Tolley®CPD

November 2021

Disclaimer

CONTENTS

Personal tax 5
Incorrect PAYE coding and additional rate tax 5
Leased cars as a taxable benefit 6
Loans taxable as distributions 9
Betting business transferred to Gibraltar 10

Capital taxes 12
PPR on separate building 12
UKIP donation appeal fails 13
'Normal expenditure out of income' (Lecture P1284 – 8.53 minutes) 14
Woodland was residential property 16
Multiple Dwellings Relief and planning permission 16

Administration 19
Form 17 and its uses (Lecture P1283 – 9.28 minutes) 19
Alternative Dispute Resolution (Lecture P1285 – 14.45 minutes) 20
Loss creation scheme notifiable under DOTAS 23
Continued failure to comply with information notice 24
Accelerated Payment Notices and PAYE 25

Deadlines 26

News 28
Scottish Budget date announced 28
Taxis and private hire vehicles and scrap metal dealers 28
Return to the old system for registering for self-employment 28

Business Taxation 30
National insurance payable as an employee or partner? 30
Family Investment Companies (FICs) (Lecture P1282 – 17.08 minutes) 30
Extended loss carry-back for stand-alone companies (Lecture B1282 – 16.04 minutes) ... 32
Further guidance on extended loss carry-back claims (Lecture B1283 – 15.47 minutes)... 33
Penalty imposed for potential lost revenue 35
Payment to director was not deductible 36
SME relief for R&D costs (Lecture B1284 – 22.15 minutes) 37
R&D claim fails 43
How should transfer pricing adjustments be charged? 44

VAT and indirect taxes 45
Not aware of the 7-day rule 45
Hay making business or not? 46
Treatment of freemasons' membership fees 47
R&C Brief 13 – Construction self-supply charge 48
Practicalities of the VAT option to tax (Lecture B1285 – 34.28 minutes) 49
Changes to the VAT group registration and amendments forms 51

Personal tax

Incorrect PAYE coding and additional rate tax

Summary – HMRC issued valid discovery assessments to an employee who failed to declare employment income and related tax on two tax returns. It did not matter that the employer should have deducted the additional tax through PAYE.

Bruno Giuliani worked for Oliver Wyman Ltd until 10 January 2010, when he started new employment with an investment bank, earning in excess of £150,000. The bank requested a form P45, which Bruno Giuliani claimed to have supplied but which the bank did not have on its records. As a result, until April 2011, the bank operated a basic rate tax code for him despite him being subject to the additional rate tax. Consequently, for both 2009/10 and 2010/11, tax deducted from his pay was understated.

In January 2011, having received a notice to file a Self Assessment return for 2009/10, Bruno Giuliani filed his return electronically. This was the first year for which he had been asked to complete a Self Assessment return. By this time, he had been working in the UK for a number of years and believed that under the PAYE system, income tax was deducted by the employer, who paid it over to HMRC. He believed that his understanding was confirmed when he read the introduction to the Self Assessment return guidance which stated: "Tax is usually deducted automatically from wages, pensions and savings. People and businesses with other income must report it in a tax return…". Consequently, he did not include any employment income on his tax return as he believed that this was not needed as this tax had already been collected by his employer through PAYE.

In March 2011, the Bank's Payroll Governance Manager, contacted him stating: "during our end of tax year review we identified that you are currently on the Basic Rate tax code…. You are on this code because we have not received a P45 or P46 from you. Depending on your personal circumstances you may owe more taxes than we have withheld". The Payroll Governance Manager went on to suggest that he should speak to his tax adviser, or the Ernst & Young helpline established by the Bank to establish the implications of the Basic Rate coding and appropriate course of action. He did not take up this offer of support, expecting the bank to sort out the problem.

In March 2016, HMRC reviewed Bruno Giuliani's Income Tax returns for the tax years ended 5 April 2010 and 5 April 2011 and concluded there was an insufficiency of tax declared in both years and that he had been at least careless in filing inaccurate returns. HMRC issued s.29 discovery assessments for both 2009/10 and 2010/11 seeking to collect £123,000 of unpaid tax, using the extended time limit provided under s.36 TMA 197, where a loss of income tax is brought about carelessly by the taxpayer.

Bruno Giuliani appealed. He did not believe that he had acted carelessly. He was not trying to hide his employment or the income from it. HMRC knew he was employed by the bank, the income he received and the tax deducted. He argued that the error in his tax code, and therefore the underpayment of tax, was the bank's error. He argued that there was no loss caused by him for the purpose of making a valid discovery assessment. The loss of tax was caused by the bank using the incorrect PAYE coding and he was entitled to a credit for "tax treated as deducted" under Reg. 188 Income Tax (PAYE) Regulations 2003 because the bank was liable to deduct the correct income tax due from payments but had failed to do so.

HMRC argued that Reg. 188 did not apply to discovery assessments under s.29 TMA 1970. Therefore, when considering whether there has been a loss of tax, Bruno Giuliani was not entitled to any credits for PAYE deductions that should have been made but which the Bank did not make.

Decision

The First Tier Tribunal found that Bruno Giuliani had most likely submitted his form P45 to the bank on commencing employment. It transpired that the bank had problems in operating its PAYE system and he was one of more than 300 employees who had experienced a similar tax coding error.

The First Tier Tribunal accepted that Bruno Giuliani had not deliberately submitted incorrect returns with a view to gaining a tax advantage but he had acted carelessly. Given that HMRC had requested a tax return, he should have checked his understanding of what was required and not relied solely on the introduction to the guidance. On close inspection, the word 'usually' used in the sentence that he relied on, implied that this was not always the case. He should have referred to the full guidance notes on employment income. Further, by the time he was completing his 2010/2011 return, he knew that his employment taxes were not correct as his employer had notified him of his tax code problem and recommended that he should seek advice. The Tribunal found that the discovery assessments were validly raised.

In the Stephen Hoey case, the Upper Tribunal found that sums treated as deducted under Reg.188 do not apply to s.29 TMA 1970 discovery assessments. Consequently, the First Tier Tribunal rejected Bruno Giuliani's argument that he was entitled to credits for PAYE deductions that should have been made.

The appeal was dismissed.

Bruno Giuliani v HMRC (TC08188)

Leased cars as a taxable benefit

Summary – Despite full reimbursement, cars leased by a company and made available to its directors were taxable benefits liable to Income Tax and Class 1A NICs. The directors had not acted carelessly resulting in some assessments and penalties falling out of charge.

Lisa Garrit and Brian Garrity were shareholders and directors of Smallman & Sons Limited.

The company had entered into lease agreements with Lombard North Central plc to lease certain second-hand cars chosen by the two directors. All costs in relation to the cars were debited to the joint directors' loan account of Lisa Garrit and Brian Garrity, which they maintained at all times with a credit balance. Smallman & Sons Limited was the registered keeper of the vehicles at DVLA.

By entering into the lease agreements through the company, beneficial finance rates were obtained, which would not have been available to the directors as private individuals.

The company paid a mileage allowance to directors for all use of the cars on company business.

The cars were entirely paid for by the directors and were never included in company's accounts as assets of the company.

Under the terms of the lease purchase contracts, the cars remained the property of Lombard unless and until the option to purchase was exercised. At this time, it was inferred that title would have passed to Smallman & Sons Limited, who would have immediately passed ownership on to the directors, who had paid for the cars.

Over a period of several years Smallman & Sons Ltd had leased four second-hand cars under these lease arrangements for use by the two directors and their daughter.

Following an enquiry, HMRC raised a number of assessments in relation to the cars on the basis that the six-year time limit for careless behaviour applied:

- To Smallman & Sons Limited: Class 1A NICs for the 6 years from 6 April 2011 to 2017 and penalties relating to forms P11D(b);

- To the directors: Discovery assessments imposing income tax liabilities for the years 2012/13 to 2016/17 totalling just over £90,000.

Smallman & Sons Limited and the directors appealed on the grounds the company was merely acting as an agent for the directors when it acquired the cars and so the cars were not made available to them by reason of their employment. They also argued that there was no benefit to the directors as they had paid all of the costs relating to the cars.

Decision

The First Tier Tribunal found that, despite the directors bearing all of the costs by reimbursing the company through their directors' loan account, they had still obtained a benefit. Had the directors leased the cars directly with Lombard they would not have been given the preferential rates. Consequently, up to the point where ownership of the vehicles passed from Lombard to the company and on to the directors, the vehicles were 'made available' to the directors. Income tax and Class 1A NICs were due on the car benefit, calculated to be a greater value than the actual benefit received. There was no evidence that Smallman & Sons Limited acted as the directors' agent or that the company intended to make the directors liable to Lombard for the performance of the contracts it had with the leasing company.

However, the taxpayers' behaviour was not careless, as the Tribunal accepted that they had made a reasonable assumption that, having effectively paid for the cars, there would be no benefit, and professional advisers had been engaged. They had taken reasonable care. As a result, some of the assessments failed as the extended six- year time limit did not apply and the penalties for inaccuracies were cancelled.

Smallman & Sons Limited, Lisa Garrity, Brian Garrity v HMRC (TC08242)

Loans repaid and the loan charge

Summary –HMRC could not give clearance that the reinstatement of loans would not be treated as new loans under the loan charge legislation. The taxpayer could reinstate the loans and challenge any assessments raised by HMRC through the courts.

This was an application for judicial review brought by Iain Clamp in respect of HMRC's refusal to consider agreeing to his request that certain loans, if reinstated, should be taxed as if they had not been repaid.

Between 2003 and 2005, Iain Clamp was an employee of UFJ International plc 2003 to 2005.

In February 2005, the company created a settlement with Ogier Employee Benefit Trustee Ltd under which the trustees would provide various sums which could be drawn down at Iain Clamp's request.

In 2016, when the loan charge legislation was announced, Ian Clamp wanted to avoid the charge and so in 2017 and 2019 repaid the £1.885m that was outstanding, by taking out a mortgage and selling an investment property.

However, following the loan charge review and recommendations in the Morse Report in December 2019, Ian Clamp stated that became clear that the loans would not have been caught by the new charge as the loans were taken out prior to 9 December 2010.

Consequently he sought to cancel his loan repayments and effectively reinstate his original position with the trust.

HMRC argued that such action would result in 'new' loans that would fall under the loan charge legislation. HMRC stated:

> "The facts are that the loans were repaid in March 2019. This is a third party transaction between yourself and the Trust which is independent of HMRC and over which we have no ability or means to influence.
>
> Should loans subsequently be issued from the EBT this would be the taking of a relevant step for the purposes of Part 7A of the ... ITEPA 2003, so that the amount of the relevant step will count as employment income and result in a charge to tax."

Iain Clamp sought judicial review of HMRC's decision with the court needing to decide whether HMRC had the power not to raise an assessment where it believed tax was due.

Decision

The court concluded that, in appropriate circumstances, HMRC has the power to give clearances in respect of future transactions but this was not such a case.

It was clear that HMRC were of a settled view as to how Part 7A ITEPA 2003 was constructed and that tax would be payable on the reinstatement of Iain Clamp's loans. Further, no case had been made arguing that HMRC decision had been either irrational or improperly motivated. The court stated that had this been the case, such suggestion would be very unlikely to succeed.

Given such a settled position, the court found that HMRC did not have a discretion to agree that there should be no charge to tax on the basis that another view of the legislation was possible or on the basis that it would be more equitable for there not to be such a charge.

