Tolley®CPD

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Disclaimer

CONTENTS

Personal tax

CJRS and employment allowance (Lecture P1221 – 12.24 minutes)

Secondary NIC < £4,000

Previously, we reported that where an employer's 2020/21 secondary NIC liability is less than £4,000, and so covered by the Employment Allowance, employers should refrain from claiming this amount under the Coronavirus Job Retention Scheme. By adopting this approach, the employer obtains the full amount of Employment Allowance and does not risk making an incorrect Coronavirus Job Retention Scheme claim.

The ICAEW's Tax Faculty advise that where employers would benefit from claiming the Employment Allowance but have not done so, they should pay back the relevant NIC amount of the Coronavirus Job Retention Scheme grant and then tick the Employer Payment Summary to claim the Employment Allowance in the next payroll. This claim will recover the NIC for the year up to that point and then cover future NIC, up to the £4,000 limit, on an on going basis until the end of the tax year.

Secondary NIC > £4,000 from August 2020

As previously discussed, where an employer's secondary NIC for the year exceeds £4,000, they could consider deferring the claim for Employment Allowance to enable the employer to claim under the Coronavirus Job Retention Scheme. Provided that employers still have at least £4,000 of secondary NIC available to be relieved by Employment Allowance after claiming under the Coronavirus Job Retention Scheme, employers are permitted to claim under both schemes. To do this, the Employment Allowance claim must be delayed so that it applies to August 2020 onwards only, so ensuring that the Allowance is not claimed on secondary NICs covered by the Coronavirus Job Retention Scheme grants.

The ICAEW's Tax Faculty considers that where both the Employment Allowance and the NIC element of the Coronavirus Job Retention Scheme have been claimed but following this advice want to defer the Employment Allowance until August 2020, employers should not cancel their Employment Allowance claims already made, only to reinstate them later in the year. This is because most payroll software allocates Employment Allowance claims back to the start of the year, so before the claim was made. Either way, it will appear as if a double claim has been made.

The ICAEW believe that this should not be treated as a double claim provided that for the whole tax year an employer's total secondary NIC liability exceeds the £4,000 Employment Allowance plus the amount claimed under the Coronavirus Job Retention Scheme. The employer will not need to repay their Coronavirus Job Retention Scheme grant. The ICAEW suggest that:

> "Employers who want their EA claim to be for pay periods going forward from when their EA claim is made would have to either adjust their payroll software (probably impossible in most software as HMRC specified that EA claims are for a whole tax year and not just part of a tax year) or phone HMRC. See HMRC's guidance Claiming EA: further employer guidance (updated 7 May) section 7 Claiming EA after the start of the tax year."

Secondary NIC from August 2020 < £4,000

Readers have asked what is the position if the employer's total secondary NIC liability from August 2020 to the end of 2020/21 is less than £4,000. In this situation, the software will again have automatically related back the Employment Allowance to the earlier months in 2020//21 when the Coronavirus Job Retention Scheme grant was claimed. Employers will need to check that the amount of Employment Allowance claimed plus Coronavirus Job Retention Scheme grants claimed for NIC do not exceed their total secondary NIC liability for the year. Where they do, the excess will needed to be repaid either by reducing their:

- Employment Allowance claim by contacting HMRC via the employer helpline to restrict the value of their Employment Allowance claim; or
- claim for NIC under the Coronavirus Job Retention Scheme either in their next claim or by repaying the grant to HMRC.

https://www.icaew.com/insights/tax-news/2020/oct-2020/cjrs-claimants-must-act-now-on-ea-and-nic

Job retention bonus and kickstart **(Lecture P1224 – 21.11 minutes)**

In July 2020 the government announced the introduction of the Job Retention Bonus Scheme. This is a one-off bonus payment intended to provide additional support for employers whose businesses have been affected by COVID-19.

This is effectively a retention bonus to encourage employers to keep staff on their payroll doing meaningful work. Under this scheme, employers will receive £1,000 for each eligible employee that will be claimable in February 2021. It will be taxable on the business.

Eligible employers

All employers are eligible provided that they have claimed a Coronavirus Job Retention Scheme (CJRS) grant, have paid all of their PAYE due and correctly filed all of their RTI returns. In addition to being enrolled for PAYE online, they must have a UK bank account and keep all of their payroll records up to date.

Eligible employees

To be able to claim the Job Retention Bonus, employees must:

- have been furloughed (or flexibly furloughed) and included on a valid CJRS grant;
- still be employed at 31 October 2020;
- have been continuously employed until 31 January 2021;
- not be serving a redundancy notice period on 31 January 2021;
- have been paid each month from 1 November 2020 to 31 January 2021, with pay averaging at least £520 per month.

Averaging Example

John has been furloughed and flexibly furloughed under the CJRS. From November 2020 he has earned the following amounts:

November 2020	£1,000
December 2020	£200
January 2021	£900

His average monthly pay over the three months is £700 ((1,000 + 200 + 900)/3) and so this employer is eligible to receive the Job Retention Bonus.

If John had received no pay in December 2020, his average pay would still have exceeded the £520 monthly limit ((1,000 + 0 + 900)/3) but his employer would not have been eligible for the bonus as he was not paid anything in one of the three months.

The term 'employee' includes office holders, directors and agency workers and individuals on fixed term contracts

Employees returning after 10 June 2020 from statutory parental leave and military reservists are also eligible provided they have been reported on a CJRS grant claim up to the end of October 2020 and the other criteria are met.

Kickstart scheme

This is a new scheme open to all employers in England, Scotland and Wales.

The scheme aims to help fund new work placements for individuals between 16 and 24 years old who are currently on Universal Credit and at risk at long-term unemployment.

The placements must be new six-month job placements, not existing jobs, or roles created where others have been made redundant. The placements are intended to help the youngster develop skills and experience needed to find work.

Each role created must be for a minimum of 25 hours a week, paid at the National Minimum Wage rate or higher. Further, there must be no training requirement before the individual starts work.

Funding the scheme

For each job placement, the government will fund the 25 hours a week at the National Minimum Wage plus the employer's NIC and minim auto enrolment pension contributions.

There is additional funding of £1,500 per job placement to cover the set up costs, support and training on the job.

Applying for the funding

The employer must be offering a minimum of 30 job placements and can then submit their application directly to the DWP in their local area.

Where an employer has a smaller number of placements to offer, they can join with other employers to make up the 30-placement limit. Any entity that brings together groups of employers in this way are entitled to receive a grant of £300 to cover administration costs.

The application can be made online or in writing and must detail how the employees' skills will be developed to ensure good time-keeping, attendance and teamwork; how the employer will support the individual to help them to look for long term work including the help that will be given to create their CVs and prepare them for interviews.

They will need to include details of who will be providing the support and how that support will be monitored to ensure that the employees are learning and developing throughout the six-month period, and are able to provide feedback on their experience.

As part of the application process the employer will need to detail the changes in their workforce during the last six moths, the number of people affected by these changes. Where there have been redundancies, there must be an explanation of why these were made. In addition, they will need to detail the total size of the workforce, the typical roles, functions and the average salaries of staff made redundant (or had their hours reduced). Details are also needed of any recruitment that has been carried out in the last six months and whether any of these jobs advertised were similar to the jobs that they are now seeking to provide through Kickstart funding.

Review and selection

The DWP will check that the application meets the placement criteria set by the Government and notify their decision within one month.

The employer will receive a grant agreement that must be signed and returned before the placement begins.

The DWP will nominate individuals to contact the employer to apply for the job but it is the employer who decides which of these individuals to take on.

Receiving the grant

The grant will only be paid if the employer takes on an individual who has been introduced by the DWP.

The £1,500 set up grant will be paid once the employer confirms that the individual has started work and been enrolled on the payroll to be paid through PAYE.

The DWP use the RTI records to check that the individual is being paid. Provided that this is the case, the DWP will pay the grant covering the 25 hours at National Minimum Wage plus national insurance and auto enrolment pension contributions in arrears.

The DWP may check with the employer that the individual is receiving the agreed experience from the placement.

At the end of the six months when the individual moves on, the employer can offer the role to someone else to join the scheme.

Created from a seminar by Alexandra Durrant

Flat rate homeworking online portal

As previously reported, where employees are required to work at home and their employer does not reimburse homeworking expenses, they may be able to claim tax relief at a flat rate of £6 a week. Employees cannot claim tax relief if they simply choose to work from home but employees who are working from home due to COVID-19 are allowed to claim.

The claim is designed to cover additional costs incurred as a result of working from home including heating, metered water bills, home contents insurance, business calls or a new broadband connection.

HMRC has introduced an online portal for employees to check to see if they are eligible and make a claim online. The Portal can be used where employees do not file Self Assessment returns and is accessed using their Government Gateway user ID and password.

Where possible the relief will be given by adjusting the employee's PAYE code and can be backdated to earlier years. HMRC's online portal confirms that tax relief will be available for the whole of 2020/21, regardless of how long the employee worked or is working from home. At the end of 2020/21, the tax relief will stop and employees required to work from home after 5 April 2021 will need to claim again. The ICAEW has stated that they believe that these rules will revert to the previous position under which the allowance is tax-free only where paid by employers when the pandemic is over.

https://www.gov.uk/tax-relief-for-employees/working-at-home

Termination payments - no appealable decision **(Lecture P1221 – 12.24 minutes)**

Summary – Redundancy payments were taxable when they were received and the taxpayer was liable for the income tax due. No appeal was allowed against the taxpayer's own Self Assessment return.

Laura Bell was employed by the NHS in 2009/10 and 2012/13 and was made redundant, receiving termination payments from the NHS in both years.

Following a reconciliation of her 2009/10 NHS end of year returns with the relevant PAYE records, HMRC determined that there was a £22,000 underpayment of tax relating to her gross income for that year, including the redundancy payment, of £180,000. The amount due was too large to collect through PAYE in the following year and so HMRC issued a tax return to Laura Bell on 11 August 2011. She filed her tax return for 2009/10 on 24 January 2014 confirming the £22,000 underpayment.

HMRC issued her 2012/13 return in April 2013 and this was received on 20 September 2013, showing an underpayment of £3,000.

Eventually, she arranged a time-to-pay agreement but did not comply with the terms. HMRC's debt management pursued the taxpayer for the tax but she appealed, saying the underpayments arose because the employer failed to deduct the correct tax. HMRC said no appeal was possible against the taxpayer's own Self Assessment returns. The appeal should be struck out in accordance with the Tribunal's Rules.

Decision

The First Tier Tribunal stated that the redundancy payments were taxable when they were received or made available to the employee (S403 ITEPA 2003) and that the person liable for the income tax was the taxpayer (S13 ITEPA 2003). It did not matter whether the employer had calculated the PAYE deductions incorrectly. Laura Bell received significant redundancy payments on which she did not suffer the correct amount of tax.

The Tribunal confirmed HMRC's view that the legislation does not provide a right of appeal against a taxpayer's own Self Assessment return. There was no appealable decision. The judge stated that a taxpayer is permitted to amend their tax return but this is 'only realistically … made if the taxpayer paid the incorrect amount of tax, and this is simply not the case here'.

Laura Bell's only real defence was that she did not realise that the correct amount of tax had not been deducted under PAYE. This did not change the fact that the income tax under-deducted was still due.

The taxpayer's appeal was struck out.

Laura Bell v HMRC (TC7820)

Employment related securities - right to acquire shares (Lecture P1221 – 12.24 minutes)

Summary - The right to acquire securities arose when options were granted, and restricted shares were acquired by reason of his employment. Both happened while the taxpayer was UK resident, making him liable to UK income tax on the gains made.

John Charman was born in the UK and by 2001 was a senior executive in the insurance industry. In November 2001 he joined Axis Specialty Ltd and moved to Bermuda. At that time, he was granted options over 253,139 Axis Specialty shares due to vest in three equal tranches, on the first, second and third anniversaries of 20 November 2001 but these were conditional on him still being employed.

The following year, in September 2002, John Charman was awarded 50,000 restricted shares in the company. A few months later, as part of an initial public offering, the shares were exchanged for restricted shares in Axis Capital Holdings and his options became options over Axis Capital Holdings shares.

