Tolley®CPD

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CONTENTS

Personal tax ... 5
Advisory fuel rates from September ... 5
Goods vehicles or not? ... 5
Accrual credited to loan account subject to PAYE and NIC ... 7
Disguised remuneration – tax due following Rangers ... 8
Payrolling benefits online service ... 8
Salary sacrifice - updated guidance for employers ... 9
The world of pensions turned upside down (Lecture P1036 – 10.22 minutes) ... 10
Employer pension contributions and annual allowance (Lecture P1037 – 13.45 minutes) ... 11

Capital Taxes ... 14
Disposal of shares by family trust ... 14
IHT residence nil-rate band downsizing (Lecture P1039 – 14.11 minutes) ... 15
Livery –wholly or mainly making investments? ... 19
SDLT due on planning scheme ... 21

Administration ... 24
Online tax appeal service ... 24
Tighter rules on pension scheme registration ... 24
Wrong form submitted for SEIS ... 25
Minor clerical error allowed ... 25
CIS late return ... 26
Senior Accounting Officer's duties under FA 2009 Sch 46 ... 27

Deadlines ... 29

News ... 31
Finance (No.2) Bill 2017 ... 31
Finance Bill 2018: draft legislation ... 32
Scottish programme for 2017/18 ... 34
Employer bulletin – August 2017 ... 35
The latest on Making Tax Digital (Lecture P1038 – 14.45 minutes) ... 36
Annual HMRC stakeholder conference (Lecture P1040 – 19.51 minutes) ... 37

Business Taxation ... 41
New corporate loss rules (Lecture B1036 – 11.33 minutes) ... 41
Dealing with participators (Lecture B1037 – 10.30 minutes) ... 44
Base Erosion Profit Shifting action plan (Lecture B1038 – 11.11 minutes) ... 46
Notifying HMRC of country-by-country reports ... 48

VAT 50
No supply 50
Bingo participation fees 51
Two associated companies carrying out one business? 53
New Build student accommodation 55
DIY House Builder Scheme – 'separate use' of the dwelling 56
Fraudulent trader – input tax recovery denied 58
Private fuel and under-declared output tax 59
Input tax claims – winning the 'business argument' (Lecture B1039 – 12.21 minutes) 61
Practical tips with the option to tax rules (Lecture B1040 – 14.10 minutes) 64

Personal tax

Advisory fuel rates from September

HMRC has announced new fuel rates for company cars that apply to all journeys on or after 1 September 2017.

For one month from the date of change, employers may use either the previous or new rates. They may make or require supplementary payments, but are under no obligation to do either.

Engine size	*Petrol*	*LPG*
1,400cc or less	11p	7p
1,401cc to 2,000cc	13p	8p
Over 2,000cc	21p	13p

Hybrid cars are treated as either petrol or diesel cars for this purpose. The amounts can be used for VAT, but employers will need to retain receipts.

Engine size	*Diesel*
1,600cc or less	9p
1,601cc to 2,000cc	11p
Over 2,000cc	12p

Goods vehicles or not?

Summary – Of the three vehicles supplied by Coca Cola, one was held to be a goods vehicle, while the other two were not.

The appeals discussed here looked at whether each of three different types of vehicle supplied by Coca Cola to its employees were a goods vehicle under S115(2) ITEPA 2003. Under this section a goods vehicle is “a vehicle of a construction primarily suited for the conveyance of goods or burden of any description....”.

The three appeals concerned:

1. 2016/17 income tax on the use of a VW Transporter T5 Kombi van (second generation) used by Noel Payne(Kombi 2);

2. 2016/17 income tax on the use of a VW Transporter T5 Kombi van (second generation) used by Christopher Garbett (Kombi 2);

3. Class 1A NIC payable by Coca Cola for vans and fuel available to employees in 2011/12. The vans were a VW Kombi Transporter T5 (first generation) (Kombi 1) and a Vauxhall Vivaro (Vivaro).

In 1997 Coca-Cola decided to equip their technicians with more powerful vans to carry significantly more, and heavier, equipment than before. They had started using the Vivaro as well as the Kombi 1 and 2 with more powerful engines.

Coca-Cola offered its employees the choice between a panel van (i.e. with no seats in the mid-section of the vehicle) and a vehicle as modified by a third party specialist contractor to include a second row of removable seats. Employees would opt for the van as modified by the third party in order to use seats for their own private purposes.

Unsurprisingly, the taxpayers' expert witness believed that the:

- three vehicles in question were designed and constructed primarily for the conveyance of goods rather than passengers; and
- the adaptations and manufacturer supplied options (the fitment of seats and windows in the second row), although allowing passengers to be carried, did not compromise the original design functions of the three vehicles which were primarily constructed for the conveyance of goods.