The court concluded that if Iain Clamp continued to disagree with HMRC's view, he could proceed with reinstating the loans and then appeal any assessment that HMRC raised.

The application for judicial review failed.

The Queen (on the application of Iain Clamp and Jeremy Beck) v HMRC
Case No: CO/3649/2020

Loans taxable as distributions

Summary - Loans made by a remuneration trust to the sole shareholder of a company were neither earnings nor disguised remuneration. The amounts were taxable as distributions with no corporation tax deductions for the contributing company.

Dr Thomas had traded as a self-employed dentist before incorporating his business, becoming the sole director and shareholder of Marlborough DP Limited through which he now ran his dental practice.

Marlborough DP Limited established a remuneration trust which was stated to be for the 'benefit of persons who had provided or might in the future provide services, custom or products to Marlborough DP Limited.' The company made contributions to the trust representing its entire profits, deducting these sums as business expenses in computing its profits for accounting and corporation tax purposes.

Acting on behalf of the trustee of the trust, a company controlled by Dr Thomas used the funds received from the company to make loans to Dr Thomas. In each case, very shortly after each contribution was made to trust, the same or very nearly the same amount was paid out to Dr Thomas as a loan.

Dr Thomas confirmed that the scheme was designed to extract profits from his dental practice tax free, while at the same time allowing Marlborough DP Limited to obtain a tax deduction for payments to the trust.

HMRC argued the payments to the trust were earnings from employment, or alternatively disguised remuneration, with PAYE and NICs due on those contributions paid. HMRC disallowed the corporation tax deductions claimed.

Marlborough DP Limited considered that the contributions/loans were not made as a reward for Dr Thomas' services as director. Dr Thomas argued that if the money had not been paid into the trust, it would not have been paid to him as earnings, but rather as dividends. When deciding on the amounts to be paid into the trust, these were determined so as to ensure that the company's profits were reduced to nil for corporation tax purposes. In fact, this was the arrangement that he was now using.

The company appealed the PAYE assessments, accepting that the amounts received by Dr Thomas were taxable as distributions, resulting in no corporation tax deductions being available. The company also argued that if the Tribunal found that the relevant sums were taxable under ITEPA 2003, then the company must be entitled to a deduction for the contributions in computing its profits chargeable to corporation tax.

Decision

The First Tier Tribunal stated that in order to decide how the contributions/loans should be treated in the recipient's hands, it was important to establish the purpose behind the company making the payments.

Based on the evidence available, the Tribunal concluded that the relevant sums were not paid to Dr Thomas via the trust as a reward for his services as director, but rather they constituted distributions made as a return on his shareholding in Marlborough DP Limited. Adopting a purposive approach, the distribution provisions (s.383 and 384 ITTOIA 2005 and

s.1000 CTA 2010) were broad enough to capture the relevant sums notwithstanding that they were paid in the form of contributions to a trust and subsequent loans were made.

The Tribunal pointed out that there was no contractual obligation on company to pay the sums as a reward for Dr Thomas' services as director/dentist and there was nothing in the evidence to suggest that that was the reason for the extraction of the company's funds into Dr Thomas' hands. Neither were the amounts taxable under Part 7A ITEPA 2003 as the 'connection test' within s.554A(1)(c) was not met. Dr Thomas' employment was not shown to be part of the reason for the loans he received.

Rather, the sums paid to Dr Thomas comprised the whole of company's profits, as computed after the deduction of expenses, such as salaries paid to those employed by the company, including the small salary paid to Dr Thomas. The Tribunal pointed out that it is common practice for owner-managed companies to draw a low salary and high dividends when extracting funds from their company. Dr Thomas extraction policy was no different.

Finally, the First Tier Tribunal chairman found that if they were incorrect, and the contributions were in fact earnings, then a corporation tax deduction would be available. It is worth noting that one of the judges agreed with HMRC, that no deduction would be available as the amounts were not expended or incurred wholly and exclusively for the purposes of its trade.

Marlborough DP Limited v HMRC (TC08246)

Betting business transferred to Gibraltar

Summary – Two shareholders were caught under the transfer of assets abroad regime as "quasi-transferors" when they transferred their family betting business to Gibraltar. The third shareholder performed too passive a role to be caught.

The Stan James business consisted of UK betting shops, taking bets over the telephone or "tele-betting" and, more recently, internet betting. It was run by four director/shareholders. Stephen Fisher dealt with the shops and administration and had overall responsibility for the company. Stephen and Peter Fisher, his son, were responsible for the day-to-day running of the business and provided the majority of input to decisions. Anne Fisher had virtually nothing to do with the business from 1996 onwards and played no active part in the company's decision-making. Dianne Fisher was non-UK resident.

To avoid UK betting duty, the company moved its telephone bookmaking business to Gibraltar.

HMRC issued assessments under s 739 ICTA 1988 to the three UK resident shareholders (Stephen, Peter and Anne) on the basis that there had been a transfer of assets abroad and that the individuals had a power to enjoy the income from the business which had been transferred.

The First Tier Tribunal had found largely in favour of HMRC but the Upper Tribunal had upheld the taxpayers' appeals.

HMRC appealed against the decision of the Upper Tribunal that the transfer of a family-run betting business to Gibraltar was not caught by the transfer of assets abroad legislation.

Decision

The most important issue which the Court of Appeal had to grapple with was whether the legislation actually had any application at all. This is because the transfer of assets was not made by the individuals themselves but by the company which they owned. The non-statutory expression 'quasi-transferor' has been coined to describe such individuals, who do not make the transfer themselves but are associated in some way with the transferor.

With a majority decision, the court decided that the two shareholders who were actively involved in the decision to transfer the business were indeed quasi-transferors (Stephen and Peter Fisher), but the third (Anne Fisher), who had played no active role in the business, was not.

The judge in the minority thought that none of the shareholders could be quasi-transferors. He stated:

> 'In my judgment it is wrong in principle, and illogical, to regard a minority shareholder as “procuring” an act by the company of which they are a member simply by voting in favour of (or otherwise supporting) that act. Unless such a shareholder forms some voting pact with other shareholders (by formal agreement or otherwise), a minority shareholder has no power themselves to procure any outcome, having to abide by the majority decision.'

The judgment also considered the other limbs of the statutory test. It decided on the facts that the taxpayers did not have a motive defence and also that it did not matter that income tax had not actually been avoided. What mattered was that there was a tax-avoidance motive.

Finally, the court rejected the taxpayers' argument that the provisions infringed their freedom of movement under EU law.

HMRC's appeal was allowed in respect of two of the individual taxpayers and rejected in the case of the third.

HMRC v Fisher and others, [2021] EWCA Civ 1438

Adapted from the case summary in Taxation (14 October 2021)

Capital taxes

PPR on separate building

Summary – The taxpayer successfully argued that the gain arising on the sale of a flat that was adjacent to his house was eligible for PPR relief as it was part of his only or main residence throughout the period of ownership.

In July 2006 Roger Crippin bought a house in Scotland that included an adjacent annex, the "Bothy". He lived there with Ruth McKean and their four children, born between 2007 and 2011.

By 2011, the "Bothy" had been converted into a self-contained flat accessed either by a separate entrance or via a first floor balcony shared with the main house.

Initially, the flat was used as extra storage space by the family and by "their children to stay in "as an adventure for the weekend." By the end of 2011 it was occupied by friends who stayed for just under a year, but with no formal tenancy agreement. The friends contributed to the "family accommodation overheads". During this time, Roger Crippin and his family had unrestricted access to the property, they "still had their stuff" there and his parents had stayed at the property a couple of times when the friends were away.

On 24 January 2013 the three bedroomed flat was sold by Roger Crippin to his partner, Ruth McKean, for £200,000. During the 115 day period between October 2012, when the friends had left the property, and its sale to Ruth McKean, the property was advertised as available for furnished holiday lets and rented out as such to third parties for 31 of those days. When not used as holiday accommodation, the couple continued to use the property for personal and family purposes.

Roger Crippin considered the property to be an ancillary part of the house in which the couple lived to be their only or main residence. Consequently, he did not record the sale or include a CGT page in his 2012/13 Self Assessment tax return which he filed on 31 January 2014.

On 27 October 2014 HMRC opened an enquiry into this return, subsequently concluding that the flat had not at any time been a part of his only or main residence. HMRC issued a closure notice charging CGT of £26,978 on the flat's sale.

Decision

The First Tier Tribunal concluded that the flat was a dwelling-house in its own right. However, they stated that this did not prevent it from being regarded as part of an entity eligible for PPR relief. (*Lewis v Roko (1992) STC 171)*

With no formal rental arrangements in place and the family continuing to use the property, the Tribunal concluded that up until the point that the property was marketed for sale, it was occupied as part of the family's main residence.

However, once it was marketed as being available for holiday lets it could no longer be regarded as such, even though it was not let continuously and there was some personal/family use of the property during this period. However, this period was exempted as it fell within the final 36 months of ownership and so the whole of the gain was eligible for PPR relief.

The appealed was allowed.

Roger Crippin v HMRC (TC08285)

UKIP donation appeal fails

Summary – Donations to the UKIP party did not breach rights under the European Convention of Human Rights and so were liable to IHT.

In 2014 and 2015, Arron Banks made 14 donations to UKIP, totalling nearly £1 million. Some of the donations were made directly by him, while others were made through a company that he controlled. He claimed that these donations were covered by the political party exemption.

Under s.24 IHTA 1984, gifts to political parties are exempt if at the last general election either:

- two MPs were elected, or
- one member was elected and the Party received at least 150,000 votes.

UKIP did have two MPs when the donations were made, but both had been elected at by-elections and so the conditions were not met and HMRC sought to collect inheritance tax on the donations.

Arron Banks lost his appeal before the First Tier and Upper Tribunal. The case has now been heard by the Court of Appeal. He accepted the donations did not meet the requirements of S.24 but argued that this legislation infringed his or UKIP's rights under the European Convention of Human Rights.

Decision

The Court of Appeal accepted that Arron Banks was discriminated against for supporting a party which had no MPs elected at the previous general election.

Having considered Parliament’s original intentions, the Court of Appeal concluded that these were reflected in the criteria contained within the legislation, which was well established and entirely neutral.

The appeal was dismissed.

Arron Banks v HMRC [2021] EWCA Civ 1439

'Normal expenditure out of income' (Lecture P1284 – 8.53 minutes)

Background

The 'normal expenditure out of income' exemption (IHTA 1984, s 21) is very generous since it is only limited broadly by an individual's personal circumstances and the amount of surplus income available to be given away.

An individual can benefit from the exemption to the extent that the following conditions are all satisfied:

> '(1) A transfer of value is an exempt transfer if, or to the extent that, it is shown—
>
> (a) that it was made as part of the normal expenditure of the transferor, and
>
> (b) that (taking one year with another) it was made out of his income, and
>
> (c) that, after allowing for all transfers of value forming part of his normal expenditure, the transferor was left with sufficient income to maintain his usual standard of living.'

A useful exemption

As indicated, there is no fixed upper monetary limit to the normal expenditure out of income exemption - a transfer of value (e.g., a cash gift) is exempt to the extent that it satisfies the exemption conditions.