The restrictions on his Axis Capital Restricted Shares were lifted on 19 September 2005, when they were worth about $11.5 million and in March 2008 John Charman exercised some share options and sold the shares, realising a profit of around $33 million.

The First Tier Tribunal established that John Charman was UK resident until 21 November 2003, and so chargeable to tax on salary, expenses and bonuses received to that date.

There were two issues to deal with:

1. The timing of when John Charman acquired his options; and

2. Whether he had acquired his interest in the restricted shares 'as a director or employee' making him liable to income tax when the restrictions were lifted.

John Charman argued that he acquired the options when each tranche became exercisable rather than when the options were granted in 2001. The First Tier Tribunal agreed and concluded that John Charman became non-UK resident before the third tranche vested and so was liable to UK tax on exercise of the first two tranches only.

HMRC appealed, arguing that the right to acquire securities arose on grant of the options, and so all three tranches were subject to UK tax.

As for the restricted shares, the First Tier Tribunal found that John Charman had acquired these as a director or employee of the company, so they were subject to income tax. By contrast, John Charman argued that he had acquired them as a shareholder, as when they were exchanged all shareholders were granted shares in the new company, whether or not they were employees.

Decision

S.477 ITEPA 2003 defines the meaning of “chargeable event” in relation to an employment-related securities option. One such chargeable event is the acquisition of securities pursuant to the option (S477(3)(a)).

The Upper Tribunal disagreed with the First Tier Tribunal and concluded that the terms of the option were such that the right to exercise was subject to a condition precedent, namely continued employment as defined in the documents, but the grant was not so subject. The Tribunal found that the contractual rights created by the option documents amounted to the creation of a 'right to acquire securities' at the date the options were granted. The First Tier Tribunal had erred in law and all three tranches were subject to UK tax.

On the second issue, the Upper Tribunal needed to establish whether John Charman’s interest in the restricted Axis Capital shares was acquired in pursuance of a right or opportunity arising by reason of employment. The Tribunal concluded that the 'source' of the restricted shares was his employment. The Tribunal dismissed this appeal, agreeing with the First Tier Tribunal that the share exchange did not change the link between the acquisition of the shares and his employment.

John Charman lost his case.

John Charman v HMRC [2020] UKUT 0253 (TCC)

Pension drawdown age changing

Since April 2015, individuals have been able to access their pension funds from the age of 55 with flexible access being available from this age. The government has now confirmed that the minimum age from which individuals can access their pension funds is to set to increase from 55 to 57 in 2028. Workers in their mid-forties and younger will need to wait two years longer before accessing their pension.

This increase was first mentioned back in 2014 and in response to a written question on 3 September 2020, economic secretary to the Treasury John Glen said:

> 'In 2014 the government announced it would increase the minimum pension age to 57 from 2028, reflecting trends in longevity and encouraging individuals to remain in work, while also helping to ensure pension savings provide for later life.
>
> 'That announcement set out the timetable for this change well in advance to enable people to make financial plans and will be legislated for in due course.'

Compensation for mis-sold loan product (Lecture P1221 – 12.24 minutes)

Summary – In this lead case, both types of compensation paid by Barclays Bank to a taxpayer were income in nature and so liable to income tax.

Darren Wilkinson used bank borrowings to fund his UK property rental business, paying interest at a fixed amount above the Bank of England base rate.

In 2007, as a condition of a new loan, he took out an interest rate protection product that resulted in him paying substantial sums to Barclays Bank. The product was terminated in 2013 when it was discovered that the bank should have offered him a more beneficial product.

Barclays Bank paid compensation for the mis-selling of just over £466,000. This consisted of two elements:

1. Basic Redress Element: £385,000 being the difference between the interest payments Darren Wilkinson made, and those that he would have made under the better product; and

2. Interest Element: £81,000 being interest on the sum above calculated at a rate of 8% per annum, which was paid subject to the deduction of income tax at the basic rate.

Darren Wilkinson argued that the full £466,000 was a capital receipt. The sum represented his opportunity cost for not being able to undertake other investments due to entering into the mis-sold product.

By contrast, HMRC argued that the entire compensation amount was taxable as income:

- The Basic Redress Element was a receipt of Darren Wilkinson's UK property business and that it was therefore subject to income tax (Ss.268 and 269(1) ITTOIA 2005);

- The Interest Element was interest and therefore subject to income tax (S369 ITTOIA 2005).

Decision

This case was a lead case in respect of a number of other appeals relating to similar facts.

The Tribunal needed to identify the reason why Barclays Bank had offered to pay, and did pay, the Basic Redress Element and the Interest Element:

The Basic Redress Element: The Tribunal concluded that this was paid in order to compensate Darren Wilkinson for the fact that, by entering into the mis-sold product, he had incurred more expenses than he would have done if that mis-selling had not occurred.

The Tribunal concluded:

> "The Basic Redress Element was therefore a taxable revenue receipt of the Appellant's property rental business and was properly subject to income tax"

The Interest Element: This was intended to compensate the individual for the fact that they had been deprived of their money for a period of time as a result of making 'excessive' payments under the arrangement. The individual could choose to take that compensation at the 8% interest rate or submit a claim showing that their actual costs were greater than the compensation reflected in that interest rate. The Tribunal stated:

> "Those additional expenses meant that the Appellant might either have had to borrow money to replace the money that he had expended or have missed out on a valuable opportunity to earn revenue from the money he had expended."

They went on to say:

> "..it is clear beyond any reasonable doubt that the Interest Element was "interest" properly so called and therefore that it was subject to income tax as such in the hands of the Appellant."

With both Elements chargeable to income tax, the closure notice was correct and the appeal was dismissed

Darren Wilkinson v HMRC (TC07840)

Capital Taxes

FHLs and Business Asset Disposal Relief (Lecture P1223 – 20.34 minutes)

Although the letting of property is not tantamount to the carrying on of a trade, for 36 years HMRC have allowed the owners of furnished holiday accommodation situated in the UK to be treated for income tax and CGT purposes as though they were traders. Initially, overseas properties did not attract a similar relief. However, in 2009, it was decided that this distinction was not compliant with European law and so, in FA 2011, the Government announced that the rules were being extended to cover all qualifying properties situated anywhere in the EEA for 2011/12 onwards.

For many property owners, one of the biggest attractions of the FHL regime is the possibility of claiming business asset disposal relief on a sale. However, the position here is not as straightforward as it might be and the tax treatment can depend on whether the vendor owns a single holiday property or several.

It should be explained that two of the categories of a material disposal of business assets are:

- a disposal of all or part of an unincorporated trading business (S169I(2)(a) and (3) TCGA 1992); and

- a disposal of assets previously used for a trading business which has ceased (S169I(2)(b) and (4) TCGA 1992).

Illustration 1

Simon, aged 70, has owned a single holiday property in the UK for many years which has always satisfied the furnished holiday accommodation criteria.

On 1 September 2020 (towards the end of the 2020 holiday season), he sold the house to his son-in-law as he was increasingly finding that the requirements of some of his holidaymaker tenants were becoming too demanding.

It seems clear that this transaction represents a disposal of all of Simon's FHL business under S169I(2)(a) TCGA 1992, in respect of which he can claim business asset disposal relief.

Let us now vary the facts about Simon's disposal.

The holiday rental season winds up on 31 October 2020. Simon decides that, at his age, he has had enough of property letting and so he sells off the contents of the holiday house on eBay over the pre-Christmas period.

In early 2021, Simon decides to put the freehold property into the hands of a local estate agent, but, because of COVID-19, he does not receive an offer which comes close to his asking price. On 1 April 2021, Simon therefore lets the property on a six-month tenancy, following which it is finally sold in January 2022.

S169I(2)(a) TCGA 1992 clearly cannot apply, but Simon is still able to rely on S169I(2)(b) TCGA 1992 in order to obtain his 10% business asset disposal rate.

When the 2020 holiday season finished, Simon's property letting business came to an end and, because the house was eventually sold well within the three-year window following this cessation, he was still able to claim the relief. Two points should be noted:

1. HMRC do not have discretion to extend the three-year period under any circumstance – see Para CG64045 of the Capital Gains Manual;

2. There is no restriction on the use to which the former holiday property can be put during the period from the cessation of the FHL business up to the date of the sale. The fact that it was subsequently rented out on a non-holiday basis is irrelevant. Contrast this position with the rules for associated asset disposals.

Another commonly encountered scenario is where a client has owned, say, five holiday rental properties for several years but only sells one of them. It is prima facie unlikely that he can argue for a part disposal under S169I(2)(a) TCGA 1992. And there has obviously not been a cessation of the FHL business which is a prerequisite if S169I(2)(b) TCGA 1992 applies. As a result, business asset disposal relief may not be available. However, do not neglect the following lines of argument:

If two of the five properties were located in Cornwall, another two in Suffolk and the fifth one in the Lake District (which was the property sold), it may be possible to contend that, because of the different locations and types of holidaymaker, the vendor operated more than one business so that the sale of the Lake District building represented a distinct part of his FHL business. In that case, a business asset disposal relief claim should be competent.

Even if all five properties were in the Lake District, it might well be that the sale of the first property was followed by a sale of the remaining four properties to a different buyer shortly thereafter. In other words, the vendor has disposed of the entirety of his property letting business, leading to a relief claim. In this instance, timing would be crucial and it might be better planning to arrange for the business to close down first before any of the sales were made (which could then be staggered over the next three years).

UK FHL activities and overseas FHL activities are regarded as separate businesses. Thus the letting of a furnished holiday cottage in Cornwall and the letting of a very similar property on the other side of the English Channel in Brittany (owned by the same individual) will always be treated as two distinct businesses.

When dealing with the sale of furnished holiday accommodation which is jointly owned by, say, a married couple, it should be borne in mind that the rental profits from an FHL do not have to be divided between the spouses on a 50 : 50 basis (S836 ITA 2007). However, if the property was purchased by the couple as equal tenants in common, the resulting gain should be split between them in that proportion, even if the income has been shared in a different way for tax purposes. This should maximise the benefit of business asset disposal relief for the husband and wife. As a practical point, if the rental profits have in recent years been divided on, say, a 10 : 90 basis, it might be sensible to ensure that, for the two years prior to the sale, the profits were split on a more even footing.

Contributed by Robert Jamieson

Educational campaign letter: Deferred consideration

HMRC are issuing an educational campaign letter to taxpayers who they believe may have disposed of shares in an unlisted company during the sale of the company and may, as part of that sale, have received deferred consideration.

HMRC does not suggest in these letters that the customers have made any errors or omissions but rather, it is a prompt to action before the return is submitted to help them get things right.

The letter directs them to help sheets, HMRC guidance and relevant professional support to help them before their returns are submitted.

The link below directs you to sample letters that have been sent to individuals and their agents.

https://www.tax.org.uk/policy-technical/technical-news/hmrc's-educational-campaign-letter-deferred-consideration

Administration

PAYE Settlement Agreement payments

Tax and national insurance payable under a PAYE Settlement Agreement (PSA) for 2019/20 are due by either 19th or 22nd October 2020 depending on whether they are paid by post or electronically. Where employers settle these amounts late, they may be fined or charged interest or a late payment penalty.

HMRC has informed the Association of Taxation Technicians (ATT) that payslip confirmation letters to employers may not have been sent out for the tax year 2019/20 and have stated:

> "If your client has not received their payslip confirmation letter, they should pay the tax and National Insurance amount they calculated and submitted for their PSA to HMRC. Customers should not wait until they receive their payslip confirmation from HMRC."

HMRC go on to say:

> "When making payment, your clients should ensure they quote their PSA reference number, which is shown on their PSA confirmation letter. They should not use their PAYE Accounts Office reference to make their PSA payment. This is because payments received with the PAYE Accounts Office reference are allocated to their normal PAYE account and they will continue to receive reminders for the PSA payment even though they have paid."

Where an employer does not have the PSA reference number as no confirmation letter has been received, , they should contact the PSA team on 0300 322 7077.

https://www.att.org.uk/technical/news/making-paye-settlement-agreement-psa-payments

No daily penalties for 2018/19 (Lecture P1221 – 12.24 minutes)

Under normal circumstances, where tax returns are filed more than three months late, HMRC imposes a late filing penalty calculated as £10 per day for a maximum of 90 days.

