ordinarily be more than a year.

https://www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat/vat-notice-70022-making-tax-digital-for-vat

Output tax apportionment (Lecture B1164 – 12.48 minutes)

If a business did not claim any input tax when it bought an asset (or goods) because it wholly related to exempt activities, then the good news is that no output tax is payable when the item is sold in the future. The sale is exempt from VAT by virtue of VATA1994, Sch 9, Group 14 – Supplies of goods where input tax cannot be recovered. This situation would also apply to the onward sale of a motor car where input tax was blocked on purchase because the vehicle was available for private use.

However, a twist to the tale is that if the asset was used for both exempt and taxable purposes, i.e. a proportion of input tax was claimed as residual input tax, then output tax is still chargeable on the full selling price. This is not such a good deal – 100% output tax being paid on the selling price but less than 100% claimed for input tax purposes.

Example 1

Janet trades as a financial services adviser, so is partly exempt for VAT purposes.

She purchased a computer three years ago and only claimed 50% input tax under the partial exemption standard method (residual input tax) because the item was used for both taxable and exempt activities. She bought another computer at the same time and claimed no input tax because it wholly related to exempt use. Each computer is now being sold for £1,000 – how much output tax is payable?

Answer – the partial input tax claim mean that output tax is due on the full selling price of the first computer i.e. £1,000 x 1/6 = £166.67. But no output tax is due on the sale of the second computer because input tax was wholly blocked when it was purchased.

Private or non-business use

When input tax is blocked on the purchase of goods because there is partial or total use for private or non-business purposes, this part of the asset is being taken out of the business. So when it is subsequently sold, there is no output tax to declare on the same percentage. This outcome is particularly important for many charities, which often have non-business and business activities, but also many commercial organisations as well.

Example 2

Sean the builder bought a van for £5,000 plus VAT last year and only claimed input tax on 80% of the expense and he blocked the other 20% as being relevant to private use. He is now selling the van for £3,000 plus VAT.

Sean will want to ensure he does not overcharge VAT on the sale because it is possible the buyer might not be able to claim input tax. Output tax is charged on 80% of the selling price i.e. £3,000 x 80% x 20% = £480.

Flat rate scheme (FRS)

An important exception to the rules considered so far relates to the FRS. The sale of assets is always included as flat rate turnover if no input tax was claimed on the purchase of the item. As an example, if a VAT registered accountant who uses the FRS sold his business motor car for £3,000, he would not charge VAT on the sale to the buyer but must still account for FRS tax of £435 on the sale i.e. £3,000 multiplied by the 14.5% FRS percentage for accountants. There is no partial exclusion for private use. However, if he bought an asset and claimed input tax because the total cost exceeded £2,000 including VAT (allowed for scheme users – see VAT Notice 733, para 15.2), then he would charge his customer 20% VAT and fully account for output on his VAT return i.e. the sale is excluded from FRS turnover.

Reference: VAT Notice 733, para 15.9.

Mixed supplies

Imagine that a business owns a boat that can accommodate 30 passengers and it charges passengers a single fee of £50 for a two-hour boat trip that also includes a hot meal and wine. The boat trip is zero-rated because it carries more than ten passengers (VATA1994, Sch 8, Group 8, Item 4) but the catering supply is standard rated. How much output tax should be declared within the £50 selling price?

The key point is that there is no specific method set in law that must be used – the legislation states that any method can be adopted, as long as it gives a fair and reasonable result (HMRC Notice 700, para 8.1.1).

A logical way of approaching this challenge might be to look at the cost of items that are bought by a business, and work out the standard-rated percentage, which is often an easy method when goods rather than services are involved in a mixed supply situation.

In the case of the boating supply, does the business offer customers the same trip but without any catering? If so, it would be 'fair and reasonable' to treat the same amount as relevant to the ride within the £50 price for the trip that also includes food and drink. The balance of the payment would then be standard rated as relevant to the supply of catering.