An important feature of the exemption is that if a gift satisfies the conditions, it is immediately free of IHT. This is a big advantage compared to potentially exempt transfers, which require the person making the gift to survive at least seven years before the gift becomes exempt.

Satisfying the conditions

Whilst the exemption conditions may seem straightforward enough on paper, in practice everyone's personal circumstances are different, so it can be difficult to determine whether the exemption is due from one case to the next.

For example, there is no statutory definition of 'normal' for these purposes. HMRC adopts the dictionary definition of normal as including standard, regular, typical, habitual or usual. The test of normality is a qualitative test, rather than a quantitative one (A-G for Northern Ireland v Heron [1959] TR 1). Indeed, HMRC confirms that it is possible for a single gift to qualify for the exemption, if it is (or is intended to be) the first of a pattern, and there is evidence to that effect (IHTM14241). HMRC's general approach is to require a pattern of giving to be demonstrated, normally over a period of three to four years.

'Income' for these purposes is considered (by HMRC) to mean net income after tax and calculated using normal accounting rules. With regard to income from earlier years, HMRC's view is that income does not retain its identity as income indefinitely: "At some point it becomes capital but there are no hard and fast rules about when this point is. If there is no evidence to the contrary, we consider that income becomes capital after a period of two years" (IHTM14250).

Transferors should be capable of maintaining their usual standard of living from their remaining income after making gifts, for the exemption to apply. This test is applied at the time of making the gift, so a change in usual living standards due to reasons outside a donor's control (e.g., redundancy) will not necessarily be fatal for exemption purposes, if an earlier commitment had been made when the surplus income was available.

Record keeping

Keeping and maintaining a record of net income and usual living expenses is important.

Donors may find HMRC form IHT403 useful on an ongoing basis for lifetime gifts. The form includes a spreadsheet, which allows various types of income and expenditure to be listed in arriving at a surplus (or deficit) income figure for the tax year, as well as a record of gifts made.

Case law - Was it 'normal'?

Bennett & Others v CIR [1995] STC 54 - Mrs Bennett executed a form of authority in 1989 addressed to the trustees of her late husband's will trust, authorising them to distribute equally between her three sons 'all or any of the income arising in each accounting year as is surplus to my financial requirements of which you are already aware'. Payments were made to each of the sons of £9,300 on 14 February 1989 and £60,000 on 5 February 1990, prior to Mrs Bennett's sudden death on 20 February 1990. In allowing the taxpayers' appeal against Revenue determinations that the payments did not qualify for the normal expenditure exemption, the court held that Mrs Bennett's considered determination for the rest of her life to give to her sons all her surplus income from the trust beyond what she reasonably required for maintenance had been implemented by the execution of the authority and the trustees' actions. Mrs Bennett had therefore adopted a pattern of expenditure in respect of the surplus income.

Nadin v Inland Revenue Commissioners [1987] STC (SCD) 107 - The deceased gave away over £271,000 during the tax year 1993-94. Her gross income for that year was £18,625, and her expenditure included nursing home fees of £13,440. The normal expenditure exemption was claimed (inter alia) on gifts of over £58,000 during 1993/94. Perhaps unsurprisingly, the denial of the exemption did not turn upon the nursing home fees.

Case law - Made out of income?

McDowall and others (Executors of McDowall, deceased) v IRC and related appeal [2004] STC (SCD) 22 - The deceased (WCM) had formed a habit of making small cash gifts to his children, and had executed a Trust Disposition and Settlement. His habit of making gifts to his children continued until 1991, when he began to suffer from dementia. WCM gave a power of attorney to his son-in-law (M) in 1993. M as attorney made a commitment to distribute a substantial part of WCM's excess income over the amount required for his maintenance. In early 1997, a payment of £12,000 was made to each of WCM's five children. The Special Commissioners held that, on a proper construction of the Power of Attorney, M had no power to make gifts. The gifts had therefore not been validly made. However, the Commissioners went on to decide (albeit that their comments were obiter) that had the five gifts of £12,000 been valid, they would have constituted part of WCM's normal expenditure (acting through his attorney). The payments were substantial because of the build-up of excess income in previous years. There had been an intention to make regular payments, and a settled pattern had been established by M's prior commitment.

Contributed by Mark McLaughlin

Woodland was residential property

Summary – With no evidence of commercial or agricultural use, a property sold with woodland was correctly treated as residential property, rather than mixed use.

The How Development 1 Limited is a property developer who bought a country estate including nearly 16 acres of land, including the main house, the lodge house, outbuildings, areas formerly used as market gardens, orchards, gardens, large grounds and a wooded area to the south.

The company submitted its SDLT return on the basis the property was residential but later sought a refund of £204,000, claiming that the property was mixed use due. HMRC denied the claim. There was no dispute that the main house constituted a dwelling nor that the lodge, market gardens, orchards, outbuildings and the land immediately surrounding the dwelling formed part of the property. The land in dispute was the woodland.

The issues for the Tribunal to determine was whether the woodland fell within the garden or grounds of the dwelling or subsisted for the benefit of the dwelling and so constituted residential property.

The company argued that the woodland was agricultural land, with a public footpath running through it and it was not accessible from the main house.

Decision

The First Tier Tribunal stated that:

> "Certain types of land can be expected to be garden or grounds, so paddocks and orchards will usually be residential, unless actively and substantially exploited on a regular basis. That logic applies equally to woodland."

The Tribunal found that there was no evidence supporting the claim that the woodland was used for commercial purposes, or indeed any purpose other than that of woodland which forms a natural hillside barrier between the main house and the River Ouse. The woodland provided privacy and security for the house and enhanced its setting. The woodland's use did not fall within the commonly accepted meaning of 'agriculture' or fall within the definition of 'agriculture' under section 109 of the Agriculture Act 1947.

SDLT had been correctly charged and paid following the purchase and no refund was due. The appeal was dismissed.

The How Development 1 Limited v HMRC (TC08194)

Multiple Dwellings Relief and planning permission

Summary – Neither company had acquired dwellings and the existence of planning permission did not mean that a dwelling was in the process of being constructed.

This case consisted of two appeals heard together, with the appellant in each case acting as lead appellant, each with a group of appeals stayed behind them.

Both cases involved whether having planning permission in place meant that SDLT Multiple Dwellings Relief could be claimed:

- Group 1 (Ladson Preston Limited's case): The company had acquired a freehold interest in land with planning permission already in place to erect two four-storey buildings for flats and ground commercial space. These were erected after the effective date of the transaction for SDLT purposes.

- Group 2 (AKA Developments Greenview Ltd's case): The company acquired the freehold interest in certain property and like Group 1, planning permission was already in place, this time for the demolition of existing commercial buildings on the property and the subsequent erection of nine detached dwellings. The company stated that prior to the effective date of the transaction, it had already dug several bore holes in the ground, and immediately after the transaction had been completed, it commenced work for the removal of the existing buildings. Group 2 consists of appeals where varying levels/types of physical works have been undertaken towards construction or adaptation either before or on the effective date.

In both cases, the companies argued that having planning permission in place meant that para. 7 Sch. 6B FA 2003 was satisfied and that Multiple Dwellings Relief could be claimed as the purchase was of dwellings that were in the process of being constructed or adapted for such use. HMRC disagreed.

Decision

The First Tier Tribunal concluded that neither company was entitled to claim Multiple Dwellings Relief.

The Tribunal stated that SDLT is a tax on a transaction and for a transaction to fall within the relevant paragraph of Sch. 6B FA 2003, the main subject matter of that transaction must consist of "an interest in at least two dwellings", or of "an interest in at least two dwellings and other property". Consequently, for something to count as a "dwelling" (or a dwelling in the process of being constructed) it must be something in respect of which a chargeable interest can be, and is, acquired from the seller by the purchaser as, or as part of, the subject matter of the transaction that is subject to SDLT. The Tribunal stated that planning permission is not something that a seller owns and therefore cannot be acquired by the purchaser as part of the subject matter of a land transaction on which SDLT is payable. Similarly, the buyer's plans and arrangements made before purchase are not something that is acquired from the seller as part of the subject matter of the transaction that is subject to SDLT.

Referring specifically to AKA Developments Greenview Ltd's case, The Tribunal stated that the bore holes that existed on purchase were the consequence of activities undertaken by that company in advance of the purchase and were not transferred as part of the main subject matter of the transaction that was subject to the SDLT.

Ladson Preston Limited and Aka Developments Greenview Ltd v HMRC (TC08197)

Administration

Form 17 and its uses (Lecture P1283 – 9.28 minutes)

Background

Some assets (e.g. an investment property) will be jointly held in the names of a married couple (or civil partners). The general rule is that the couple is treated for income tax purposes as beneficially entitled to the property income in equal shares (commonly referred to as the '50:50 rule') (ITA 2007, s 836(2)).

The 50:50 rule applies while the couple are living together. For these purposes, a married couple are treated as 'living together' broadly unless they are separated under a court order or by deed of separation, or they are in fact separated in circumstances where the separation is likely to be permanent (ITA 2007, s 1011).

Unequal interests

However, this 50:50 rule is subject to certain statutory exceptions. Those exceptions are listed as A to E in the legislation at ITA 2007, s 836(3).

Exception B applies where the couple have unequal beneficial interests, and they submit a declaration to HMRC for their income from the joint property to be taxed based on their actual interests in the property, instead of on a 50:50 basis.

The individuals may make a joint declaration (under ITA 2007, s 837) if either one of them is entitled to the income to the exclusion of the other, or if they are beneficially entitled to the income in unequal shares, and their beneficial interests in the income correspond to their beneficial interests in the property from which it arises.

Form 17

The declaration must state the beneficial interests of the individuals in the income to which the declaration relates, and in the property from which that income arises. The form lists the circumstances in which it cannot be used, such as for partnership income or income from shares in a close company.

A declaration is only effective if made in such a form and manner as HMRC prescribe. In practice, declarations of unequal beneficial interests are normally made on HMRC Form 17, which is generally completed online on the Gov.UK website (tinyurl.com/HMRC-Online-Form17).

The declaration on Form 17 is made by both individuals jointly. Furthermore, individuals who are not spouses or civil partners (such as parent and adult child, or siblings) cannot make a Form 17 declaration.

The declaration must be submitted to HMRC within 60 days from the date of signature of the last spouse to sign; otherwise, it is invalid. HMRC generally enforces the 60-day time limit strictly and has no power to extend it. Late declarations are invalid and have no effect.

However, that does not mean that another declaration cannot subsequently be made. The couple can make another declaration and submit it to HMRC within the 60-day time limit if they wish, although only income arising after the date of the declaration is covered by it (ITA 2007, s 837(4)).

HMRC treats a valid declaration on Form 17 as continuing to apply in later tax years. Hence for a married couple, it continues until one spouse dies, or if the couple separate permanently or divorce, or until the beneficial interest of a spouse in the property or income changes (see TSEM9864).

Practical issues

It is important that spouses or civil partners check that they jointly own the property as beneficial 'tenants in common'. Property may be owned in an individual's sole name (i.e. husband, wife or civil partner), or as 'joint tenants', or as 'tenants in common' (although different rules apply in Scotland).

On the death of a 'joint tenant', the survivor takes the entire interest absolutely by operation of property law. By contrast, ownership as beneficial 'tenants in common' gives each spouse or civil partner a separate (typically equal) share of the property, which can be left by will or disposed of during lifetime.