Taxpayers who failed to file a return in May, June, or July 2020 could therefore incur a total penalty of £900. However, due to the difficult circumstances that many taxpayers have faced due to COVID-19, HMRC has stated that it will:

- accept COVID-19 as a reasonable excuse for missing return deadlines;
- not charge individuals or businesses daily penalties for late filing 2018/19 = returns.

However, the mandatory six- and 12-month penalties will continue to apply as normal.

https://tinyurl.com/y6cqunof

No need to disclose documents

Summary – HMRC did not have to disclose documents of 'low relevance' relating to the application of the mutual agreement procedure under the UK/Belgium double tax treaty that was used to determine that the taxpayer was UK resident. The documents had no bearing on the outcome of the appeal.

Kevin McCabe argued that he was not resident in the UK or, alternatively, that he was resident in Belgium under the UK-Belgium double tax treaty. He instigated the Mutual Agreement Procedure (MAP) contained in Article 25 of the treaty that resulted in an agreement between the UK and Belgian tax authorities that he was UK-resident for tax purposes. However, he did not accept this agreement and applied to HMRC to disclose documents relating to the application of the MAP.

Both HMRC and the Belgian Authorities refused disclosure on the grounds that the documents sought were of 'low relevance' and there were reasons of public policy why disclosure should not be directed. They also claimed that the scope of the disclosure was too wide and amounted to a fishing expedition.

Kevin McCabe applied to the First Tier Tribunal for a direction for disclosure but this was refused and so he appealed to the Upper Tribunal arguing that the First Tier Tribunal's conclusion that the documents were of 'low relevance' was an error of law.

Decision

The Upper Tribunal confirmed the First Tier Tribunal's decision that the MAP documents were of 'low relevance' and would have no 'probative value' in deciding the taxpayer's residence. The Tribunal stated that the MAP was a separate process to the appeal on Kevin McCabe's residence and would provide no further information on the actual facts supporting his residence status; views expressed in correspondence between the UK and Belgian authorities had no bearing on this.

Further, the First Tier Tribunal had correctly assessed the importance of the confidentiality of inter-governmental correspondence under the MAP.

The appeal was dismissed.

Kevin McCabe v HMRC [2020] UKUT 0266 (TCC)

Responding to HMRC Nudge Letters (Lecture P1225 – 13.02 minutes)

What is a "nudge" letter?

A nudge letter is correspondence that HMRC send to a taxpayer which is designed to encourage a certain type of behaviour. The letters are issued in their thousands by HMRC, sometimes in batches. The letters are designed to encourage the taxpayer to review their tax affairs, and to disclose any irregularities. Alternatively, the taxpayer is asked to confirm that their tax affairs are correct. The nudge letter comprises the letter and, usually, a certificate of tax position. The certificate asks the taxpayer to make a declaration about their tax affairs, and carries a warning about the risk of criminal prosecution in the event that a false statement is provided to HMRC.

The request to review the taxpayer's affairs is broad – it is without limit of time, and without regard to any materiality limit. Standard wording is used, although HMRC sometimes use different versions when sending letters addressing the same issue. Taxpayers are usually given 30 days to respond.

The key issue to note about a nudge letter is that it does not constitute a formal enquiry notice, and is non-statutory.

A sample nudge letter, together with a certificate of tax position, is included with these notes. The sample is indicative of those issued in July 2020 in relation to information received by HMRC under the Common Reporting Standard.

A brief history of the nudge letter

Nudge letters have been used by HMRC, in various forms, for about ten years. Sometimes the letters have been sent to taxpayers in specific business sectors (for example, painters and decorators), and at other times they have been sent to address particular risk issues (including use of the remittance basis, income from rental property and the use of tax planning schemes). The use is often backed by the receipt of information received by HMRC. This has included those relating to the Foreign Account Tax Compliance Act (FATCA) provisions, and the Common Reporting Standard (CRS) (including a batch of nudge letters issued in July 2020). More recently, in August 2020, HMRC issued nudge letters encouraging businesses to consider their furlough applications.

Why do HMRC issue nudge letters?

HMRC have limited resources to enquire into every taxpayer where they consider there may have been an underpayment of tax. There is an ongoing desire within HMRC to change taxpayer behaviour, so that there is a greater level of compliance. In addition, the nudge letters are a cost-effective way of dealing with the large volume of information that is provided under the Common Reporting Standard provisions, and similar sources.

HMRC do not automatically issue a nudge letter where they are in receipt of bulk information, and is one of several options available. As an alternative to issuing a nudge letter, HMRC may commence an enquiry or investigation under their civil provisions (which could include the use of the Contractual Disclosure Facility, where fraud is suspected), or they could start a criminal investigation.

How to respond to a nudge letter

The key point to remember is that a nudge letter does not have any statutory basis, and your client does not have a legal obligation to respond. The letter does not provide any of the protections associated with a formal enquiry.

However, it is important that the letter is not ignored. HMRC will not go away, and there will be an escalation of the matter by HMRC, which may result in one of the alternative options noted above. Advisers need to be aware that, in the past, HMRC have not always issued a copy of the letter that is sent to taxpayers.

The issue of a nudge letter does not mean that an incorrect return has been submitted, or that there has been an underpayment of tax. Advisers should note that cases are not always risk-assessed before the nudge letter is issued.

There can be numerous reasons why there may not be a reportable issue. However, it is important to assess the position with the client. As noted above, the nudge letter is without limit of time, and advisers should establish whether there is a disclosure to make. Where there is a disclosure, consideration should be given as to the most effective option to use (the Worldwide Disclosure Facility, which the nudge letters direct the taxpayer towards, is not necessarily the best route). Specialist advice should be taken, particularly where the disclosure is significant.

Any disclosure made in response to a nudge letter is likely to be treated by HMRC as "prompted" for penalty purposes. However, it is important to establish the facts, and it may be possible to argue a different position, depending on the disclosure being made.

A response should be sent by letter, and advisers should not be asking their clients to sign the certificate of tax position, irrespective of the outcome of the discussions with the client.

Summary

Nudge letters are here to stay, as part of HMRC's armoury, and it is important that advisers know how to respond.

Contributed by Phil Berwick (Director, Berwick Tax)

Deadlines

1 November 2020

- SME corporation tax due for periods to 31 January 2020 (not paying by instalments)

2 November 2020

- Filing date for form P46 (Car) for quarter ended 5 October 2020

5 November 2020

- Specified employment intermediaries returns for tax quarter to 5 October 2020

7 November 2020

- VAT returns and payment for 30 September 2020 quarter (electronic payment)

14 November 2020

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

19 November 2020

- PAYE, NICs, CIS and student loan liabilities for month to 5 November 2020 if not paying electronically
- File monthly construction industry scheme return

21 November 2020

- File online monthly EC sales list
- Submit supplementary intrastat declarations for October 2020

22 November 2020

- PAYE, National Insurance, CIS and student loan liabilities should have cleared into HMRC bank account.

30 November 2020

- Accounts to Companies House
    - private companies with 28 February 2020 year end
    - public limited companies with 31 May 2020 year end.
- CTSA returns for companies with accounting periods ended 30 November 2019

News

Self Assessment 'Time to Pay' (Lecture P1221 – 12.24 minutes)

Individuals have been contacted by HMRC confirming the Chancellor's announcement that:

- the online self-serve 'Time to Pay' service has been increased to £30,000 for Self Assessment customers; and
- once a taxpayer has completed their tax return for 2019/20 they can use this service through GOV.UK to set up a direct debit and pay any tax that is owed in monthly instalments, up to a 12-month period.

To use this facility taxpayers must have no:

- outstanding tax returns;
- other tax debts;
- other HMRC payments set up.

Additionally, it must be no more than 60 days since the tax was due for payment.

Taxpayers have been informed that, although the payments will be deferred under a 'Time to Pay' arrangement, they will have to pay interest on the tax paid late and this will run from 1 February 2021.

STOP PRESS – CJRS extended by a month (Lecture B1221 – 20.53 minutes)

From Thursday 5th November, England will enter a second lockdown due to run until 2 December 2020. Pubs, restaurants, gyms and non-essential shops will close, but schools, colleges and universities can stay open.

The Coronavirus Job Retention Scheme was due to close on 31 October 2020 but the Government has stated that this scheme will remain open for November:

- The flexibility of the current CJRS will be retained so that, where possible, employees will be able to continue to work;
- For hours not worked, employees will be paid at least 80% of their salary, up to £2,500 a month. Employers must cover the employer NICs and pension contributions.

To be eligible to claim for November, employees must be on an employer's PAYE payroll by 23:59 30th October 2020. In other words the employee must have been on a RTI submission notifying payment for that employee on or before 30th October 2020.

The Government has confirmed that the Job Support Scheme, that was due to start on 1 November 2020, has been delayed until the furlough scheme ends.

https://www.gov.uk/government/news/furlough-scheme-extended-and-further-economic-support-announced

Changes to the Winter Economy Plan (Lecture B1221 – 20.53 minutes)

Job Support Scheme delayed

Due to the extension of the Coronavirus Job Retention Scheme (see above), the Job Support Scheme (JSS) has been postponed. The Government has confirmed that this scheme will be introduced once the CJRS eventually closes.

How the Job Support Scheme will work

Originally, the scheme was designed to help employers bring back staff to work on reduced hours rather than making them redundant but only for viable businesses, where businesses were operating but with reduced or uncertain demand.

The scheme required employers to provide at least a third of normal working hours, with the employer paying for the time. In addition, for every hour not worked by the employee, both the Government and employer will pay a third each of the employee's usual hourly wage, with the Government contribution capped at £697.92 a month. Remember, Class 1 employer NICs and pension contributions are not covered and were payable by the employer. This has become known as the Job Support Scheme Open i.e. for businesses that are open.

On 22nd October 2020, the Chancellor amended the Job Support Scheme Open as follows:

- Employees now only need to work at least 20% of their normal hours which is paid for by their employer (previously 1/3rd), so working the equivalent of just one day a week is now sufficient to be eligible for the scheme;

- Where previously employers were required to pay for 1/3rd of any hours not worked, this has now been reduced to just 5%;

- Employers will continue to receive the £1,000 Job Retention Bonus.

The Chancellor has also announced that the scheme would be expanded to support businesses across the UK required to close premises due to increased local or national restrictions, resulting in their employees not being able to work. This has become known as the Job Support Scheme Closed i.e. for businesses that are required to close.

For Tier 3 businesses required to close:

- The government will pay two thirds of employees' salaries, up to a maximum of £2,083.33 a month;

- Employers will pay the related NICs and pension contributions. The government believes that around half the employees covered by the extended scheme will not be paid enough to trigger these costs;

- Employees will effectively take a pay cut while unable to work of one third of their normal pay and will have to agree to that change in their employment contract in writing if they are not already on a zero hours contract.

- The scheme was due to run for 6 months from 1 November 2020 but, as already stated, the start date has been postponed until the CJRS ends.

Businesses in Tier 2 areas, especially in the hospitality sector, claimed they would be better off moving to Tier 3 restrictions.

Self-employed income support scheme (SEISS) extended

In September 2020, the Chancellor announced the extension of the SEISS for those continuing to actively trade but on a reduced basis. Two further grants were planned: grant 3 covering the three months to the end of January 2021 and grant 4 covering February 2021 to April 2021. These grants will be available to anyone who was previously eligible for the SEISS grant 1 and grant 2, and meets the eligibility criteria.

Grant 3 was to be calculated as 20% of average monthly profits up to a total of £1,875; capping average monthly profits at £3,125 (£3,125 x 20% x 3 months = £1,875). In his latest announcement, grant 3 has been increased to 40%, meaning the maximum grant will increase from £1,875 to £3,750.

As previously stated by the Chancellor, the government will review the level of the fourth grant and set this in due course.

New Business Grants

The Government had announced that increased cash grants will be available to businesses that are required to close. These grants will be linked to rateable values, with up to £3,000 per month payable every two weeks.

Properties with rateable value of:

- ≤ £15,000: grants of £667 per 2 weeks of closure (£1,334 per month);
- > £15,000 but < £51,000: grants of £1,000 per 2 weeks of closure (£2,000 per month);
- ≥ £51,000: grants of £1,500 per two weeks of closure (£3,000 per month).