Example 3

Janet is a book retailer and she sells a standard rated pen and zero-rated book for a single price. There are two possible methods of apportioning the output tax:

If Janet also sells the book as a single item, she could treat this selling price as the zero-rated element within the pen and book package (or vice versa for the standard rated value of the pen).

If she only buys in and sells the book as part of a pen and book package, she could base the standard rated element of her selling price according to the VAT charged by her supplier on the items in question. However, there is an element of danger with this approach – each business is responsible for deciding how much output tax it should charge on its supplies and not rely on third parties e.g. suppliers.

Incidental sales

Don't forget that if a business sells two items that are subject to different rates of VAT, but one of the items is 'incidental' to the other (i.e. a minor part of the deal) then VAT is wholly payable based on the rate that applies to the main item. For example, if our boat owner charges £40 for a boat ride, and the price includes a free cup of tea and a biscuit, it is reasonable to conclude that this is not a separate supply of catering but an incidental benefit to the customer to enhance his enjoyment of the boat trip. The sales proceeds are wholly zero-rated.

Common error

As a final twist, output tax apportionments need to ensure there is no confusion between VAT exclusive and VAT inclusive prices i.e. the difference between 20% and 1/6 in the calculations. Errors need to be corrected going back four years, which is good news for the overpayments but not such good news if an underpayment has occurred.

Example 4

Janet from the previous example buys a particular book for £7 per copy and a pen for £2.50 plus VAT, which she sells for £20 as a single package. She has decided to apportion her output tax based on cost prices. The standard rated ratio based on cost is 30% i.e. £3 divided by £10 (i.e. the relevant figure for the fraction is the VAT inclusive price of the pen) so output tax to declare on each sale is £20 x 30% x 1/6 = £1. The standard rated cost price includes VAT in the calculations because the selling price of £20 also includes VAT.

Reference: VAT Notice 700, para 8.1.

Contributed by Neil warren

Land sold for residential development **(Lecture B1165 – 12.42 minutes)**

Case study

Farmer Giles owns 10 acres of land jointly with his wife and daughter. The land has generated income from grazing rights over the last 10 years i.e. another farmer has paid them to put his sheep on the land. The Giles are not VAT registered for this source of income because the turnover has always been below the compulsory threshold. The land has a current market value of £500,000 but this figure could increase to £2m if the land is sold with planning permission in place to build dwellings. In order to achieve this enhanced value, the Giles family will require the services of a land professional, who will take on the role of 'promoter' in order to obtain planning permission from the local authority. The promoter's fee will be based on 20% of the increased land value i.e. £300,000 plus VAT.

Liability of land sale

There is often a view among the farming community that all of their income is zero-rated. Farmers like this outcome because no VAT is charged on their income but they still get input tax recovery on their expenses.

However, the key point with a land sale is that it will be exempt from VAT in 99% of cases (never say 'always' in the VAT world – it is the exceptions that keep us on our toes) unless the seller has made an option to tax election in which case it will be standard rated. A land sale will never be zero-rated. This means that input tax can be reclaimed on expenses if an option to tax election is made and VAT is charged on the land sale but not if it is sold as VAT exempt.

VAT registration

The first important point is to always remember that jointly owned land is a partnership as far as VAT is concerned. I still have the occasional challenge from solicitors who claim that jointly owned land represents separate sole trader businesses with each owning a proportion of the land. This is not correct and is helpfully confirmed by VAT Notice 742A, para 7.3.

There is a planning opportunity for the Giles family, namely that they could register for VAT as a partnership and backdate their registration date up to four years ago. The reason is because the grazing rights income they have earned is zero-rated – it is classed as a supply of animal feeding stuff rather than a supply of rental income (HMRC Manual VFOOD3120).

Don’t forget that zero-rated income is still ‘taxable’ – you are charging VAT to your customers but at a rate of 0%.

The Giles’ registration will be voluntary because the grazing rights income has never exceeded the compulsory registration threshold. But it means that input tax can be claimed retrospectively on any costs that they have incurred, even if this is just accountancy fees for completing partnership accounts and fertiliser used on the land.