A Form 17 declaration cannot be made if the couple own the property as 'joint tenants' (i.e. the property income cannot be split other than in equal shares). HMRC requires evidence that the couple's beneficial interests are unequal, such as a written declaration of trust. The declaration is only available if the individuals are beneficially entitled to the income in unequal shares, such as 80:20, or even 100:0 (ITA 2007, s 837(1)(a)); see TSEM9848).

Planning points

It is not possible for the couple to simply choose to end the split of income resulting from the declaration. However, it may be possible to stop the declaration on Form 17 having effect by making a small change of beneficial interest in the income or property, such as by one spouse transferring part of their beneficial interest to the other (ITA 2007, s 837(5)). HMRC accepts that even the smallest change of interest stops the declaration from running (TSEM9864). The 50:50 rule would then apply once again unless another declaration is made.

It may also be helpful to note that a Form 17 declaration applies on an asset-by-asset basis. The couple may choose to be taxed on their actual entitlement for some of their jointly-owned assets, but on the standard 50:50 basis for others. There is no limit on the number of declarations that can be made, provided that the relevant conditions are satisfied.

Contributed by Mark McLaughlin

Alternative Dispute Resolution **(Lecture P1285 – 14.45 minutes)**

HMRC's Alternative Dispute Resolution ("ADR") is a non-statutory process for resolving personal tax and business tax disputes between HMRC and a taxpayer. This session considers the process to follow, what disputes are suitable for ADR, and various practical issues.

What is Alternative Dispute Resolution?

Under ADR, a mediator (a trained HMRC officer not connected to the case) assists the taxpayer and the HMRC caseworker to resolve their dispute. Not all disputes are suitable for ADR, and each application is considered by HMRC on a case-by-case basis. As the process is not statutory, there isn't a right of appeal if HMRC rejects an application for ADR.

HRMC's current policy is that an application for ADR can be made at any stage of an enquiry, and an appealable decision is not needed, which is an advantage for the taxpayer.

How to apply for Alternative Dispute Resolution

Taxpayers wishing to use the ADR process need to apply online, although an adviser can make the application for their client. Where direct taxes are involved, and HMRC has made a decision, an appeal must be made to HMRC against the decision. In addition, where a statutory review has been requested or accepted, the taxpayer must wait for the conclusion of the review, and appeal to the tribunal (and have the appeal accepted) before applying for ADR. Where the offer of a statutory review has not been accepted, an appeal must be made to the tribunal (and have the appeal accepted) before the ADR application can be made.

In relation to disputes involving indirect taxes, the taxpayer must wait for the conclusion of the statutory review (where a review was offered), and appeal to the tribunal (and have the appeal accepted) before applying for ADR. Where a statutory review is not offered, the taxpayer must appeal to the tribunal (and have the appeal accepted) before the ADR application can be made.

The Alternative Dispute Resolution process

Once an application has been made, HMRC will usually give their decision within 30 days as to whether the case can be included in ADR. If the application is rejected, the taxpayer can refer the case to the tribunal, where there is an appealable decision, otherwise the adviser will need to consider other remedies to resolve the matter with HMRC.

If the application is successful, the mediator will liaise with the adviser and HMRC caseworker. Both parties are required to prepare statements of the matters in dispute, and the documents are exchanged prior to the mediation. The mediation hearing, which can take place by telephone, video or face-to-face meeting, is held within 90 days of confirmation that the application has been successful.

At the mediation hearing, there will be a mixture of joint sessions ,where the mediator meets with HMRC and the taxpayer (and his adviser), and private sessions, where the mediator meets with each party separately. The role of the mediator is to facilitate discussion between the two parties, and for the HMRC officer and the taxpayer to reach a decision regarding the dispute, if possible. At the end of the meeting, which usually lasts one day, both parties agree the outcomes, which may require further action before the case can be concluded, where appropriate. If there are not any agreed outcomes, the dispute will proceed to the tax tribunal, where there was an appealable decision.

What disputes are suitable for Alternative Dispute Resolution?

Broadly, the following types of disputes can be dealt with through the ADR process, subject to HMRC's approval:

- When communications have broken down with HMRC
- When there are disputes about the facts
- When there has been a misunderstanding
- When the dispute relates to a technical point, or a point of law

What disputes are not suitable for Alternative Dispute Resolution?

HMRC do not accept the following types of disputes into ADR:

- Complaints and disputes about HMRC delays in using information or giving misleading advice
- Payment issues or debt recovery
- Application of HMRC's Extra Statutory Concessions
- Cases being dealt with by HMRC's criminal investigators
- Accelerated payments and follower notices
- Cases the First-tier Tax Tribunal have categorised as 'paper' or 'basic'

Other circumstances where ADR is not available are given in HMRC's factsheet, CC/FS21, which can be accessed on the following page:

https://www.gov.uk/government/publications/compliance-checks-alternative-dispute-resolution-ccfs21 .

Practical considerations

When a dispute has been accepted into the ADR process, a successful outcome is dependent on the willingness of the parties to engage. It is important to ensure that your client is prepared to settle, which may mean that compromises have to be considered. An effective mediator is also needed. They should ensure that there is a HMRC decision-maker present at the mediation hearing, as well as the HMRC officer dealing with the case, if they are not able to make the decision for HMRC.

There can be significant time and cost savings over formal litigation, although sufficient time should be spent on preparation for the mediation, including providing guidance for the client on what to expect. There can also be benefits, even if agreement cannot be reached, as the ADR may help the client prepare for the tribunal hearing, if appropriate. If there is not a satisfactory outcome, the appeal can be heard at the tribunal, where there is an appealable decision.

A word of caution is required. Although ADR is a confidential process, and conducted on a 'without prejudice' basis, there are circumstances in which information may be disclosed by the mediator and used in formal proceedings. This includes, but is not restricted to, information which provides evidence of criminality.

In my opinion, ADR should be a consideration for advisers when their clients have a dispute with HMRC, and the process should be combined with statutory review (which is covered in a separate session), where available. Advisers may want to seek specialist advice before embarking on the ADR route. They may find that the specialist adviser is able to engage with HMRC to avoid the need to make an ADR application.

Contributed by Phil Berwick, Director at Berwick Tax

Loss creation scheme notifiable under DOTAS

Summary – The First Tier Tribunal approved HMRC's application under s.314A FA 2004 for an order that the structures promoted by the LLP were notifiable arrangements under the disclosure of tax avoidance scheme (DOTAS) rules.

The scheme used paired forward contracts to purchase and sell securities. The outcome depended on the value of the FTSE 100 in a 10 to 15-day period with the aim of creating an allowable loss and a matching tax exempt gain. Because the outcome was uncertain, users would repeat the transactions (in practice up to five times) until a material loss was generated. The LLP sold the scheme, known as 'Volatility', mostly to tax advisers, who then made it available to their clients.

Decision

The First Tier Tribunal considered each of the requirements for the existence of notifiable arrangements in s.306(1) FA 2004 in turn.

It agreed with HMRC that the sequences of paired contracts were 'arrangements', rejecting the LLP's argument that there were no arrangements beyond each pair of contracts (so that there were no arrangements specified in the application). The nature of the structure was such that it made no economic sense for a user to drop out after the first pair of contracts or until an allowable loss was made.

The arrangements also satisfied the requirement that they might be expected to result in a tax advantage (s 306(1)(b)); they included the repeating of the pairs of contracts until a tax loss was realised. Furthermore, the tax advantage was a main benefit that might be expected to arise from the arrangements (s 306(1)(c)); it was plain that users participated in order to obtain the advantage.

The final requirement (s 306(1)(a)) was for the arrangements to fall within one of the DOTAS hallmarks. The First Tier Tribunal found that the scheme fell within no less than three: premium fee, standardised tax product and loss schemes.

HMRC v Redbox Tax Associates LLP (TC08235)

Adapted from the case summary in Tax Journal (17 September 2021)

Continued failure to comply with information notice

Summary – The taxpayer had failed to provide the information requested under a Schedule 36 information notice, resulting in the Upper Tribunal imposing £350,000 of penalties for non-compliance.

Sukhdev Mattu was the settlor and sole beneficiary of an offshore trust, the Taj Trust, based in Geneva.

HMRC believed that he was taxable on income and gains created by the trust's offshore companies under the Transfer of Assets Abroad and Settlements legislation. These companies were incorporated in the British Virgin Islands, Monaco and the Seychelles.

Following unsuccessful attempts to obtain information in relation to the trust, HMRC successfully applied to the First Tier Tribunal for permission to issue a Schedule 36 information notice. Despite this, Sukhdev Mattu failed to provide the information requested. Consequently, HMRC issued protective Discovery Assessments totalling just under £2 million and applied to the Upper Tribunal for a tax-related penalty to be imposed under para. 50 of Schedule 36.

Decision

The Upper Tribunal were satisfied that HMRC's belief that the total tax at risk was reasonable, totalling £1,917,578 (plus interest) for the years 2013/14 to 2016/17.

The Upper Tribunal found that Sukhdev Mattu had failed to comply with the information. HMRC had imposed daily penalties under Schedule 36 on 5 March 2020 and 15 May 2020 totalling £9,480 but these had had little effect on his behaviour, although he did appeal them.

The Upper Tribunal decided that it was appropriate to impose a penalty under paragraph 50. There could be substantial tax at stake which could only be established with the information that HMRC had requested. However, the Tribunal rejected HMRC's submission that the penalty should be the full amount of the tax at risk and applied a substantial discount to the that figure as the tax liability remained uncertain. The final penalty imposed was £350,00, which also took into account a number of factors including that HMRC did not allege any dishonesty and that Sukhdev Mattu's behaviour could be categorised as a failure to comply rather than outright obstruction. The Tribunal stated:

> "In fixing the amount of the penalty we have had regard to the aggravating and mitigating factors and applied a 50% reduction to the tax at risk. We have had regard to the fact that the amount of the penalty should be proportionate to the tax at risk but not a proxy for the tax. We have taken into account of the public interest and objectives to ensure compliance with Information Notices, deterrence and punishment, but that the amount should be no more than necessary to achieve these objectives and should be fair and proportionate."

HMRC v Sukhdev Mattu [2021] UKUT 0245 (TCC)

Accelerated Payment Notices and PAYE

Summary – Agreeing with the First Tier and Upper Tribunals, the Court of Appeal found that 'disputed tax' for accelerated payment notices (APNs) included amounts specified in a Reg. 80 PAYE determination.

Sheiling Properties Limited entered into a scheme which had been assigned a DOTAS reference number. Under this scheme, the company argued that payments to its directors were not earnings and so no deduction for income tax was required.

However, HMRC decided that the payments constituted employment income from which income tax should have been deducted at source under the PAYE regulations and made a determination under reg 80 of those regulations.

Sheiling Properties Limited appealed against the reg 80 determination and requested postponement of the amount due pending the dispute. Although HMRC initially agreed to the postponement, it subsequently issued APNs to the company so that the income tax specified in the APNs became due.

Sheiling did not pay the APNs on time and appealed against the resulting late payment penalties.

Both the Upper Tribunal, and the First tier Tribunal before it, had already determined that the company had no reasonable excuse for not paying the APNs on time, so the only remaining issue before the Court of Appeal was whether an amount specified in a PAYE determination can constitute 'disputed tax' for the purposes of s.221(3) FA 2014 and ss55(8C)(b), (8D) TMA(where an APN is given, preventing or cancelling any postponement of disputed tax).