The government is also extending the scheme to include businesses forced to close on a national rather than a local basis.

https://www.gov.uk/government/news/job-support-scheme-expanded-to-firms-required-to-close-due-to-covid-restrictions

Local Restrictions Support Grant (Tier 2)

On 22 October 2020, the Chancellor announced additional funding to allow Local Authorities to support Tier 2 businesses who are not legally required to close but which are severely impacted by the restrictions on socialising. The funding that each Local Authority will receive will be based on the number of hospitality, hotel, B&B, and leisure businesses in their area. It will be up to Local Authorities to determine which businesses are eligible for grant funding in their local areas, and what precise funding to allocate to each business.

The levels below are an approximate guide:

- £934pm for properties with a rateable value of ≤ £15,000;
- £1,400pm for properties with a rateable value between £15,000 and £51,000; and
- £2,100pm for properties with a rateable value of ≥ £51,000.

Local Authorities will also receive a 5% top up amount to these implied grant amounts to cover other businesses that might be affected by the local restrictions, but which do not neatly fit into these categories.

Businesses in Very High alert level areas will qualify for greater support whether closed (up to £3,000/month) or open. In the latter case support is being provided through business support packages provided to Local Authorities as they move into the alert level. The government is working with local leaders to ensure the Alert Level very high packages are fair and transparent.

https://www.gov.uk/government/news/plan-for-jobs-chancellor-increases-financial-support-for-businesses-and-workers

Update to Pensions schemes newsletter 124

Some individuals who were members of pension schemes before 6 April 2006 have protected pension ages in respect of those schemes, meaning they are able to receive pension benefits at an age below the current normal minimum pension age of 55.

Without government intervention, individuals with a protected pension age in the range 50 to 54 would have lost this protection and become liable to unauthorised payment tax charges if they accessed their pension benefits and either:

- continued to work without a break in service; or
- returned immediately to service without a break of at least one month.

In April 2020 the government confirmed that it would temporarily suspend these tax rules if such individuals returned to work as part of the government's response to the COVID 19 outbreak.

However, in an update to Pensions schemes newsletter 124, on 6th October 2020 HMRC announced

> "The protected pension age easement will not be extended and will expire on 1 November 2020."

https://www.gov.uk/government/publications/pension-schemes-newsletter-124-september-2020/pension-schemes-newsletter-124-september-2020

Business Taxation

IR35: Finalised Employment Status Manual

6 April 2021 will see the start of off-payrolling in the private sector. HMRC has updated the IR35 aspects of its Employment Status Manual which include:

- HMRC not using information acquired through this new system to open compliance checks for previous tax years;
- HMRC not asking contractors, agencies or engagers for any Status Determination Statements that may exist relating to 2020/21 as evidence in ongoing enquiries but may use such statements if provided;
- a template to use when a worker requests confirmation of the engager's size;
- wording stating that when an engager issues a CEST output as a Status Determination Statement, HMRC will deem this to mean the engager agrees with the CEST output;
- guidance on the interaction between statutory payments and the IR35 rules;
- a page explaining that the IR35 rules take precedence over the CIS rules

HMRC has also published further:

- detail on how HMRC will use its legislative recovery of debt powers, including a view that there are 'likely to be limited circumstances' where both the new Finance Act 2020 joint and several liability provisions and the IR35 recovery from other persons provisions could apply;
- guidance, with examples, on making PAYE deductions from chain payments

HMRC has committed to publishing a 'self-help guide' for contractors and agency workers on how to avoid entering into non-compliant arrangements.

Tolleys Tax news round up: 28 September 2020

Airbnb working with HMRC **(Lecture B1221 – 20.53 minutes)**

It has been reported by the Press that Airbnb UK have stated they will work with HMRC by sharing data on the earnings of Airbnb hosts for 2017/18 and 2018/19. Data provided by Airbnb will enable HMRC to target enquiries into individuals' tax affairs where they have not declared their rental income. HMRC has confirmed that they plan to open such enquiries during 2021/22.

Any landlords whose income has not been declared should review their accounts to make sure that their affairs are in order. It is possible that their income is covered by the £1,000 property allowance or the £7,500 annual rent-a-room limit but if not, such individuals should consider disclosing their income now, before HMRC come looking.

Let property campaign

The taxpayer's 2018/19 return can be amended until 31 January 2021 but where property income was not included in earlier years, taxpayers should consider disclosing under HMRC's let property campaign. This was last updated at the end of September 2020 and applies to landlords who owe tax through letting out residential property, in the UK or abroad. The Campaign is not available to companies or trustees.

Taxpayer's who delay in coming forward risk higher penalties if they are subject to an enquiry and have not already notified an intention to disclose.

Taxpayer's who have already filed Self Assessment returns within the appropriate time limits, but have simply made a careless mistake when declaring their income will pay penalties for a maximum of 6 years. However, by using the campaign, the penalties charged will be much lower. Where full disclosure and payment of the tax is made before HMRC identifies the issue, the penalty could be reduced to nil.

Action to take

To take part in the Let Property Campaign taxpayers should:

- notify HMRC that they want to take part in the Campaign
- disclose all income, gains, tax and duties not previously notified to HMRC;
- make a formal offer;
- pay the tax that is owed;
- help HMRC as much as possible where they ask for additional information.

Failing to disclose

Those who do not come forward, and later HMRC discovers that income or gains has been deliberately omitted, will face larger penalties. The law allows HMRC to go back up to 20 years and in serious cases HMRC may carry out a criminal investigation.

https://www.gov.uk/government/publications/let-property-campaign-your-guide-to-making-a-disclosure/let-property-campaign-your-guide-to-making-a-disclosure

R&D relief for furloughed staff

CIRD83200 provides HMRC's interpretation of how s1123 CTA 2009 should be interpreted for the purpose of R&D tax relief for qualifying staff costs. Additional guidance has been added to explain how HMRC will treat staffing costs for employees furloughed during the COVID-19.

While furloughed under the Coronavirus Job Retention Scheme (CJRS), HMRC state that employees cannot be treated as directly or actively engaged in R&D and so staffing costs incurred while not working must not be included in R&D and RDEC claims. This includes any employer top-up payments made while employees were furloughed under the scheme.

Where later employees were flexibly-furloughed and some qualifying activity has been carried out then HMRC expect companies to claim as usual but they draw attention to the appropriate proportion rules found in s1124(3) and (4) CTA 2009.

Under normal circumstances, amounts paid for sick leave and annual leave are viewed by HMRC as potentially eligible for R&D relief. HMRC has stated that such costs met by the Government through the CJRS, will be treated as having been subsidised and will not qualify for relief within the R&D scheme for SMEs but can be eligible for RDEC relief for large companies.

https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird83200

CIS and best judgement (Lecture B1221 – 20.53 minutes)

Summary – The amount of the income tax due under a Regulation 13 determination was reduced in part to reflect materials invoiced by an insolvent supplier.

Elmpine Developments Limited had been in the construction business since October 2013 but did not register for the Construction Industry Scheme until November 2016. In October 2017, HMRC issued a Regulation 13 determination covering this period. The company provided an invoice from AKY Contractors Limited dated 10 December 2015 for payments relating to materials and labour, arguing the sum for materials should not be included in the determination.

HMRC argued that the invoice could not be accepted as evidence because AKY Contractors Limited had entered liquidation in March 2015 and the invoice was dated December 2015. They made no comment on the reasonableness of the labour/materials split nor did they challenge the authenticity of the invoice

Elmpine Developments Limited appealed on the ground the determination had not been made to the best of HMRC's judgment (Reg 13(2)).

Decision

The First Tier Tribunal could see no reason why a company in voluntary liquidation, not an insolvent liquidation, could not issue a valid invoice as it was normal practice for liquidators to continue trading and complete existing projects. The judge stated that if the project did not come to an end until December 2015, it was totally reasonable for the liquidators to continue trading until the project was finished and then to issue a satisfactory invoice once the works were completed. The Tribunal found that HMRC's judgement was not reasonable, in that they ignored the invoice from AKY Contractors Limited, which was very relevant information.

The invoice seemed to be the best information available to support the fact that, of the total payments made to AKY Contractors Limited of just under £650,000, some £420,000 related to materials and the balance to labour. The Tribunal therefore reduced the figure for 2015/16 to exclude material costs.

The taxpayer's appeal was allowed in part.

Elmpine Developments Ltd v HMRC (TC7830)

Key man insurance (Lecture P1222 – 16.20 minutes)

There are two aspects when we are looking at key man insurance taken out by a company to insure the life of a key employee or director. The first is the deductibility of the premiums for the company. The second is the potential benefit in kind on the individual whose life is insured.

Whose name is the policy in?

The first issue to consider is the practical side of things.

Who has taken out the policy, who is insured and who will receive the money in the event of a pay-out? Only then can we start to consider the purpose of taking out the policy and what the tax impact is. It is also true to say that the impact of getting the paperwork right is not always acknowledged which means that mistakes are made.

This was demonstrated in the case of Macleod and Mitchell Contractors Ltd v R&C Commrs where HMRC were trying to tax the value of premiums paid by the employer on insurance contracts that had been erroneously taken out in the name of the employee. The Upper Tribunal agreed that there was evidence that there had been a mistake and that HMRC were wrong in taxing the premiums but the First Tier Tribunal had not been so forgiving. This case will be considered further below.

The tax impacts

This will be considered assuming that there is a company involved although the basic questions are the same.

The main difference would be that an insurance policy taken out for the proprietor of an unincorporated business would always be disallowed as private expenditure but no benefit issues arise.

There are two issues to consider.

1. Are the premiums allowable for the company?

2. Do any tax implications arise for the person whose life is insured?

Are premiums allowable?

The HMRC guidance at Business Income Manual para.45525 is fairly clear on the conditions that have to be met for premiums on insurance policies to be deductible (but of course, this is HMRC's view, rather than the legislation which would simply require the expenditure to be wholly and exclusively incurred for the purpose of the trade).

The Manual states that the sole purpose of taking out the insurance must be the trade purpose of meeting a loss of trading income that may result from loss of the services of the key person.

BIM45530 lists some non-trade purposes for its inspectors to look for including where:

- benefits under the policy exceed sick pay arrangements, or other employee benefits, typically offered to employees of equivalent status in similar concerns;

- the key person is a major shareholder in the trader such that a purpose of the trader entering into the policy is to protect the value of its shares;

- there is an investment purpose; for example, where the policy has a surrender value. A policy has a surrender value where a cash payment will be made to the policyholder if the policy is terminated prior to maturity. Whole life and endowment policies are most likely to have a surrender value;

- the term of the policy extends beyond the period of the employee's usefulness to the company; or

- the policy is taken out as a condition of securing long-term finance.

Some of these issues were considered in the case of Beauty Consultants v Inspector of Taxes, which is a Special Commissioners case from 2002. It was found that the premiums were not paid wholly and exclusively for the purposes of the company's trade for a variety of reasons:

The first two policies were on the life of each of A and B, the two directors of the company, and were taken out a number of years before the company was formed. The policies related to the directors' ownership of their private residence – the only connection between the company and these policies was that the bank lending to the company had a second charge on the house.

The third policy was in the name of the director and linked to a first charge on the property used as business premises and meant that the directors' preference shares would be repaid on the sale of the business premises. The policy monies were in excess of the secured debt and would belong to the directors so the Special Commissioners could not identify any benefit to the company or its trade in paying the premiums.

The fourth policy was taken out by another company of which A and B were shareholders and directors but had been assigned to Beauty Consultants Ltd at the time A and B became involved in that business so it was found the policy had a dual purpose as the policy benefitted the directors by improving the value of their shares.

The upside to disallowing the premiums is that HMRC acknowledge that the receipt is not going to be a trading receipt for the company and so might not be taxable. However, the Business Income Manual does state that 'no assurance can be given that any future receipt will be excluded from trading income even though the premiums are not allowable'. What is not in dispute is that if premiums are allowable, then the receipt will be taxed.

There is a 2003 case involving a company called Greycon Ltd where proceeds from a series of key man insurance policies was found to be capital in nature. The intention of the company in taking out the policies was to fill the hole in the profits arising from the director's death but they were taken out as part of an agreement with an investor and as a condition of that agreement. The immediate and conscious purpose was to obtain the benefits of that agreement which were of a capital nature unconnected with any potential loss of profits. The policy monies were not, therefore, part of the trading profits. HMRC do not accept that this is a precedent for treating all key man insurance policy proceeds as capital in nature.