Option to tax election

Although we are registering the Giles family for VAT back to 2015, the option to tax election will still be made from a current date. You cannot retrospectively opt to tax, and there is no reason to do so because there has been no past exempt income in the equation. The best time to opt is just before the first costs are incurred that relate to the potential sale of the land i.e. so that they will directly relate to a taxable supply. Although the land promoters don’t usually charge a fee until the land is sold, there are usually other costs that are paid out at the planning stage of a project.

Note – the option to tax election will be made by submitting form VAT1614A to HMRC.

An option to tax election is not always a complete ‘win win’ outcome. And there are three potential disadvantages to consider:

Input tax for buyer - the land sale might be made to a business that cannot claim input tax. This will not be an issue if the sale is to a developer who will construct and sell zero-rated dwellings on a freehold basis or a lease exceeding 21 years (20 years in Scotland) but might be a problem if the developer intends to rent them out when the project is completed i.e. generating exempt income. The buyer will also have a cash flow challenge of paying VAT and then waiting up to three months to claim input tax. However, most developers will submit monthly VAT returns because they are usually in a VAT repayment situation, so this will hopefully be a minor obstacle.

Stamp duty land tax – this tax is always based on the VAT inclusive price of a property deal and is paid by the buyer. It is worth checking whether the increased SDLT payment caused by the VAT charge exceeds the input tax gain acquired by the seller who has opted to tax – the answer will almost certainly be ‘no’ in the case of projects such as the Giles family because of the big fees charged by the promoters.

Housing association – if land is sold to a housing association, it has the opportunity to issue VAT1614G to the seller before the deal takes place if it intends to build new dwellings, which means the land sale will be exempt again rather than standard rated i.e. the option to tax election is overridden. This creates a cost to the seller with the loss of input tax on related costs. In reality, most land promoters are aware of this pitfall and tend to steer clear of housing associations in their search for a willing buyer (VAT Notice 742A, para 3.6).

Abortive project

It can often take a long time for planning permission to be granted and sometimes it will be refused by the authorities. What would the position be if the Giles family incurred some costs on their proposed land sale and claimed input tax but then the project never progressed to a happy ending, perhaps because the land was unsuitable for housing?

Will HMRC expect a refund of any input tax claimed by the landowner on the basis that it will not pocket any output tax if the project is aborted? The good news is that the answer is ‘no’ as long as the sale would have been taxable. (VAT Notice 706, para 13.14).

Deregistration

Let’s move forward to the most important VAT return i.e. the one that includes the eventual land sale. The £2m sale will be subject to output tax of £400,000 but input tax of £60,000 will be claimed on the £300,000 fee being charged by the promoter. There might be other input tax to claim as well e.g. conveyancing fees.

However, once the Giles family has made its only taxable sale, and declared this on the correct VAT return, it should then deregister, unless it intends to make future taxable supplies through the same legal entity. That will be unlikely in most cases.

Contributed by Neil Warren

Simplified import procedures

In the event that we leave the EU with no deal, Transitional Simplified Procedures make importing after Brexit simpler. Up to now, businesses have had to apply for the scheme, with over 30,000 having previously registered.

Under the scheme, after importing goods from the EU, most businesses will be allowed up to 6 months to send in customs declarations and pay any customs duties to HMRC. This should prevent congestion at the border when goods enter the UK.

In the lead up to the 31 October deadline, and the uncertainty of whether we will leave the EU without a deal, the government chose to automatically enrol 95,000 VAT-registered businesses onto the scheme. These businesses import from the EU and the government believe that this is the best option for businesses that are new to customs processes and haven’t yet appointed a customs agent.

HMRC is strongly advising traders new to dealing with customs to take advantage of the benefits of Transitional Simplified Procedures. Businesses that are not registered for VAT should apply for the scheme if it would benefit them. However, importers do not have to use these procedures; they still also have the option to use full import processes instead.

https://www.gov.uk/government/news/hmrc-accelerates-95000-firms-onto-simplified-import-procedures