Decision

The Court of Appeal upheld the Upper and First Tier Tribunal decisions, that the meaning of 'disputed tax' for the purposes of the APN rules includes an amount specified in a reg 80 PAYE determination.

According to the court, it would be absurd, and contrary to the intention of Parliament, if:

- an appeal against a reg 80 PAYE determination falls within the definition of a 'tax appeal', which it does because it is expressly referenced in that definition; but

- the amount of tax specified in the reg 80 PAYE determination were to fall outside the definition of 'disputed tax' because it is not expressly referenced in that definition even though such a determination is treated as if it were a tax assessment and the amount specified in a tax assessment expressly falls within the definition of 'disputed tax'.

Sheiling Properties Limited v HMRC [2021] EWCA Civ 1425

Adapted from the case summary in Tax Journal (15 October 2021)

Deadlines

1 November 2021

- Corporation tax for periods to 31 January 2021 (SMEs not liable to pay by instalments)

2 November 2021

- Filing date for form P46 (Car) for quarter ended 5 October 2021

5 November 2021

- Specified employment intermediaries to file return for tax quarter to 5 October 2021

7 November 2021

- VAT returns and payment for 30 September 2021 quarter (electronic payment)

14 November 2021

- Quarterly corporation tax due for large companies depending on accounting year end.
- Monthly EC sales list (paper return) for businesses selling goods based in Northern Ireland

19 November 2021

- PAYE, NICs, CIS return, student loan liabilities for month to 5 November 2021 (cheque)
- File monthly construction industry scheme return.

21 November 2021

- Online monthly EC sales list for businesses selling goods based in Northern Ireland
- Supplementary intrastat declarations for October 2021
  - arrivals only for a GB business
  - arrivals and despatch for a business in Northern Ireland

22 November 2021

- Pay PAYE, NICs, CIS and student loan liabilities (online)

30 November 2021

- Accounts to Companies house
  - private companies with 28 February 2021
  - public limited companies with 31 May 2021 year end.

- CTSA returns for companies with accounting periods ended 30 November 2020

News

Scottish Budget date announced

The 2022/23 Scottish Budget will be published on Thursday 9 December 2021.

The announcement states:

> "The 2022-23 Scottish Budget will focus on delivering the new Programme for Government, reflecting the challenges facing households, communities and businesses as a result of the coronavirus (COVID-19) pandemic."

https://www.gov.scot/news/date-set-for-2022-23-scottish-budget/

Taxis and private hire vehicles and scrap metal dealers

In England and Wales, from April 2022, 'tax conditionality' will mean that the renewal of licences to drive taxis and private hire vehicles to operate a private hire vehicle business, or deal in scrap metal, will only be given if the person applying for that licence can show they have completed a tax check with HMRC.

When renewing licences, applicants will need to complete a basic online check to confirm they are registered for tax if they need to be.

A new online checking service will help applicants complete the tax check and pass on confirmation to a licensing body once the check is complete. Linked to licensing processes, the service does not include an option for agents to complete the check on a client's behalf.

https://www.gov.uk/government/publications/agent-update-issue-88/agent-update-issue-88

Return to the old system for registering for self-employment

During the COVID-19 pandemic, the government suspended interviews for customers applying for a National Insurance number(NINO).

Consequently, HMRC advised those without a NINO wanting to register as self-employed, to complete form SA1 rather than a CWF1, which registered them for Self Assessment only.

HMRC has confirmed that going forward, everyone applying to register as self-employed must now obtain a NINO before registering by applying online at https://www.gov.uk/apply-national-insurance-number.

HMRC advise that any individuals who have registered as self-employed without a NINO, must now obtain one.

To avoid the need to attend an appointment to prove identity, individuals must use one of the following documents when they apply:

- a passport from any country
- a biometric residence permit (BRP)
- a national identity card from:
  - a country in the EU
  - Norway
  - Liechtenstein
  - Switzerland

https://www.gov.uk/government/publications/agent-update-issue-88/agent-update-issue-88

Business Taxation

National insurance payable as an employee or partner?

Summary - Payments made by an LLP were to the taxpayer as a member and not as an employee, making him liable to pay Class 2 and Class 4 national insurance contributions.

Peter Wilson, a chartered accountant and an international tax specialist, was engaged by Haines Watts London LLP in November 2011 to develop a separate international tax department within the London Office of the UK firm. He was engaged as a Fixed Income Member, with restricted voting rights. He was entitled to £180,000 p.a. plus 25% of the profits from the international tax practice. If the LLP made a loss, he would not be paid.

He filed his 2011/12 and 2012/13 tax returns showing his earnings as profit from the partnership. However, in his 2013/14 return he declared his earnings as employment income, stating that he was an employee and that the previous returns years were incorrect.

HMRC sought to collect Class 4 national insurance contributions from him on the basis that he was a member of the partnership and should be taxed as if self-employed.

The First Tier Tribunal dismissed his appeal.

Decision

The Upper Tribunal stated that they needed to decide whether Peter Wilson would have been a partner if the other members of the LLP had been partners in a partnership (s.4(4) LLPA 2000). If the answer was no, it would only be at that stage that their employment status needed to be considered

The Tribunal concluded that although Peter Wilson was not entitled to any surplus assets on a winding up, he did have voting rights and was effectively entitled to a share of the partnership profits as a whole, as he was only entitled to his income if the partnership as a whole made a profit.

The Upper Tribunal concluded that he was a partner in the sense that he was carrying on a business in common with the other Members of the LLP with a view of profit.

The appeal was dismissed.

Peter Wilson v HMRC [2021] UKUT 0239 (TCC)

Family Investment Companies (FICs) **(Lecture P1282 – 17.08 minutes)**

In essence, an FIC is a structure which can be used to transfer value to the younger generation of a wealthy family, while allowing the older members to maintain control over the assets. This is done without creating an immediate IHT charge and so, in recent years, has increasingly been seen as a popular alternative to family trusts following the changes in FA 2006.

In April 2019, HMRC established a special team to review the use of FICs in view of the surge of interest in setting up these arrangements. At the time, it was stated that the team's work was merely of an exploratory nature.

HMRC have now published their findings in the 13 May 2021 minutes of the Wealthy External Stakeholder Forum, concluding that:

- they have a better understanding of the characteristics of FICs; and
- the use of these structures does not suggest that the taxpayers who establish them are non-compliant when it comes to their tax affairs.

While so far there have been no significant shake-ups to the taxation of FICs, it is possible that we may see new anti-avoidance legislation in this area before too long. For the time being, FICs are 'business as usual' within HMRC – they do not have to be dealt with by a dedicated team in the Department.

An FIC is typically formed by parents providing funds for investment through interest-free loans or by subscribing for preference shares. Neither of these arrangements is regarded as a chargeable event for IHT purposes and the money transferred can be extracted tax-free from the FIC at a later date, using cash generated by the company's investments. The parents, who will be directors of the FIC, will also subscribe for two further classes of shares in the company:

- voting shares which will give them control of the FIC at shareholder and board level; and
- non-voting shares which are handed over to the children (preferably before significant value accrues on those shares).

The gift of the non-voting shares will not be subject to IHT, provided that the parents survive this event by seven years.

Dividends paid by the FIC will come from the non-voting shares. Assuming that the children are adults, any amount in excess of the younger individual's combined personal and dividend tax allowances (£14,570 for 2021/22) will be taxed at 7.5% if it falls into the basic rate band and at 32.5% if it reaches the higher rate bracket.

One important feature is that the FIC will pay corporation tax on its profits at 19%. However, with effect from 1 April 2023, this rate is due to rise to 25%. The 19% small profits rate, which applies to companies with profits of £50,000 or less from then onwards, is unlikely to be relevant for FICs in view of the fact that the lower rate is not available for close investment companies.

Other tax-related considerations for FICs are:

- Capital gains realised by an FIC are currently chargeable at 19%. For the time being, this is lower than the main rate of CGT for individuals (20%). Where assets have been held since before 1 January 2018, an indexation allowance can reduce the FIC's gain. If an FIC is disposing of all or part of a holding of at least 10% in a trading company, the substantial shareholding exemption should be available.

- Virtually all dividends received by an FIC (including from overseas) are exempt from corporation tax.

Dividends from abroad may be subject to a withholding tax. Withholding tax is offset against the UK corporation tax on the corresponding income. However, if the income is exempt from tax, any withholding tax will not be repaid by HMRC and so will represent a real cost to the FIC.

An FIC can claim a corporation tax deduction for interest paid on loans taken out against the value of its investments where the loans have been used for the purposes of the company's business (e.g. in order to acquire new shares or to manage the operation). Annual loan interest deductions may be restricted where the total interest payable exceeds £2,000,000. By contrast, individuals are not permitted to claim tax relief on the interest on loans to acquire a share portfolio.

Expenses incurred by the FIC in managing its investments and running the business will be eligible for corporation tax relief. This will include investment managers' fees and remuneration paid to employees or directors. The company can set off these expenses against its taxable income and gains – any unrelieved amount can be carried forward and deducted from the FIC's future taxable profits. Tax relief for such expenses is not available to individual investors.

On the liquidation of an FIC, CGT will be charged at 20% on any capital distributions. This assumes that the provisions of S396B ITTOIA 2005 have not been invoked by HMRC.

Contributed by Robert Jamieson

Extended loss carry-back for stand-alone companies **(Lecture B1282 – 16.04 minutes)**

Case study A

Russell (Financial) Ltd has a 31 March year end. The company's results for recent accounting periods have been:

		£
Year ended 31 March 2021	Trading loss	(3,400,000)
Year ended 31 March 2020	Total profits	1,100,000
Year ended 31 March 2019	Total profits	1,750,000
Year ended 31 March 2018	Total profits	1,250,000

The existing rules which allow £1,100,000 of the trading loss from the year ended 31 March 2021 to be carried back against the total profits of the previous year remain unaffected and are uncapped. Therefore, if the total profits for the year ended 31 March 2020 had instead been £2,500,000, full relief would have been available.

The legislative changes in FB 2021 allow Russell (Financial) Ltd to carry back £1,750,000 of the current year's trading loss against the total profits of the year ended 31 March 2019 and £250,000 of the same trading loss against the total profits of the year ended 31 March 2018. Notice that the second carry-back claim has been restricted to the unused amount of the

annual £2,000,000 limit. Both these claims exceed the de minimis of £200,000 and must therefore be made in a corporation tax return.

The remaining £300,000 of the company's trading loss will be carried forward for relief under Ss45A and 45B CTA 2010.

Case study B

Fagerson Industries plc has been particularly badly hit by the COVID-19 pandemic. The company's recent results have been:

		£
Year to 31 December 2020	Trading loss	(2,150,000)
Year to 31 December 2019	Total profits	1,200,000
Year to 31 December 2018	Total profits	3,250,000
Year to 31 December 2017	Total profits	1,400,000

The existing rules allow £1,200,000 of the trading loss from the year ended 31 December 2020 to be carried back against the total profits of the year ended 31 December 2019. The remaining £2,150,000 – £1,200,000 = £950,000 can be carried back under Para 4 Sch 2 FB 2021 against the total profits of the year ended 31 December 2018, leaving £2,300,000 in the charge to tax for that year.