Is this taxable on the employee?

There are various different possibilities here and again, it is not straightforward.

If the policy is taken out by the individual and any receipt paid directly to him (or his estate), then the payment of premiums by the employer is the meeting of the pecuniary liability of their employee. This is taxable as remuneration under s62 ITEPA 2003.

If the policy is taken out by the employer and any receipt is to be paid to the individual (or his estate) then it is a benefit in kind which would need to be reported as such with the relevant tax consequences arising from that.

The receipt by the individual in that situation should not itself be taxable.

If the policy does not allow for payment to the individual directly, then it may be that no benefit in kind would have arisen as the receipt would have been intended to be retained by the company. However, if the intention is for the money to be used in a particular way, such as repurchase of shares, then you would need to consider again whether a benefit does arise to the employee but then it may be a case of proving the intention at the time the policy was taken out. If the company has some discretion over what it is going to use the money for, then it may be difficult for HMRC to assume that there is a benefit charge on the employee.

This leads us on to the question of what happens if money is paid out of the company following receipt of the proceeds. Once again, it will depend on how it is paid out.

Payments under transactions such as purchase of own shares would be considered on their own merits as to whether capital treatment would apply. This is something that is seen commonly when a person has died; the insurance pay-out is allowing the shares to be repurchased from the estate.

If the payment is made under a critical illness policy and is then paid out to the employee, then HMRC would probably want to tax it as employment income. There is an exemption from employment income where compensation is paid on termination of an employment due to injury or disability. This can be following a period of physical or mental deterioration but note that ageing is not a disability. This is why payments can normally be paid out to employees under these types of policies without any tax being paid. It does have to be the sole reason that the money is being paid out but given the nature of critical illness policies (there has to be good evidence of the ill health) then normally that is not an issue but if the insurance policy is excessive compared to any put in place for comparable employees, then there might be more of an argument.

A payment which is not paid out due to termination of employment due to injury or disability but is being paid on termination could be taxed as a payment under an unapproved retirement benefit scheme as it is paid ‘on or in anticipation of retirement’ so would be taxed as employment income even if it cannot be shown to be normal remuneration.

Of course we might then have an argument about whether that payment is wholly and exclusively for the purposes of the trade, and whether a deduction would be allowed for the company. It would be hoped in this situation that the receipt is taxable but there is a deduction for the amount paid out to the employee. This risk is increased if no BIK has been declared on the policy but the amount paid out is excessive.

Other thoughts

This issue often arises when a company is about to encash a policy of this type and have not really ever thought about what the tax implications would be in that case. I have had a couple of cases in the past where we have got HMRC to accept that we could disallow premiums retrospectively so that a receipt under a key man policy was not taxable. In both cases the money was then used to repurchase shares from the estate of a deceased shareholder. But those cases were probably 15 years ago (if not more!) and it was a different regime then and we were talking about five years' premiums at most in each case.

However, the case referred to at the beginning is a good example of the Courts being more realistic about these situations. In that case, the taxpayer was the sole director and shareholder of the company, which had paid insurance premiums relating to life insurance, critical illness and income protection policies which were all in the name of the taxpayer. The issue for the appeal was whether the premiums should be treated as earnings for the taxpayer.

When the taxpayer took out the insurance policies he had intended them to be in the name of the company and had left the details to a financial advisor. However, the taxpayer confirmed that he had received copies of the final polices which clearly stated that they were in his name. The error did not come to light until copies of the policies were requested by HMRC in a PAYE audit in 2013.

The Tribunal concluded that, although the intention was to take out the policies in the name of the company, they were actually taken out in the name of the taxpayer. Therefore, as the payment of the premiums counted as money's worth under s62 (2)(b) ITEPA 2003, the amounts were earnings from employment and subject to income tax and NIC. The appeal was therefore dismissed. The taxpayer appealed.

The first question was whether the transactions in question had conferred a profit or benefit upon the taxpayer that had derived 'from' his employment. It was held that the First-tier Tribunal had erred in law in that it had failed to focus correctly on the critical questions, namely whether there had been any real benefit to the taxpayer from the payment of the premiums and, if there was, whether it had arisen from his employment.

On the facts found both questions ought to have been to be answered in the negative. The First-tier Tribunal had misdirected itself in treating MMCL's intention as an irrelevant consideration. It was well established that the purpose of an employer in granting a benefit to an employee was an important factor in determining whether it was properly to be regarded as a reward or return for the employee's services. The First-tier Tribunal had further erred in failing to take proper account of the fact that the taxpayer had been a fiduciary and that, as soon as he became aware that he was the policyholder, he had an obligation to account to MMCL for the policies and any proceeds and to assign the policies to MMCL if and when it demanded it.

The second question was whether the continued payment of premiums until the assignation were earnings chargeable to income tax and NIC. MMCL had not intended to bestow the benefit of those payments on the taxpayer as a reward or return for his services as an employee or officeholder.

On the contrary, the intention from the inception of the policies until the assignation had always been that MMCL would be the beneficiary of the policies and of the policy premiums.

The discovery of the error had not altered that. The assignation had been a mechanism to confer title to the policies upon MMCL to reflect what had always been the parties' objective. The continued premium payments had been made in order to provide the benefit of insurance cover to MMCL, just as they had been before the error had been discovered. They were not a reward, return or remuneration for the taxpayer's services to the company nor were they earnings from his office or employment.

The appeal was allowed.

Contributed by Ros Martin

Retail, hospitality and leisure grants issues (Lecture B1222 – 12.46 minutes)

A business was eligible for a grant if:

- It was based in England;
- It was in the retail, hospitality or leisure sector; and
- It had a rateable value of under £51,000 on 11 March 2020.

Properties eligible for the grant will be those that are wholly or mainly being used as a hospitality, retail, or leisure venue, such as a:

- Shop;
- restaurant, café, bar or pub;
- cinema or live music venue;
- estate agent or letting agency;
- assembly or leisure property - for example, a bingo hall, a sports club, a gym or spa;
- hospitality property - for example, a hotel, a guest house or self-catering accommodation.

If the business had a property with a rateable value of £15,000 or under, the grant was £10,000.

If the business had a property with a rateable value of between £15,001 and £51,000, the grant was £25,000.

This article deals with the tax implications of the grant (it was confirmed that the grant was taxable from the outset), which will flow from the accounting treatment.

Accounting treatment

The grants were unconditional – the only requirement being that the business was in the sector. Local councils will have contacted businesses that were eligible.

FRS 102 and FRS 105 (UK GAAP) require the grant to be recognised when it was receivable i.e. on 11 March 2020. The Financial Reporting Faculty of the ICAEW has agreed with this and apparently has passed it by Financial Reporting Council, which also agreed.

Even if a business did not get confirmation that it is entitled to the grant until (say) mid-May but has a 31 March year end, this is an 'adjusting event' since it confirms an entitlement which existed at 11 March and therefore the grant should be recognised in year ending 31 March 2020.

The only remaining accounting issue is how it should be recognised in profit or loss. It would appear that the grant was simply to support the business and was not designed to cover specific costs, or losses in revenue over a given period of time.

As such, the grant should be recognised as income in the profit and loss account on 11 March 2020, when it was receivable.

Tax issues

This creates a problem for a business with a 31 March or 5 April year end – especially for income tax since the income is recognised in a profitable period, i.e. where the accounting period largely covers the period before lockdown, and before losses or lower profits started arising the next period of account.

For a company it merely accelerates the due date for payment but for income tax could result in tax payable at higher rates, problems with loss relief, waste of personal allowances etc.

One possible solution to mitigate any adverse effect is to change the accounting period (to 28 February before the announcement) or 31 July (after lockdown). It may also put pressure on finalisation of subsequent accounts to get the benefit of being able to carry back loss relief.

There is a potential issue in that tax returns and accounts may have been incorrectly completed without recognising the grant and there are accounting issues arising from this (prior year adjustments) and tax issues (having to amend prior period returns).

Example

A sole trader in the leisure sector has an accounting date of 31 March. The business received a Coronavirus Leisure Grant of £10,000 on 30 April 2020.

In its year ended 31 March 2020, the tax-adjusted trading profit is £48,000 before considering the grant. In the previous year, taxable profits were £36,000.

Since mid-March 2020, its business has been severely affected by Covid-19 and the sole trader is expecting to incur a loss in its year ended 31 March 2021 of approximately £25,000, ignoring the grant received.

Analysis

The grant needs to be included in the accounting period ending 31 March 2020. This increases the taxable profit to £58,000.

Assuming the taxpayer has no other income, this means that £2,000 of the grant is taxable at 20% and £8,000 of the grant is taxable at 40% which will need to be paid by 31 January 2021.

The loss of the following year will not be established until well after 31 March 2021 and so the carry back of that loss will not generate a repayment of tax until late 2021.

If the trader changes the accounting date to 29 February 2020, then the grant will not fall into this period. Assume that the profit for this period is £49,000 (March 2020 making a loss due to COVID-19).

The taxable profits for 2019/20 would be based on the 12 months to February 2020:

March 2019: 1/12th x 36,000	3,000
1 Apr 2019 – 29 Feb 2020:	49,000
	52,000

This gives a smaller taxable profit than with a 31 March 2020 accounting date, and creates £3,000 of overlap profits to carry forward.

The grant would form part of the profit for the year ended 28 February 2021, reducing the forecast loss for that period.

Contributed by Malcolm Greenbaum

Country by country reporting update

In releasing the outcomes of the third phase of peer reviews of the BEPS Action 13 country by country (CBC) reporting initiative, the OECD reports 'strong progress' in continuing efforts to improve the taxation of multinational enterprises (MNEs) worldwide. The report considers implementation of the CBC reporting minimum standard by jurisdictions as of April 2020, highlighting the following:

- the peer review now covers 131 jurisdictions;
- almost all MNEs over the €750m group revenue filing threshold are now covered;
- national implementation of CBC reporting is largely consistent with BEPS Action 13; and
- more than 2,500 bilateral relationships for CBC exchanges are now in place.

The report also notes that work is continuing on the 2020 review of the CBC reporting minimum standard and is expected to be completed this year.

Tax Journal (2 October 2020)

OECD publishes pillars one and two blueprints

The OECD/G20 Inclusive Framework on BEPS has published 'blueprints' for the two-pillar consensus-based approach to taxation of the digital economy. The blueprints reflect the 'convergent views' of the 137 jurisdictions signed up to the Inclusive Framework on many of

the key policy features and principles of both pillars, and identify remaining political and technical issues where differing views need to be bridged.

Pillar one blueprint (profit allocation principles) retains much of the three-part 'unified approach':

1. Amount A: local market jurisdiction right to tax a proportion of residual profits associated with sustained and significant participation in that jurisdiction.

Various issues on the scope of amount A remain to be resolved including on quantum (threshold amount and percentage rate), although the blueprint confirms a number of broad principles on amount A:

- it will apply to companies providing 'automated digital services' and 'consumer-facing businesses';
- it will include a revenue threshold based on annual consolidated group revenue, along with a de minimis foreign in-scope revenue carve-out;
- new nexus rules will determine which market jurisdictions receive amount A; and
- provision will be made for the carry forward of losses.

2. Amount B: standardisation of the remuneration of related-party distributors that perform 'base-line marketing and distribution activities', aligned with the arm's-length principle.

3. A dispute prevention/resolution mechanism, likely to require an 'innovative solution' to ensure agreement between tax administrations as to how Amount A applies to a group.

The blueprint also confirms the expectation that a consensus-based agreement will include a commitment to remove unilateral measures (such as digital services tax) and not to introduce any such measures in the future.

Pillar two blueprint (BEPS 2.0, ensuring a minimum level of taxation) sets out detail on:

- the income inclusion rule (IIR) based around existing controlled foreign company rule principles; and
- the undertaxed payments rule (UTPR) which acts as a backup to the IIR by making a top-up tax adjustment in relation to profits of a constituent entity that is not in scope of the IIR.

Together the IIR and UTPR are known as the global anti-base erosion (GloBE) rules. They would apply to MNE groups with €750m or more in annual revenues, and would by necessity rely on a common tax base. In essence, the GloBE rules would provide jurisdictions with the right to 'tax back' up to an agreed minimum rate of tax, where other jurisdictions have not fully exercised their primary taxing rights.