Unfortunately, for the year ended 31 December 2021, Fagerson Industries plc suffers an even larger loss than in the previous year of £5,600,000. This cannot be carried back to 2020 because there are no profits for that year.

However, FB 2021 allows the loss of £5,600,000 to be carried back further against the profits of 2019 and 2018 in that order. The profits of the year ended 31 December 2019 have already been relieved in full by the earlier loss claim and so the only remaining period which may have 2021's losses offset against it is the year ended 31 December 2018.

The profits for the year ended 31 December 2018 currently stand at £2,300,000. Therefore, a maximum of £2,000,000 can be relieved under Para 4 Sch 2 FB 2021 for that accounting period. £300,000 remains chargeable to corporation tax.

As far as the year ended 31 December 2021 is concerned, an unrelieved loss of £5,600,000 – £2,000,000 = £3,600,000 will be carried forward for relief under Ss45A and 45B CTA 2010.

Contributed by Robert Jamieson

Further guidance on extended loss carry-back claims (Lecture B1283 – 15.47 minutes)

On 5 July 2021, HMRC published further guidance on the provisions in FA 2021 which allow extended loss carry-back claims by companies and unincorporated businesses.

Companies

A claim for relief in respect of a trading loss can only be made once the extent of the loss has been 'established'. The claim must be for an amount which is quantified at the time when

the claim is made. This is usually done with the submission of a CT600 return. Claims for the extended carry-back relief must be made within two years of the end of the loss-making accounting period. Therefore, if a company suffers a trading loss for its year ended 30 September 2020 which it wishes to carry back under the FA 2021 regime against the total profits of the year ended 30 September 2018 and then against the total profits of the year ended 30 September 2017, it must make the claim by 30 September 2022.

A de minimis claim (i.e. up to a maximum of £200,000) to carry back trading losses can be made under Sch 1A TMA 1970 outside a company tax return as soon as the accounting period in which the loss arose has ended. This is subject to the proviso that the loss can be determined with a reasonable degree of accuracy. This will require sufficient information and evidence such as management accounts to be available in order to verify the validity and correctness of the loss claim.

This latest guidance includes an online link for companies and their agents to make a de minimis claim outside a tax return. The following details must be provided:

- company's unique taxpayer reference;
- company's name;
- tax adviser's agent code (if applicable);
- start and end dates of the loss-making accounting period;
- amount of the loss;
- dates of the accounting periods to which the loss is to be carried back;
- total profits of those earlier accounting periods; and
- company's management accounts for the loss-making accounting period in the form of a PDF.

Non-de minimis claims (i.e. those exceeding £200,000) must be made in a CT600 return. Such claims, if made by companies which are members of a group, are only valid if they are accompanied by a loss carry-back allocation statement (see SI 2021/704). This statement must be submitted by a nominated group company.

The group member is normally nominated by the ultimate parent company of the group. There is no need to send the nomination in to HMRC, but HMRC say that 'groups should have a nomination in place which fulfils the legislative requirements and should be able to supply this, if it is requested'.

A 2020 loss carry-back allocation statement refers to an accounting period ended in the financial year 2020. It must be submitted by 31 March 2023.

A 2021 loss carry-back allocation statement refers to an accounting period ended in the financial year 2021. It must be submitted by 31 March 2024.

Loss carry-back allocation statements must:

- be in writing;

- be signed by the appropriate person in relation to the nominated company (usually an officer of the company);
- identify the ultimate parent company of the group;
- list all the members of the 2020 or 2021 group (as appropriate);
- list all the de minimis claims made by group members (including the name of each claimant company and the claim amounts);
- state the total amount of relief given by de minimis claims; and
- list all the non-de minimis claims made by group members (including the name of each claimant company and the claim amounts).

Where there are both de minimis and non-de minimis claims, the total amount of relief given must not exceed the group cap of £2,000,000. If any changes to non-de minimis claims are required, the nominated company must notify HMRC of the changes in writing.

Unincorporated businesses

A claim for loss relief will normally be made in the businessman's tax return, but, where the claim will affect more than one tax year, a standalone claim can be made outside the tax return.

The claim must specify:

- the name of the business;
- the period for which the loss was made;
- the amount of the loss; and
- how the loss is to be used.

A standalone claim can be made as soon as the basis period in which the loss arose has ended and the loss has been calculated. Note that, unlike the position for companies, no online facility has been provided for unincorporated businesses.

Contributed by Robert Jamieson

Penalty imposed for potential lost revenue

Anthony Marsden was the sole director and shareholder of Grangewood Ltd. By the end of the September 2015 accounting period the director's loan account was overdrawn by £2.9m and the company had paid tax of £704,000.

For the accounting period ended 30 September 2016, Anthony Marsden withdrew a further £379,641 which gave rise to a tax charge of £103,472.

The accounts for that period showed Anthony Marsden had transferred an intangible asset valued at £4 million to the company, which brought the director's loan account into credit. As a result, the company claimed a repayment of the tax.

After an enquiry, it transpired that the intangible asset was an option to buy shares and ultimately the taxpayers withdrew the repayment claim and submitted amended accounts and an amended return.

HMRC imposed a penalty against Grangewood Ltd for 52.5% of the potential lost revenue; the tax liability that would have been repayable had the inaccuracy not been corrected. It issued Anthony Marsden a personal liability notice for 100% of the penalty on the basis that he was responsible for the inaccuracy and had attempted to gain personally from it.

Grangewood Ltd and Anthony Marsden appealed, saying the errors were made by their advisers, on whom they relied. Further, the errors were not deliberate and had been rectified before the repayment was made.

Decision

The First Tier Tribunal found that the taxpayers did not have a reasonable belief in the accuracy of the value or validity of the asset when the document was submitted to HMRC.

Further it was enough for the inaccuracy to be deliberate when the parties involved 'consciously or intentionally chose not to find out the correct position' regarding the asset as was the case here.

There was no evidence to show that Anthony Marsden had taken steps, 'let alone reasonable steps', to check the value of the asset. Indeed, the tribunal considered he was 'reckless' not to have done so, given the tax at stake.

On the penalty, the tribunal said the fact that no tax was lost because HMRC had found the inaccuracy before making the repayment was not relevant.

The tribunal concluded the penalty for deliberate inaccuracy was correct. However, it reduced the penalty to 43.75% to take into account the fact that the taxpayers had corrected the inaccuracy.

Finally, it agreed with HMRC that Anthony Marsden was liable to pay the entire penalty and therefore upheld the personal liability notice.

The appeal was dismissed.

Grangewood Enterprises Ltd; Anthony Marsden v HMRC (TC08264)

Adapted from the case summary in Taxation (30 September 2021)

Payment to director was not deductible

Summary – A payment made by a company to a shareholder was neither a distribution nor was it a deductible non-trading loan relationship debit.

Mr Ahmed was the sole shareholder of the Shinelock Limited. In March 2009, using a bank loan and funds provided by Mr Ahmed, the company bought a property for £725,000. The property was sold in December 2014 for £1,030 million. The day after the sale the difference between the two values of £305,000 was paid to Mr Ahmed. This was the gain before expenses and indexation allowance had been deducted.

Shinelock Limited did not include any chargeable gain in its tax return for the year ended March 2015.

During HMRC's enquiry, the company argued that the property had been beneficially owned by Mr Ahmed, who was non-UK resident at the time. HMRC concluded that Shinelock Limited had realised a chargeable gain on the disposal of the property which was subject to corporation tax and amended the tax return.

However, at the hearing before the First Tier Tribunal, the company accepted that it had been the beneficial owner of the property but that the gain was effectively cancelled out as the corresponding payment to Mr Ahmed was deductible as a non-trading loan relationship deficit.

Shinelock Limited appealed.

HMRC applied for the appeal to be struck out on the basis that no claim had been made to use the deficit within two years of the end of the accounting period and no late claim had been accepted by HMRC. HMRC argued that the payment was a distribution.

Decision

The First Tier Tribunal confirmed that the payment to Mr Ahmed discharged a liability owed to him and so did not represent a distribution by the company.

Further, the Tribunal found that the payment was not deductible as a loan relationship debit as:

- it was not recognised in determining the company's profit or loss for the period under GAAP, as the payment had been netted off against the gain made. A related party disclosure and balance sheet adjustment in respect of the payment was not enough;

- paying the gain to Mr Ahmed did not represent any expense relating to bringing the loan relationship into existence.

The appeal was therefore dismissed

Although not relevant to the case's outcome, the Tribunal did also consider whether the company had made a valid NTLRD claim. With no prescribed way of making such a claim, the Tribunal confirmed that a letter from Shinelock Limited made it clear that the company intended to set its £305,000 NTLRD against the gain on the disposal of the property and this amounted to the making of a late claim.

Shinelock Limited v HMRC (TC08261)

SME relief for R&D costs **(Lecture B1284 – 22.15 minutes)**

Definition of R&D

The legislation defines research and development (R&D) as activities that fall to be treated as R&D in accordance with generally accepted accounting practice. Thus we need to look at FRS 102 or IAS 38 for the definition.

FRS 102 distinguishes R&D activity from non-research activity by the test of whether there is presence of an appreciable element of innovation. If the activity departs from routine and breaks new ground it is normally included; however, if it follows an established pattern it is normally excluded.

The guidelines state that:

- R&D for tax purposes takes place when a project seeks to achieve an advance in science or technology.

- The activities which directly contribute to achieving this advance in science or technology through the resolution of scientific or technological uncertainty are R&D.

- Certain qualifying indirect activities related to the project are also R&D. Activities other than qualifying indirect activities which do not directly contribute to the resolution of the project's scientific or technological uncertainty are not R&D.

- An advance in science or technology means an advance in **overall knowledge or capability** in a field of **science** or **technology** (not a company's own state of knowledge or capability alone). This includes the adaptation of knowledge or capability from another field of science or technology in order to make such an advance where this adaptation was not readily deducible.

- An advance in science or technology may have tangible consequences (such as a new or more efficient cleaning product, or a process which generates less waste) or more intangible outcomes (new knowledge or cost improvements, for example).

- A process, material, device, product, service or source of knowledge does not become an advance in science or technology simply because science or technology is used in its creation. Work which uses science or technology but which does not advance scientific or technological capability as a whole is not an advance in science or technology.

A project will be R&D which seeks to, for example—

(*a*) extend overall knowledge or capability in a field of science or technology; or

(*b*) create a process, material, device, product or service which incorporates or represents an increase in overall knowledge or capability in a field of science or technology; or

(*c*) make an appreciable improvement to an existing process, material, device, product or service through scientific or technological changes; or

(*d*) use science or technology to duplicate the effect of an existing process, material, device, product or service in a new or appreciably improved way (e.g. a product which has exactly the same performance characteristics as existing models, but is built in a fundamentally different manner)

Even if the advance in science or technology sought by a project is not achieved or not fully realised, R&D still takes place.

If a particular advance in science or technology has already been made or attempted but details are not readily available (for example, if it is a trade secret), work to achieve such an advance can still be an advance in science or technology.

However, the routine analysis, copying or adaptation of an existing product, process, service or material, will not be an advance in science or technology.

Small and medium sized companies

A company incurring qualifying Research and Development (R&D) expenditure will be able to claim a deduction equal to 230% of the costs incurred in calculating its taxable total profits, for expenditure incurred.

The usual effect of this is that the further 130% of the R&D expenditure needs to be deducted in arriving at the adjusted profits for tax purposes.

To qualify as a small or medium sized enterprise (SME) the company must have:

(i) less than 500 employees; and

(ii) either annual turnover of less than €100m or an annual balance sheet figure of less than €86m.

There is an upper limit of €7.5 million on the total amount of aid you can receive on any one R&D project.

Qualifying R&D

Certain conditions have to be met in relation to the expenditure:

(i) it must be revenue not capital in nature;

(ii) it must be related to a trade carried on or to be carried on by the company;

(iii) it must be incurred on:

  (a) staff costs;

  (b) software;

  (c) relevant payments to the subjects of clinical trials;

  (d) consumable or transformable materials;

  (e) subcontracted R & D costs; or

  (f) externally provided workers.

(iv) It is not incurred in the carrying on of activities which are contracted out to the company by any person

(v) It is not subsidised, (although an SME is allowed large company R&D relief - see separate session on RDEC).

Staff costs

Staff costs comprise:

(i) all emoluments of whatever nature paid out to the directors or employees other than benefits in kind;

(ii) secondary Class 1 NIC paid by the company;

(iii) contributions to pension funds paid by the company for the benefit of directors and employees;

(iv) The compulsory contributions paid by the company in respect of benefits for directors or employees of the company under the social security legislation of an EEA State (other than the United Kingdom) or Switzerland;

Only staffing costs for directors and employees directly and actively involved in R&D will qualify. Where someone is partly engaged in R&D, their time is apportioned so that only staffing costs incurred on R&D activities can be included. The cost of staff who provide support to R&D staff do not qualify, for example secretaries or administrative staff.

Sub-contracted R & D

Where the SME subcontracts R&D work to a third party, the SME may claim large company R&D relief. The treatment varies depending on whether the two parties are connected.

Where the payment is to a connected company, which draws its accounts up under GAAP, the whole of any payment up to the amount of the connected company's expenditure is allowable.

In any other case 65% of the payments made can be claimed. However a joint irrevocable election can be made for connected company treatment. The time limit for the election is two years from the end of the first accounting period in which the contract is entered into.

Externally provided workers

Where a company makes a payment to another person for the provision of workers, several conditions apply in order to get relief for the payment. An externally provided worker must:

(i) be an individual;

(ii) not be also a director or employee of the company;

(iii) be obliged to provide services to the company personally;

(iv) be under the control of the company.

As with the company's own staff, the externally provided workers must be directly and actively involved in R&D. Secretarial and administrative services are specifically excluded.

Where a worker is partly engaged in R&D, the expenditure must be apportioned. HMRC generally do not accept that a worker can spend 100% if their time on R&D and any claims made on this basis are likely to be challenged.

If the externally provided workers are not provided by a connected company 65% of the payment made will be qualifying expenditure. However, the company and the staff provider can jointly elect in writing for the connected company rules to apply. The election is irrevocable and must be made within two years from the end of the first accounting period in which the contract is entered into.

Where the workers are provided by a connected company and that company draws up its accounts in accordance with GAAP then the whole of the payment up to the staff provider's cost of the workers can be claimed.

Subcontractors and R&D relief

You cannot claim R&D Relief under the SME Scheme if you are a subcontractor - that is, if you have been subcontracted to do the work on behalf of somebody else because the SME itself will be claiming R&D relief on the cost of the subcontract work.

But, even if your company is small or medium-sized, you may still be able to claim, as a subcontractor, under the Large Company Scheme.

This will be where the R&D has been contracted out by either a large company or a person otherwise than in the course of a trade profession or vocation the profits of which are chargeable to tax.

The expenditure must be relevant R&D expenditure, must be revenue in nature and be incurred on either:

- consumable items
- consumable stores
- software
- staffing costs
- externally provided workers
- subjects of clinical trials

or: work contracted by the SME company to be directly carried out by a qualifying body (institution of higher education such as a university, a scientific research organisation or a health service body) , an individual or a partnership made up of individuals

R&D Tax Credits

An SME company with a trading loss that has incurred qualifying R&D can surrender all or part of the loss as follows.

Firstly, the amount available to surrender must be calculated. This is the smaller of:

(i) the unrelieved trading loss; and

(ii) 230% of the qualifying R&D expenditure

For these purposes an unrelieved trading loss means the trading loss of the period reduced by any actual *and potential claims* for relief for that loss in the current period and any other actual loss relief claims made in respect of the loss. No account is taken of losses brought forward or carried back to this accounting period.

Since 1 April 2021, repayable R&D credits are generally capped at a total of

- £20,000 (pro-rata if the CAP is less than 12 months), plus
- 3 x 'relevant expenditure'

Relevant expenditure

1. PAYE and NIC liabilities of the claimant for the payment period, plus
2. Relevant proportion of any PAYE and NIC costs incurred by a connected company in providing R&D workers for the company, plus
3. Relevant proportion of any PAYE and NIC costs incurred by a connected company in undertaking contracted out R&D of the claimant

Example

A loss-making SME has R&D spend of £100,000 which would attract an enhanced deduction of £130,000 giving total R&D costs of £230,000.

Its losses exceed this amount so the tax credit which could be claimed is 14.5% of the surrenderable losses so without the cap, £33,350.

The R&D claim includes £50,000 of payments to a connected company for externally provided workers

- The actual payment made for those workers is £60,000 but the connected company's costs are only £50,000
- The total PAYE and NIC liability of that company is £5,000

Assume that the claimant company has no PAYE and NIC liability itself.

The cap therefore limits the amount which can be claimed to:

Minimum	£20,000
Plus 3 x (£5,000 x 50,000/60,000))	£12,500
	£32,500

Contributed by Malcolm Greenbaum

R&D claim fails

Summary – The company's witness statements were delivered late, making them inadmissible. Based the evidence available, the Tribunal was unable to conclude that the company's activities fell within the definition for qualifying R&D expenditure.

Grazer Learning Limited matched providers and consumers of digital learning services.

It used a third party to implement a digital learning platform. The company claimed research and development tax credits on the expenditure but HMRC, on enquiring into the claim, determined that the qualifying conditions were not met and amended the company's return.

Grazer Learning Limited appealed.

Decision

The burden of proof was on the company to demonstrate that its activities were within the guidelines set out by the Department for Business, Innovation and Skills. Unfortunately for the company the way in which the case was managed made it almost impossible for it to meet that burden.

The First Tier Tribunal had issued directions to the parties in the normal way, requiring them to exchange witness statements from those witnesses on whom they would rely. The company's representatives sent (albeit late) witness statements to the tribunal but did not send them to HMRC.

The result was that HMRC arrived at the hearing unprepared for the fact that witness evidence was to be given, let alone having any knowledge of the nature of that evidence. The tribunal therefore agreed with HMRC's request that the witness evidence would not be admitted.

Without that evidence the tribunal had very little material to go on. The judge could only conclude:

> 'In my view, it is wholly unclear from those documents whether the creation of the platform described ….involved the creation of new technology which was designed to resolve a scientific or technological uncertainty or was no more than a novel utilisation of existing technology or an adaptation of existing technology, and, in the latter case, whether that adaptation was readily deducible by a competent professional working in the field.'

Further, the judge was concerned that the company had described the platform as being in a 'permanent beta' state. That suggested there could not have been a definable project which was designed to resolve a technological uncertainty. Not surprisingly in the circumstances, the tribunal found that the company had not met the burden of proof.

The company's appeal was dismissed.

Grazer Learning Limited (T0C8282)

Adapted from the case summary in Taxation (14 October 2021)

How should transfer pricing adjustments be charged?

Summary - HMRC were directed to issue closure notices within 30 days to give effect to transfer pricing adjustments that were also the subject of diverted profits tax (DPT) charging notices.

The applicant companies were members of an international group which traded energy and commodities globally. The companies carried on the UK activities of the group and entered discussions with HMRC with a view to agreeing a new advance pricing agreement. In the course of the discussions, HMRC opened enquiries into the returns of the companies for the three years ended 31 December 2018 and also issued DPT charging notices to two of the companies for the two years ended 31 December 2017. At the time of the hearing, the review period for those notices was ongoing.

The companies applied to the First Tier Tribunal for a direction for the issue of closure notices and HMRC opposed the application on two grounds.

1. The companies had not provided information requested by HMRC and required to formulate the closure notices.

2. The issue of closure notices would pre-empt the end of the DPT review periods. HMRC argued that doing so would mean that the First Tier Tribunal was deciding which tax should apply to the transfer pricing adjustments and that such a decision was outside its jurisdiction.

Decision

On the first argument, the First Tier Tribunal held that HMRC had already set out their conclusions and the basis for amendments before the information in question had been requested. In oral evidence, an HMRC officer had accepted that this was the case and that HMRC had then been in a position to issue closure notices.

The First Tier Tribunal rejected the second argument, relying on a ministerial statement made when introducing DPT:

> 'DPT incentivises companies to agree adjustments to their CT return during the DPT review period and thus pay the correct amount of corporation tax on their diverted profits, thereby removing such profits from the DPT charged.'

In this case, HMRC had established the correct amount of corporation tax, so that the effect of a closure notice would be to give the intended effect to the DTP legislation.

The First Tier Tribunal rejected all of HMRC's further arguments, including that HMRC was expressly obliged to bring taxable profits into charge under DPT. There was nothing in the statute to create such a requirement and the ministerial statement clearly stated the opposite.

The First Tier Tribunal directed HMRC to issue closure notices.

Vitol Aviation UK Ltd and others v HMRC (TC08276)

Adapted from the case summary in Tax Journal (15 October 2021)

VAT and indirect taxes

Not aware of the 7-day rule

One Motion Logistics Ltd had been registered for VAT since 25 February 2014.

In November 2017, HMRC wrote to the company informing them that going forward they needed to make monthly payments on account (POA)under s28(2A) VATA 1994 as their total VAT liability in the previous year exceeded £2.3 million.

The letter:

- set out the monthly payments to be made by the company for the 02/18 and 05/18 periods (see below);
- confirmed that, under the POA regime, the company was no longer entitled to the seven-day extension normally applied for electronic payment and filing of returns;
- advised the company to cancel their direct debit as PoA payments cannot be made by direct debit, and also advised that it normally takes three bank working days for payments to reach HMRC's bank account;
- included a reminder that late payments are subject to default surcharge.

The monthly payments to be made by the company and when they were actually paid for the 02/18 and 05/18 periods were as follows:

- For 02/18: £98,301 was due on each of 31 January 2018 and 28 February 2018, with the balance due by 29 March 2018.

  The January payment and March balancing payment as well as the return for the period were received late

- For 05/18: £98, 301 was due on each of 30 April 2018 and 31 May 2018, with the balance due by 29 June 2018.

  The payment due on 30 April 2018 was received late as were both the return and balancing payment which were not received until 7 July 2018.

There was no dispute as to when the returns and payments were made. The issue was whether the company had a reasonable excuse for the defaults.

Mr Hershey, the company's head of operations confirmed that he had not paid close attention to the letter as he had sent it to the company's accountants and he relied on them to tell him when to pay VAT. He thought that the company had filed their return and paid their VAT due on time.

He only became aware that surcharges had arisen when he received a letter from HMRC in July 2019. As he was not aware of the removal of seven-day rule under the POA regime and the delay in filing and payment were 'relatively minor', he believed that the company had a reasonable excuse.