Alongside the GloBE rules, a subject to tax rule (STTR) will aim to restore taxing rights to the source jurisdiction where intragroup payments use tax treaty protection to shift profits to low-tax jurisdictions.

The OECD notes that the 'absence of a consensus-based solution could lead to a proliferation of unilateral digital services taxes and an increase in damaging tax and trade disputes, which would undermine tax certainty and investment. Under a worst-case scenario — a global trade war triggered by unilateral digital services taxes worldwide — the failure to reach agreement could reduce global GDP by more than 1% annually.'

In an OECD webcast, OECD deputy director Grace Perez-Navarro, said that while there was broad agreement on the need for the rules and on some elements of pillar one, thre is still disagreement over its scope, the calculation of amount A, and whether pillar one should be made optional, as the US has suggested.

Charlotte Richardson, UK tax partner at PwC, noted:

> 'This new framework has the potential to be a once in a lifetime change to the corporate tax system. If agreed, it would potentially remove the highly distortive, gross base taxes such as the recently introduced UK digital services tax (DST) and address the prospect of double taxation. In doing so, this could overcome a significant stumbling block in any UK/US trade negotiations.
>
> 'Nonetheless, there is still a long way to go and the complexity and implementation challenges shouldn't be underestimated. This is particularly important for UK businesses which not only have to adjust to a post-pandemic world but also to a post- Brexit environment.'

The Inclusive Framework is consulting on the blueprints until 14 December 2020 and public consultation meetings will be held in January 2021.

The Inclusive Framework countries had intended to move towards a consensus-based solution by the end of 2020, but the coronavirus pandemic has delayed the timings which are now likely to see no agreement before mid-2021 — calling into question whether existing unilateral DSTs will continue to be collected with the potential for retaliatory tariffs from the US.

Tax Journal (16 October 2020)

VAT

Ice-skating - single or multiple supplies (Lecture B1221 – 20.53 minutes)

Summary - Admission to an ice skating rink and hire of children's ice skates were separate supplies, being standard and zero rated respectively.

The Ice Rink Company Ltd and Planet Ice (Milton Keynes) Ltd ran ice rinks where customers could choose to pay for:

1. Admission to the rink only;

2. Rink admission and skate hire;

3. Skate hire only.

The companies claimed that where a customer paid for admissions to the rink as well as the hire of skates this was two separate supplies, with the admission charge being standard rated while the hire of children's skates was zero-rated. By contrast, HMRC argued there was a single supply of a skating package that was standard rated.

This case may well sound familiar as this was the second hearing by the First Tier Tribunal, the original hearing being back in 2017. The companies had been successful at the First Tier Tribunal but on appeal by HMRC, in 2019 the Upper Tribunal had concluded that the First Tier Tribunal had erred in law. The First Tier Tribunal should have considered the supplies from the perspective of customers of the skates and rink admission package (Option 2) rather than from the perspective of customers of the rinks as a whole (Options 1 to 3). The case was referred back to the First Tier Tribunal for a second hearing.

Decision

At this second hearing, the First Tier Tribunal concluded that customers were free to choose to buy skates outright, either from the rink shop or from a third party, or they could hire the skates when they paid for admission to the rink. Indeed, most customers were aware of this before they arrived at the rink. A typical customer seeking to hire skates and pay for admission would not regard the purchase as a single supply. They stated that:

"…it would by no means be artificial in this case to split the supply of the package into its two separate components. ".

There were multiple supplies with the supply of children's skates being zero -rated.

The Ice Rink Company Ltd Planet Ice (Milton Keynes) Ltd v HMRC (TC7829)

No supply of sub-contractors

Summary – With no evidence that the Intermediate Companies supplied sub-contractors to the company concerned, their input tax claim was denied.

Smart Organiser Limited is a UK resident company. It acts as an employment agency, and provides temporary workers as well as accounting, bookkeeping and tax services.

The company was involved in a number of property refurbishment projects which at the start, meant dealing with 47 different entities who were providing various workers for those projects. To simplify matters, three Intermediate Companies were set up to manage the sub-contractors so that so that Smart Organiser Limited only had to deal with these entities which would be treated as the "gang masters" for the project.

The three companies invoiced Smart Organiser Limited for the workers that were supplied, charging VAT on invoices raised. Initially the Intermediate Companies were not registered for VAT and did not have their own bank accounts. To solve this issue Smart Organiser Limited agreed to pay the sub-contractors themselves.

Smart Organiser Limited sought to recover the £110,000 VAT charged on the invoices raised.

HMRC refused the claim. The Intermediate Companies were not registered under the CIS scheme as contractors. They were registered as sub-contractors and so could not act as contractors and could not make a taxable supply of workers. The Intermediate Companies were not entitled to issue a valid VAT invoice. HMRC argued that the supplies were made directly by the sub-contractor workers to Smart Organiser Limited who made its payments directly to the sub-contractors, not to the Intermediate Companies.

Decision

The First Tier Tribunal questioned the commercial role of the Intermediate Companies as they did not receive any economic reward for their role.

It concluded that there was no evidence to suggest that supplies of staff were made by any of the Intermediate Companies.

There was no evidence of what was actually done by the Intermediate Companies, other than a generic description of each of the projects and (a list of the individuals who carried out the works at the project sites.

There was nothing to explain what services the Intermediate Companies were providing, over and above the value of the services provided by the individual sub- contractors.

The evidence showed that the work was carried out but did not show that the Intermediate Companies supplied the sub-contractors to Smart Organiser Limited.

The appeal was dismissed.

Smart Organiser Limited v HMRC (TC07815)

COVID - 19: Bad debt relief during the deferral period

Bad debt relief is available where a supplier has a bad debt that is more than six months old. However, for the relief to be available, the VAT due on the unpaid supply must have been paid over to HMRC.

In Spring 2020, the Government announced that businesses could defer VAT liabilities arising between 20 March and 30 June 2020. The CIOT asked HMRC to clarify what would happen where a business had both part paid and part deferred the VAT due in a VAT quarter falling within this period.

HMRC acknowledged that the bad debt relief provisions within the VAT Regulations 1995 do not expressly address the issue of part-payments. HMRC's view is that that a trader cannot choose which supplies part-payments made to HMRC relate to. Instead, the trader should apportion the total VAT paid for a period across the supplies made in that period to determine the VAT that was paid for the unpaid supplies. It is only this proportion that should be claimed as bad debt relief. HMRC stated that:

> " if a supplier paid "X"% of the tax due for the VAT period when it made the supplies, it can claim that same % of the VAT on bad debts subsequently arising from the supplies it made in that VAT quarter."

https://www.tax.org.uk/policy-technical/technical-news/covid-19-interaction-between-vat-bad-debt-relief-payments-account

Online account to keep the supply of goods flowing

Summary – With no economic activity, no business was being carried on and the input VAT claim was denied.

Y4 Express Limited was incorporated in May 2010 and arranges for the importation of goods from companies based in China and Hong Kong to the UK. The company collects goods from the airport, stores them if required, and sorts and arranges delivery of the goods to the final customer. The company uses delivery companies such as UPS, DPD, Yodel and Royal Mail to deliver the goods and typically settles the cost of the deliveries on a monthly basis.

Y4 Express Limited made use of Royal Mail's Online Business Account scheme for high-volume customers, providing delivery at lower rates. Under this scheme, the company was required to make daily declarations of the items that it sent via the system. Royal Mail then used this information to calculate the amount owed by Y4 Express Limited and invoice accordingly.

As a result of spot checks that were carried out by Royal Mail in 2013, they raised concerns that the items declared under the scheme were being understated. Subsequently, the account was suspended, meaning that the company could not use Royal mail for their deliveries.

Through personal contacts, a director at Y4 Express Limited arranged for two Royal Mail Online Business Accounts to be set up: one through a friend, Mr Man; and the second through a company, Colemead Limited, set up by a personal contact. Using their login details, Y4 Express Limited continued to use the Royal mail facility. Royal Mail issued invoices to Mr Man and new entities, which in turn raised invoices to Y4 Express Limited. The company sought to reclaim the related input tax.

HMRC disallowed the claim arguing that Y4 Express Limited had received no supplies of goods or services from either Mr Man or Colemead Limited. Neither Mr Man nor Colemead Limited processed orders, interacted with customers nor sought new customers. They did not pursue any activities of any significance. With no 'economic activity' or business, they should not be registered for VAT. HMRC issued penalties relating to the excessive input tax claim on the basis of 'deliberate and concealed behaviour'.

Decision

The First Tier Tribunal agreed with HMRC. Neither Mr Man nor Colemead Limited received any commission for their involvement. Indeed, they were pretty much unaware of what was going on. There was no business activity being carried out. Y4 Express Limited was not eligible for a refund of input VAT.

If the dispute with Royal Mail had never arisen, Y4 Express Limited would have been able to reclaim the input tax on the Royal Mail invoices. By inserting a third party to solve their problem, Y4 Express Limited came unstuck. Y4 Express Limited's appeal against the assessment was dismissed but the penalties were reduced, based on careless rather than deliberate behaviour.

Y4 Express Limited v HMRC (TC07777)

MTD for VAT - Update (Lecture B1223 – 23.29 minutes)

Making Tax Digital has been heralded by HMRC as both offering significant administrative savings to businesses and in addition considerable additional tax take for the exchequer – the latter claim based mainly on the reduction of errors but also the opportunity for HMRC to police the tax system more effectively.

From 1 April 2019 all businesses with taxable supplies in excess of the VAT threshold have been required to submit returns through MTD enabled software. For businesses using accounting software this has been possible through their accounting software, but for many smaller businesses this has been through the medium of what is known as "bridging software", which provides a link through spreadsheets from basic record keeping functions to filing the return.

From April 2021 the mandation of digital links, which was planned for 1 April 2020 will be implemented, and from April 2022 all VAT registered businesses must file their VAT returns through the MTD process, and keep digital records in accordance with the legislation.

What are the requirements – who and when?

Businesses with taxable supplies in excess of £85,000 in a 12-month period must join MTD from1 April 2019 onwards.

Businesses that are not yet mandated but are registered for VAT need to check their turnover monthly and join MTD from the next quarter after they meet the threshold.

For example, a business with VAT quarters ending in February, May, August and November should check the value of their supplies each month, and if they exceed £85,000 in September 2020 then they are mandated into MTD for VAT from 1 December 2020.

Voluntary application of MTD for VAT

A business which is registered for VAT can elect to keep records and file according to the MTD rules and is also free to choose to leave MTD and file under the old rules should they wish to.

Accounting software

Businesses within the new regime must keep digital records. However, HMRC uses the term "functionally compatible software" to specify how digital records must be kept and returns submitted to HMRC. Here is some guidance on that issue.

Example 1

A business receives an invoice and types selected data contained in the invoice into functional compatible software. They must still keep the invoice in its original form as the data in the functional compatible software is not a copy of the invoice.

Example 2

A business has functional compatible software that scans the invoices received and puts the information in its ledger. If the image is retained and contains all the detail required for VAT purposes then the business does not need to keep the original invoice unless it is required for another purpose.

If you deregister from VAT you will no longer need to keep digital records in functional compatible software, but you must retain your VAT records for the required period.

Functional compatible software is a software program, or set of software programs, products or applications, that must be able to:

- record and preserve digital records;
- provide to HMRC information and returns from data held in those digital records by using the API platform;
- receive information from HMRC via the API platform.

HMRC expects that there will be software products available that will perform all of the functions listed above. Some software programs will not be able to perform all of these functions by themselves. For example, a spreadsheet or other software product that is capable of recording and preserving digital records may not be able to perform the other 2 functions listed above, but can still be a component of functional compatible software if it is used in conjunction with one or more programs that do perform those functions.

The complete set of digital records to meet Making Tax Digital requirements does not all have to be held in one place or in one program. Digital records can be kept in a range of compatible digital formats. Taken together, these form the digital records for the VAT registered entity.

"End to end digital" – digital links

The expectation is that transfers of data between elements of the software systems will be achieved by digital links and not retyping or cut/copy and paste. This aspect is the subject of a "soft landing" allowing businesses an extra 12 months to create the necessary digital links between their functional software. Here is the guidance on that topic:

Digital links

Data transfer or exchange within and 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.