Decision

The First Tier Tribunal stated that it was clear that the company and its advisers believed that the seven-day extension was available to them and made payments and filed returns accordingly.

However, the Tribunal stated that they did not consider that this amounted to a reasonable excuse for the default. The company acknowledged receiving HMRC's letter of 22 November 2017, that clearly stated that the extension was not available. Neither failing to read the letter properly, nor relying on a third party who also failed to read the same letter, did not provide the company with a reasonable excuse.

The Tribunal confirmed that there was nothing complex or unclear about the POA regime and its application to this case. The Tribunal confirmed that the level of the penalty was not 'disproportionate' under the EU concept of proportionality. The penalty is not disproportionate simply because the company and its advisers were unaware of how the POA regime operated. All of the relevant requirements were clearly set out in HMRC's letter of 22 November 2017. The Tribunal stated that following the decision in the Trinity Mirror plc case, there is limited scope for surcharges to be disproportionate as the system is based on penalties that increase with each offence.

The appeal was dismissed.

One Motion Logistics Ltd v HMRC (TC8206)

Hay making business or not?

Summary – The company was not entitled to recover input tax suffered over a three-year period as it was not carrying on a business.

Babylon Farm Limited had been registered for VAT since 1991 and had historically run a farming business. Mr McLaughlin and his wife, controlling shareholders and directors of Babylon Farm Limited.

At the time of this appeal, hay making was the only activity that remained of its previous farming business, although during the relevant period, Mr McLaughlin claimed that was seeking to develop new businesses.

The couple owned land on which hay was grown. This was sold to Mr McLaughlin for his livery business, generating the company £440 per annum. The company claimed input tax of £19,760.50 relating to the period from May 2014 to February 2018 that arose mainly from costs incurred by the company in building a new barn to replace outbuildings which it had sold and which was to be used to store equipment use by Babylon in carrying out its haymaking activities.

HMRC denied the claim on the basis that Babylon was not carrying on a business for VAT purposes in the relevant period but allowed the company to be registered for VAT until the dispute was resolved.

Babylon Farm Limited appealed and also challenged HMRC's decision to deregister the company for VAT purposes on the basis that it was not carrying on a business.

The First Tier Tribunal agreed with HMRC and so Babylon Farm Limited appealed to the Upper Tribunal.

Decision

Unlike the First Tier Tribunal, who focussed on the criteria set out in the High Court decision in *Lord Fisher* case, The Upper Tribunal considered the *Wakefield College* case to be more appropriate.

The Upper Tribunal found that Babylon Farm Limited was not carrying on a business as there was no direct link between the hay making and the income generated. The income generated was not determined by the value of the supplies or the costs incurred and the only customer was a director. There was no evidence of any efforts to obtain other customers.

The Upper Tribunal confirmed that it was not necessary for HMRC to cancel a VAT registration before claiming that a person was not carrying on a business.

The taxpayer's appeal was dismissed.

Babylon Farm Limited v HMRC [2021] UKUT 0224 (TCC)

Treatment of freemasons' membership fees

Summary - Membership fees charged to freemasons in England and Wales were not exempt from VAT.

The United Grand Lodge of England is the governing body for most freemasons in England and Wales, and it accounts for VAT on the membership fee charged to its members.

United Grand Lodge of England submitted a previous claim to HMRC in 2013 on the basis that the membership fees between 1973 and 1996 should have been exempt from VAT. HMRC refused the claim and the taxpayer appealed to the tribunal. The tribunal dismissed the appeal.

However, the tribunal did comment in reaching its decision that since 2000 the activities undertaken by the appellant had changed to become more involved in charitable work, and these comments encouraged United Grand Lodge of England to submit a further claim to HMRC for overpaid VAT for the period April 2010 to March 2018, based on the assumption that the membership fees should now be exempt from VAT.

HMRC dismissed the claim arguing that although United Grand Lodge of England had aims of a philosophical, philanthropic and civic nature, it did not accept that those aims, or any one of them, were United Grand Lodge of England's main or primary aims.

United Grand Lodge of England appealed to the First Tier Tribunal arguing that the supply of services made by United Grand Lodge of England to its members should be exempt from VAT under Sch 9 Group 9 item 1(e) VATA 1994 because either United Grand Lodge of England's:

- sole main aim was philosophical in nature; or

- main aims, taken together, were of a philosophical, philanthropic or civic nature and it did not have any other main aims.

The First Tier Tribunal rejected United Grand Lodge of England's appeal, finding that one of the main aims of the taxpayer was the provision of support to freemasons and their dependants in distress, and this is not a philanthropic aim for the purposes of the exemption; therefore, the supplies were not exempt for VAT purposes.

United Grand Lodge of England v HMRC (T0C8250)

Adapted from the case summary on Tax Journal (8 October 2021)

R&C Brief 13 – Construction self-supply charge

Following the Supreme Court's decision in the Balhousie Holdings Limited case, HMRC has revised the meaning of 'entire interest' for the purposes of the self-supply charge.

The case

Balhousie Care Ltd bought a zero rated care home. To finance the deal, the company entered into a sale and leaseback arrangement with Target Healthcare REIT, conveying the land to Target, and Target simultaneously granting the land on a long lease back to Balhousie. The premises continued to operate as a care home without interruption.

Where a zero rating has been obtained on the construction or acquisition of a property for 'relevant residential' or 'relevant charitable' purposes, there is a self-supply charge if there is a change of use or disposal of the property within a 10-year period.

HMRC argued that the sale and leaseback arrangements represented the disposal of the 'entire interest'. The Supreme Court disagreed finding that the company had always maintained an interest in the property, without interruption. There had not been a disposal of an 'entire interest' and so no self-supply charge arose.

HMRC's view

HMRC now accept that certain sale and leaseback transactions will not be considered disposals triggering a self-supply charge.

To avoid the charge, HMRC has stated that the following conditions must be satisfied:

- a qualifying property must have been purchased;
- when sold, there must be an immediate lease in place, with no time lapse;
- the lease must be for the remaining term of the 10 years from the original purchase date or longer;
- the property must be continually used or operated for a qualifying purpose, with no break in trade during the sale and leaseback

This policy change is relevant to:

- organisations within the care home, NHS or charities sector;
- businesses engaged in property transactions carried out for a relevant residential or relevant charitable purpose.

https://www.gov.uk/government/publications/revenue-and-customs-brief-13-2021-change-in-the-vat-treatment-of-the-construction-self-supply-charge

Practicalities of the VAT option to tax (Lecture B1285 – 34.28 minutes)

An option to tax should be notified to HMRC on Form 1614A within 30 days of making the decision to opt to tax. Form 1614A can be signed and submitted electronically if preferred.

If the 1614A is not submitted within 30 days of the decision to opt you should submit a belated notification. Provided HMRC are satisfied that your client made the decision to opt and has charged VAT since that date then a belated notification will be accepted by HMRC.

A client should only consider opting to tax when input tax recovery is at stake. Exempt income will prevent input tax recovery – an option changes the income stream to standard rated and as such any related input tax is then deductible.

If a client incurs VAT on a property and they use it in their taxable business then the input tax is recoverable. There is no need to opt to tax as VAT is being recovered. If they were to sell the property within 10 years of the standard rated purchase then the client needs to consider the capital goods scheme prior to selling the property. If the purchase was for £250,000 or more (plus VAT) then the property is within the capital goods scheme and an exempt sale will result in a proportional input tax clawback. An option to tax prevents this clawback and in some cases creates a repayment where full input tax was not recovered on purchase.

If the client is buying the property for commercial letting an option to tax would be required to recover input tax on purchase. The rents would be exempt without an option to tax and exempt income would prevent input tax recovery.

If there is a standard rated property within a transfer of a going concern (TOGC) the buyer would need to opt to tax IF they wanted the property to be within the TOGC. They must opt to tax and notify HMRC by completion date to ensure the property is outside the scope of VAT. This may be advantageous if cash flow is an issue or if the buyer wants to reduce their SDLT exposure. TOGCs can include trading concerns and tenanted properties.

Generally an option to tax will be effective for a minimum of 20 years. Once 20 years has passed the taxpayer might choose to revoke their option to tax. A Form 1614J would need to be submitted to notify HMRC of their revocation. Unless the Form is submitted the option to tax will remain in place.

Disapplying the option to tax

Normally an option to tax will result in VAT being charged on income derived from the property e.g. rent or sale proceeds. There are however a few occasions when the option is disapplied and the income reverts to exempt.

VAT Notice 742A Para 3 provides a useful summary of these occasions.

The main ones would be:

- Selling an opted property to a buyer with residential (or relevant residential) intent who provides the seller with a Form 1614D by exchange.
- Selling an opted property to a buyer with relevant charitable intent
- Selling opted land to a housing association who provide the seller with a Form 1614G confirming their intent to build houses on the land
- Selling opted land to a DIY housebuilder

If you sell opted land to a developer the option to tax cannot be disapplied and VAT should be charged.

Anti-avoidance rules

Within the option to tax legislation there is an anti-avoidance rule which can catch clients unaware.

Consider a partially exempt trading company that wishes to buy a newly constructed property for £400,000 plus VAT. If the company bought the property the input tax of £80,000 would not be fully recoverable as they are partially exempt.

They shareholders of the company are considering forming a partnership and buying the property in the partnership. They plan to opt to tax the property and grant a lease to the trading company. They believe the partnership can recover the VAT on the property purchase as the costs incurred relate to taxable rental income. The lease would be at market value so they accept that the trading company would suffer the VAT on the lease rentals just as if they were letting from an unconnected landlord.

Due to the anti-avoidance rules within Schedule 10 Paragraph 12 the partnership's option to tax would be disapplied. The rental income would then be exempt and as a consequence the partnership would <u>not</u> be able to recover VAT on the purchase. If they have done so then this would be an error and penalties may apply.

The anti-avoidance test is explained very clearly in VAT Notice 742A paragraph 13 and is as follows:

1. Is the property within the capital goods scheme?

   The property is bought for £400,000 plus VAT and as this is greater than £250,000 plus VAT (CGS limits) it will be within the capital goods scheme.

   If it is within the capital goods scheme we must then consider Test 2. If it is not within the capital goods scheme then the anti-avoidance rule would not apply.

2. At the time for grant (of the lease) does the grantor or financier expect non-qualifying use by the grantor, financier or a connected person (s.1122 CTA 2010) within the next 10 years?

Non qualifying use will be more than 20% exempt activity or usage by a person who is not registered for VAT.

If test 2 is met then the option to tax is disapplied.

In the example above they will be connected parties i.e. a company owned by the partners. As such the grantor (the partnership) expects exempt use by a connected party (partially exempt company). The option to tax is disapplied.

Contributed by Dean Wootten

Changes to the VAT group registration and amendments forms

As part of the introduction of VAT Groups to the VAT registration service, HMRC has combined the previous VAT50 and VAT51 into one simpler form.

In the future, the VAT registration service will be developed further to gather the data for up to 20 members digitally, so some 97% of group registrations in 2019/20. Groups with more than 20 members will still be required to compete the combined VAT50/51 form as an attachment for group registrations.

Changes to Group amendments will remain a manual print and post process going forward.

https://www.gov.uk/government/publications/agent-update-issue-88/agent-update-issue-88