Once data has been entered into software used to keep and maintain digital records, any further transfer, recapture or modification of that data must be done using digital links. Each piece of software must be digitally linked to other pieces of software to create the digital journey.

It follows that transferring data manually within or between different parts of a set of software programs, products or applications that make up functional compatible software is not acceptable under Making Tax Digital. For example, noting down details from an invoice in one ledger and then using that handwritten information to manually update another part of the business functional compatible software system.

A 'digital link' is one where a transfer or exchange of data is made, or can be made, electronically between software programs, products or applications. That is without the involvement or need for manual intervention such as the copying over of information by hand or the manual transposition of data between 2 or more pieces of software.

A digital link includes linked cells in spreadsheets, for example, if you have a formula in one sheet that mirrors the source's value in another cell, then the cells are linked.

HMRC will also accept digital links as:

- emailing a spreadsheet containing digital records to a tax agent so that the agent can import the data into their software to carry out a calculation (for instance, a Partial Exemption calculation);

- transferring a set of digital records onto a portable device (for example, a pen drive, memory stick, flash drive) and physically giving this to an agent to import that data into their software;

- XML, CSV import and export, and download and upload of files;

- automated data transfer;

- API transfer.

However, as this aspect may prove very challenging, HMRC announced a 'soft landing period' for businesses to action the full digital links requirements. This was extended as a result of Covid and now ends on 31 March 2021.

You should, however, be aware that the soft landing for digital links only applies to data moved within the functional software. When a separate package is to be used to submit the return figures prepared within the software, the transfer of data at this point MUST be by digital link from the start of MTD. This will most generally apply to spreadsheets used with bridging software to submit the return.

Manual calculations and input

The guidance does accept that some specific calculations will need to be manually input into software to prepare the figures for the VAT return. This is acceptable – the example given is capital goods scheme adjustments, but this could equally apply to fuel scale adjustments and partial exemption calculations.

What are the requirements for digital records?

The records listed in the following paragraphs must be kept, maintained and preserved in digital form. The regulations refer to this information as your 'electronic account'. The exact way you must enter the information will depend on the software package you have. Contact your software provider if you are unsure how to enter information into your software. HMRC can only provide advice on the legal requirements of Making Tax Digital.

You will need to keep additional records, such as invoices. You do not have to keep these digitally but you may choose to do so. For more information on the additional records that must be kept for VAT purposes, see VAT Notice 700/21: keeping VAT records.

Supplies made

For each supply you make you must record the:

- time of supply (tax point);
- value of the supply (net value excluding VAT);
- rate of VAT charged.

This only includes supplies recorded as part of your VAT Return. Supplies that do not go on the VAT Return do not need to be recorded in functional compatible software. For example intra-group supplies for a VAT group are not covered by these rules.

The time of supply is the date that you must declare output tax on. Typically this is when you send a VAT invoice or, if you are on cash accounting, when you receive payment for the supply.

Where more than one supply is recorded on an invoice and those supplies are within the same VAT period and are charged at the same rate of VAT you can record these as a single entry.

Example 1

You sold 10 standard rated items and 15 zero rated items on a single invoice then you would only need to record the total figures for each of the VAT rates.

Example 2

You are on standard accounting and a customer makes a part payment before you send out an invoice. If the payment and invoice were received and sent in the same period, you can record the supply as one transaction with one transaction date. Otherwise, where one supply needs to be recorded in different periods the precise manner will depend on the software. This could be done by splitting the amounts out, or the software may allow one line to show different periods for the VAT to be recorded.

You must also have a record of outputs value for the period split between standard rate, reduced rate, zero rate, exempt and supplies which are outside the scope of UK VAT. However, you only need to keep a digital record of 'outside the scope' supplies that you are required to include in your VAT Return.

The following rule has the force of law:

> Where you need to apportion the output tax due on a mixed rate supply with a single inclusive price you do not have to record these supplies separately. You can record the total value and the total output tax due.

Not all software will allow you to record a rate of VAT other than the standard, reduced or zero/exempt. If this is the case, this mixed supply should be recorded as either one standard rated supply and one zero rated supply or you can record the sale at one rate and correct the VAT through an adjustment at the end of the period. You will also need to do this if you are using a margin scheme or the flat rate scheme.

Supplies received

For each supply (my emphasis) you receive you must record the:

- time of supply (tax point);
- value of the supply;
- amount of input tax that you will claim.

This only includes supplies recorded as part of your VAT Return, supplies that do not go on the VAT Return do not need to be recorded in functional compatible software. For example, wages paid to an employee would not be covered by these rules.

There is no requirement under the regulations to record inputs for the period split by VAT rate.

The time of supply is typically the date on the VAT invoice or, if you are on cash accounting, when you pay for the supply. However you must also hold the associated evidence to claim deduction of input tax.

If more than one supply is on an invoice you can record the totals from the invoice. Where the amount of input tax that you will claim is not known at the time you record the supply you have received, you can record:

- the total amount of VAT and adjust for any irrecoverable VAT once calculated;
- no VAT and adjust for any recoverable VAT once calculated;
- VAT recoverable based on an estimated percentage and adjust for any VAT once calculated.

Commentary

The very light requirements make keeping records on a spreadsheet for those who have previously kept manual records a sensible option, but may encourage businesses to seek the "minimum viable" requirement as opposed to changing the business records completely. This will make the transition to MTD for income tax much more challenging.

For very small businesses using the bank as a source of data for transactions this presents a potentially major change in record keeping. Most small businesses will not keep a purchase ledger and enter payments only as they are made, based on the payment from the bank records. The requirement that each supply be recorded separately means that payment of a batch of invoices all of which are standard rated and all of which have tax points in the same VAT period cannot be recorded as a single item but must be spilt into the individual supplies.

Where a client runs a purchase ledger it is likely that the transactions are entered invoice by invoice so that the requirement is already met.

Adjustments

Where you are allowed or required to adjust the input tax claimed or output tax you owe according to the VAT rules you must record this adjustment in functional compatible software. Only the total for each type of adjustment will be required to be kept in functional compatible software, not details of the calculations underlying them.

If the adjustment requires a calculation, this calculation does not have to be made in functional compatible software. If the calculation is completed outside of functional compatible software then digital links are not required for any information used in the calculation. However using software for all your calculations will reduce the risk of errors in your returns.

The following rule has the force of law:

> Where the input tax claimed or output tax due on a supply has been changed as the result of an adjustment you do not need to amend the digital record of the supply.

Flat rate scheme

The following rule has the force of law:

If you account for VAT using the Flat Rate Scheme:

- you do not need to keep a digital record of your purchases unless they are capital expenditure goods on which input tax can be claimed
- you do not need to keep a digital record of the relevant goods used to determine if you need to apply the limited cost business rate

If your software does not include a Flat Rate Scheme setting, and does not allow you to include a rate of VAT other than standard, reduced, zero/exempt, then you will need to record the supply as either one standard rated supply and one zero rated supply. Alternatively, you can record the sale at one rate and correct the VAT through an adjustment at the end of the period, using the same method HMRC will allow you to use to correct the VAT on a mixed supply.

Margin schemes

You are not required to keep the additional records required for these schemes in digital form, nor are you required to keep the calculation of the marginal VAT charged in digital form. These records must still be maintained in some format.

If you do keep a digital record and your software does not allow you to record the VAT on the margin, then you will need to record the supply as either one standard rated supply and one zero rated supply. Alternatively, you can record the sale at one rate and correct the VAT through an adjustment at the end of the period, using the same method HMRC will allow you to use to correct the VAT on a mixed supply.

Returns

The requirement is that returns are submitted through functional compatible software. The return consists (presently) of the nine boxes submitted under the general VAT regulations, boxes one to five dealing with the VAST element of supplies and boxes six to nine dealing with the value of transactions in the VAT accounting period.

Bridging software has been developed to provide a link from records based in simple spreadsheets to the VAT submission architecture.

Next steps

From April 2021 the digital links soft landing comes to an end but given that an extra 12 months was allowed for this, it should not present any particular problems for most businesses.

So the next step is the mandation of the remaining VAT population with effect from 1 April 2022.

Businesses which are VAT registered but keeping manual records will have to move to digital records over the next 18 months and it is wise to start planning for imp0lementation now. It is also worth taking into account what the requirements for bookkeeping are likely to be under making tax digital for income tax, as that will follow quite quickly after.

Firms will need to make decisions about what software they will be encouraging their clients to use and supporting the move to more sophisticated digital records for those who need it.

Contributed by Rebecca Benneyworth

MTD VAT issues **(Lecture B1224 – 21.40 minutes)**

Digitally excluded - Grounds for an exemption

Businesses are exempt from MTD if they are above the threshold but the exemptions apply and the business has applied for and been granted exemption. The grounds for exemption are:

- It is not reasonably practicable for you to use digital tools to keep your business records or submit your VAT Returns because of age, disability, remoteness of location or for any other reason;
- you or your business are subject to an insolvency procedure;
- your business is run entirely by practising members of a religious society or order whose beliefs are incompatible with using electronic communications or keeping electronic records.

Note that if the religious exemption is sought for a partnership all members of the partnership must be entitled to the exemption for an exemption to be granted.

Applying for an exemption

To make a claim for exemption, call or write to VAT: general enquiries. HMRC's guidance in Section 3 of Notice 700/22 provides the following help:

You'll need:

- your VAT Registration Number;
- your business name and principal place of business;
- the reason for your exemption request;
- details about how you currently file your VAT Returns;
- the reasons why you would not be able to file returns through software or keep digital records (even if you can file using VAT online services);
- any other reason why you cannot follow the rules for Making Tax Digital.

You can ask an agent, friend or family member to ask for an exemption on your behalf, but they must:

- fully understand your circumstances in relation to getting an exemption;

- have authority to act on your business' behalf - such as written authorisation sent to HMRC or verbal authorisation on a phone call.

It's usually better to call HMRC yourself as you'll have a better understanding of your abilities and how you engage with technology in your personal life. The helpline advisers will talk to you about support that HMRC can provide to help you transition to Making Tax Digital.

Whilst HMRC intends to deal with as many telephone requests as possible, we may ask you to make a request in writing.

HMRC will make a decision after you have provided all the necessary information. If you write to us or call us to request an exemption, you'll receive our decision in writing.

Benefits of using accounting software

One of the intentions behind a digital revolution is for businesses to benefit from the advantages that using simple accounting software offers, with more up to date business information enabling better management decisions.

It is likely that the future will bring cheap digital solutions for many businesses and offer cost savings in record keeping and accuracy which will outweigh any additional costs of software or hardware upgrades.

Practices should think carefully about the future of MTD more widely, when all businesses will be required to keep digital records – and adopting a pragmatic approach tailored to clients' needs may pay dividends – but this of course will take time to roll out. Hence the need to think carefully about how MTD will be adopted across the client base.

Migration of all VAT clients to new IT system

Unless clients are registered for MTD their VAT records are held on the HMRC VAT mainframe, a very old computer system which is expensive to keep up to date largely due to its age. This system has limited capabilities and cannot communicate with any other HMRC systems, and is to be replaced. The work to start "mothballing" the old VAT mainframe will take more than a year in total, but it is intended to commence that work in 2021.

Enterprise Tax Management Platform (ETMP)

This is the new hub for taxpayers central to the MTD system and a joined up approach to dealing with all taxpayers, but it is particularly important to the affairs of businesses that might be registered for a number of taxpayers. It will act as a Master File of all taxpayers enabling better and more joined up access to the tax records of a particular individual or business. When businesses enrol for MTD for a particular tax their records are migrated from the old legacy systems to ETMP for that tax.

For example, a Self Assessment business which is VAT registered will probably only be enrolled in MTD for VAT. Their VAT records will already be on ETMP, but the SA records remain on the SA system (a separate computer system) until they join MTD for income tax.

The work to decommission the old VAT mainframe means that all VAT businesses will have to be migrated to ETMP, whether they are enrolled for MTD or not.

Impact on MTD clients

There is no impact associated with the changes in 2021 on businesses already enrolled in MTD. There will be no changes to the way that they or their agents submit returns.

Impact on non-MTD VAT businesses

These businesses will be migrated over approximately April to October 2021. Once migrated there may be an impact on the way returns are filed by a business, depending on the software they are using to file returns. HMRC has notified software providers of the changes and asked them to update their customers if any changes are needed. It is anticipated that the number of businesses affected by the issue will be very small.

However, there is a major impact for agents filing VAT returns on behalf of non-MTD clients.

The existing filing route by logging into your agent portal and selecting VAT from your list of services and then filing a return for a particular client will end as clients are migrated to ETMP.

Clients who have been migrated will need to be moved (by the agent) to their new Agent Services Account and returns filed from there (it will still be a non-MTD filing).

You will not know which clients have been mandated until you attempt to file a return under the old method, and if it fails then you will have to move the client across to your Agent Services Account and file from there.

My suggested solution

For those clients with digital records, or for whom digital records could be implemented fairly easily, this problem can be avoided by enrolling as many clients as possible into MTD during the period from now until March 2021. This will remove the uncertainty explained in the previous paragraph and provide a smooth transition, given that MTD will be mandated for these clients in April 2022 in any event.

Email addresses for direct debit clients

From April 2021, HMRC will require an email address for all clients who have registered for direct debit payment. This is because HMRC is required under banking law to notify the customer before the direct debit is taken of the date and amount of the direct debit.

Given that HMRC will only know the amount when the return has been filed, there is only one practical way to notify businesses and that is electronically. Hence the requirement for email addresses. Your clients will need to log onto their business tax account to check that they have entered an email address in order to continue to pay by direct debit. Once the change has been made next year, HMRC will not action direct debits unless they have been able to notify the customer in advance, which could lead to non-payment of liabilities and eventually penalties.

Contributed by Rebecca Benneyworth

Policy change – R&C Briefs 11 and 12/2020 (Lecture B1225 – 13.47 minutes)

Early termination fees and compensation payments – R&C Brief 12/2020

HMRC issued a Brief on 2 September 2020, stating its new policy that early termination fees and compensation payments that relate to contracts are now subject to VAT in most cases. The previous policy was that the payments were outside the scope of VAT because they did not relate to a specific supply of goods or services.

This issue is important for both suppliers and customers. A VAT charge will not be claimable as input tax by a business that makes exempt supplies, or is partially exempt. And suppliers receiving compensation fees could be faced with a large assessment for VAT owed on past supplies, as the policy change is retrospective.

Example

Mary trades as an insurance broker and is dissatisfied with the services provided by the office cleaners at her premises. She has decided to cancel the contract but must pay a termination fee equal to six months of cleaning fees to the supplier. HMRC now regards the charge by the cleaners as being subject to VAT, even though no cleaning work will be done in return for this payment. This will be an extra cost to Mary because her insurance business is partially exempt and cannot fully claim input tax.

The Brief states that fees will still be subject to VAT, even if the payment is agreed by the two parties through a separate agreement, i.e. it is not relevant to a specific clause in an existing contract.

CJEU tribunal cases

HMRC's policy has changed because it has reviewed the outcome of two VAT tribunal cases heard in the Court of Justice of the European Union (CJEU) and decided its own interpretation of the legislation was incorrect.

The first case Meo (C-295/17) related to payments made by customers with mobile telephone contracts, who had to make a one-off payment to escape a contract early. The charge was reasonable because the customer had received a discount on the deal because of the extended period of the contract. The Portuguese tax authorities assessed Meo for output tax on the payments but Meo claimed they didn't relate to any actual supply of services and should not be subject to VAT. The CJEU agreed with the tax authority that the payments related to remuneration for a supply of services. The mention of the payment being a 'penalty' for early termination was irrelevant. The other case was Vodafone Portugal C-43/19 with similar principles.

The difference between the two CJEU cases was that in the Meo case, the customer had to make a full compensation payment to cancel their mobile phone contract ie paying the same amount of money as if the contract had continued until it expired. In the Vodafone Portugal case, there was a specific formula used to determine how much compensation the customer needed to pay – this would be less than the full contract value. But the VAT outcome was the same: the remuneration received by both companies directly related to a VATable mobile phone contract and tax was therefore payable on the cancellation fees.

HMRC guidance

If your clients provide any services where early termination fees and compensation payments are earned, it must review the VAT position urgently.

HMRC has issued new guidance about the changes: VAT Supply and Consideration Manual: VATSC05910 to VATSC05930.

Policy change is retrospective

HMRC has confirmed that the change in policy announced in the Brief is retrospective. The exception is if a business has received a past ruling from HMRC confirming that its termination fees and compensation payments are not subject to VAT. In such cases, the revised policy must be applied from the date of the Brief i.e. from 2 September 2020.

A business must adjust errors for the last four years where output tax has been understated, using the usual VAT correction procedures: VAT Notice 700/45. This is unexpected because HMRC's own manuals previously stated that these payments were outside the scope of VAT.

But the manuals are not VAT law and HMRC says that it must apply the law correctly. The previous incorrect guidance has been removed from the manuals.

A telephone ruling from HMRC should be acceptable as evidence of a past ruling, as long as you or your clients kept the call reference number that should have been provided by the officer. Even if you do not have a call reference number, it is likely that HMRC will be able to find details of the call on their system via your client's VAT registration number.

Input tax

The issue of termination fees and compensation payments is not only important for your clients who must decide if they should charge VAT on the fees they have received in the past and will receive in the future.

It is also important if you have clients who have cancelled or terminated contracts but cannot fully claim input tax on their expenses, i.e. their business is exempt or partially exempt. The VAT charged by the supplier whose contract has been cancelled will be an extra cost to your clients' business.

Even if your clients can claim input tax because their business is fully taxable, it is always important to check if VAT charged made by a supplier is correct. Input tax cannot be claimed on incorrectly charged VAT.

Descriptions are no longer the key issue

In the past, a question about the VAT liability of a source of income would be influenced by the use of words in contracts and on invoices such as 'cancellation fee,' 'termination payment,' 'penalty for ending contract early.' However, this approach can no longer be adopted - to quote directly from HMRC's Supply and Consideration Manual VATSC05910:

"Whether a payment is for a VAT supply depends on whether anything is done in return for consideration. Where a party agrees to do something in return for a fee there is a supply. How that fee is described does not affect whether there is a supply for VAT."

"Most early termination and cancellation fees are therefore liable for VAT. This is the case even if they are described as compensation or damages."

Guidance note VATSC05920 confirms that VAT is due even if a separate cancellation agreement is made between the parties, i.e. outside the terms of the original contract.

Compensation payments in other situations

Despite the radical change of policy by HMRC, there will still be some compensation payments that will be outside the scope of VAT. For example, penalties and fines that are charged as a result of customer behaviour will still be VAT free in most cases.

Example

Seaside Guest House has a policy that if a guest smokes in their room, the hotel will apply a cleaning charge of £100. This is a compensation payment to the hotel for the extra cleaning costs caused by the guest's misdemeanour. There is no supply of goods or services by the hotel to the guest and the payment will be outside the scope of VAT.

In this situation, there is no termination fee or compensation payment that directly relates to a contract for services between the two parties. This is a useful issue to consider when reviewing the VAT liability of income received by your clients.

Lease variations - R&C Brief 11/2020

It is quite common at the moment for landlords to offer rent discounts to tenants to help with the financial problems caused by the Covid-19 crisis. In most cases, the discount offered will be reflected in a reduced rental payment. The motive for the discount is so that the landlord is not faced with an empty building and no income if the tenant goes bankrupt or has to cease trading. In some cases, the reduced rent might be conditional on the tenant having to perform a separate service or services in return for the discount. These services might be subject to 20% VAT. An example will illustrate the issue:

Example

The owner of a commercial warehouse has not opted to tax the building and therefore the rent charged to the car dealer tenant who trades there is not subject to VAT i.e. exempt rental income.

As a result of the Covid-19 crisis, the landlord has agreed to reduce the rent by £5,000 per month for the next 12 months and £2,000 per month for the following six months.

A condition of the discount is that the tenant must redecorate the entire building and also have new windows put into the main showroom. These expenses would normally be paid for by the landlord.

In this situation, the work performed by the tenant has a monetary value to the landlord – not all of the £72,000 of rent discount but perhaps a percentage of it. If the landlord had opted to tax the building, it would not be a problem because they could issue cancelling sales invoices (plus VAT) for 'extra rent' and 'building improvement works' i.e. no net loss of tax to HMRC. But the exempt rent creates a VAT loss to HMRC.

Extracts from Business Brief:

> "If, however, the tenant agrees to do something in exchange, this could be classed as a payment for a supply by the tenant to the landlord - unless they are only agreeing to accept the normal responsibilities of a tenant, such as paying rent. If the tenant agrees to do something more, it is likely that:
>
> - the tenant is making a supply and the rent reduction will be the value of the supply – whether the supply is taxable or exempt will depend on what the tenant agrees to do, in the same way as if they were being paid to do it;
>
> - the landlord must account for the VAT as though the rent was still being paid if they have opted to tax the property.
>
> If both supplies are taxable at the standard rate:
>
> - the amounts of VAT due on each supply are likely to be the same;
>
> - the landlord and tenant will need to issue VAT invoices to each other if either of them is registered for VAT".

Contributed by Neil Warren

Streamlining optician and hearing aid supplies

Revenue and Customs Brief 14/2020, effective from 1 October 2020, explains the simplifications being introduced for opticians and dispensers of hearing aids when accounting for VAT on their supplies. The changes will take effect from 1 October 2020.

Opticians that dispense spectacles or contact lenses are treated as making two supplies for VAT purposes:

1. Supply of spectacles or lenses, which are taxable at standard rate;

2. Supply of dispensing services, which is exempt from VAT.

Similarly, dispensers of hearing aids make a taxable supply of hearing aids and an exempt supply of dispensing services.

Currently such businesses can choose to account for VAT on the taxable element of their sales, by:

- using separately disclosed charges for each supply, notifying each separate charge to the customer at the time of sale;

- charging a single price to the customer and making a fair and reasonable apportionment of the income between the taxable and exempt elements of the supply, using a method of their choice, which must be approved by HMRC.

From 1 October 2020 traders:

- will only need to hold a till slip or similar evidence to demonstrate that they are making two separate charges to the customer at the time of supply, and that this information is being conveyed to the customer;

- using a method of apportionment will no longer require the seeking of prior approval from HMRC before operating a method.

Revenue and Customs Brief 14/2020

R&C Brief 15 (2020): Input VAT recovery by non-owners

This brief explains the outcome of HMRC's review of the policy outlined in R&C Brief 2 (2019) that was issued in April 2019 concerning the correct treatment for deduction of import VAT paid by taxable persons that are not the owners of the relevant goods.

R&C Brief 15 (2020) confirms that only the legal owner of the goods:

- is eligible to reclaim import VAT. Their details should be included in box 8 of the import declaration;

- who can used postponed VAT accounting; other persons involved in the import of the goods are not able to use the process.

https://tinyurl.com/y66q46vp

Electronically Supplied Services (B2C) **(Lecture B1221 – 20.53 minutes)**

The place of supply for all suppliers of B2C electronic services is where the customer belongs which means that in each EU country of download there will be an obligation to register for VAT.

Non-established traders do not enjoy the registration threshold that applies to established traders so £1 of sales in a country will require registration in that country. A business making sales in a number of EU countries is required to register in each of those countries. In order to simplify their registration obligations, businesses can choose to use the MOSS scheme. This will be the union MOSS scheme for EU suppliers and the non-union scheme for non-EU suppliers. From 1 January 2021 the UK will have to access to non-union scheme.

Example – Zoom licences

Zoom is a USA based supplier of electronic services who use the non-union MOSS scheme to deal with their EU VAT liabilities.

A UK VAT registered company buys a Zoom licence. When setting up their Zoom account, they did not enter their VAT number in the set up procedures. As far as Zoom is concerned, they are invoicing B2C and will account for UK VAT via their non-union MOSS registration. Invoices will be received by the UK company with UK VAT charged but no UK VAT number is shown on the invoice. These are not VAT invoices for recovery purposes as VAT has not been properly charged.

The UK company should provide their UK VAT number to Zoom so that the services can be correctly classified as B2B services with a mandatory reverse charge on the UK company.