Decision

The Vivaro had a dual capability of carrying passengers and cargo. However, on a narrow balance, the Tribunal held that construction of the Vivaro was primarily suited to the conveyance of goods; its engine and transmission were mounted transversely and the driver's position was set high, each in order to maximise the load area and load volume. The mechanical components (fuel tank, exhaust, rear suspension) were packaged to allow a large flat load space floor and the Vivaro's height was designed to maximise the load area and load volume. The design and dimensions of the sliding door and the rear door facilitated loading. All these features seemed to be more characteristic of a vehicle the construction of which was designed to carry goods. This appeal was allowed.

By contrast the Tribunal concluded that neither version of the Kombi vans were constructed primarily to be suitable for the conveyance of goods. They were both multi-purpose vehicles, intended to enable workmen to be taken to work and for goods to be carried. The mid seat section was consistent with such a multi-purpose role. The appeals in connection with these vehicles were dismissed.

Noel Payne, Christopher Garbett, Coca-Cola European Partners Great Britain Limited v HMRC (TC6082)

Accrual credited to loan account subject to PAYE and NIC

Summary – Salary credited to director's loan account and reversed as a prior year adjustment was liable to PAYE and NIC.

Ventura Ltd buys and sells boats. David Buchler was a non-executive director, and chairman of the company. At some point prior to April 2010 he made a substantial loan to the company. As at 7 November 2013, the sum due to him was £375,872.14.

Mr Buchler did not have a service contract but it was agreed that on 30 September annually his loan account was to be credited with an annual salary of £16,000. By 30 September 2013 eight such sums had been so credited totalling £128,000.

As part of an inspection carried out by HMRC on 7 November 2013, it was explained that no payments had in fact been made to Mr Buchler and accordingly, it was the Appellant's belief that no PAYE or NICs were due by the company in respect of the sums credited.

By letter dated 13 November 2013 HMRC advised the company that in their view the sums credited to Mr Buchler's loan account represented earnings from employment and were subject to both PAYE and NICs by reference to the earlier of the date on which:

- The sums were credited in the company's accounts; or
- Mr Buchler became entitled to them.

On 2 January 2014 the company's representative confirmed that the sums credited to Mr Buchler had been voted upon but as they had not been paid it was proposed that in the 2013 corporation tax accounts the £128,000 would be reversed by way of prior year adjustment which was included in the 2013 accounts and provided to HMRC on 30 June 2014. HMRC took the view that the annual sums had been accrued and any attempt to reverse the accrual by prior year adjustment or otherwise was ineffective and that the PAYE and NICs remained due.

Decision

It was clear to the Tribunal that the provisions of ITEPA were clearly met on an annual basis such that the company was liable to account for PAYE and NICs on the sums credited to Mr Buchler. In each of the tax years 2011/12 and 2012/13 a charge to tax and NICs arose.

The sole question for the Tribunal was whether the prior year adjustment eliminated the charge to tax and NICs. The company did not restate its prior year financial accounts; those prior year accounts had not been altered.

The Tribunal took the view that even if it were possible to reverse the accrual in a way which reversed the charge to tax and NICs (and on that the Tribunal expresses no view) this prior year adjustment cannot be said to do that.

All the adjustment acknowledges is that the accrual is being reversed and that sums which were payable are "no longer" payable. To the Tribunal Mr Buchler was entitled to the payments in the year but the adjustment has absolved the company of its liability to Mr Buchler. He cannot absolve it of its liability to HMRC.

If the company had wanted to escape the PAYE and NIC, Mr Buchler needed to have indicated that he did not consider the annual fees payable to him in advance of each trading year end, before the vote for accruals in his favour and before the entries in the company accounts.

Ventura Ltd v HMRC (TC06028)

Disguised remuneration – tax due following Rangers

The decision in the 'Rangers' football case discussed last month, *RFC 2012 Plc (in liquidation) (formerly Rangers Football Club Plc) v Advocate General for Scotland,* states that where a sum is employment earnings, tax cannot be avoided by diverting that money to someone else. The Supreme Court's decision impacts on a wide range disguised remuneration schemes.

Following this Ruling, it does not come as a surprise that HMRC will be inviting participants of such schemes to settle tax liabilities that now fall due. This was recently announced in its agents' blog. Doing so will prevent further action by HMRC, reduce interest charges that would be payable and give access to extended payment terms, where needed.

Details will follow in the next few weeks on how to register and settle the amounts due. Anyone wanting to get ahead of the game can email ca.admin@hmrc.gsi.gov.uk.

taxagents.blog.gov.uk/2017/08/17/employee-benefit-trusts-tax-agent-blog/

Payrolling benefits online service

Rather than submitting P11Ds for employee expenses and benefits, employers can elect to add the cash equivalent of employees' expenses and benefits to their pay and then tax them through their payroll instead. Remember that employers will still need to work out the Class 1A National Insurance contributions on benefits and complete form P11D(b).

To use the online service, employers must register online before the start of the relevant tax year and then HMRC will make sure that the value of the benefit is not included in the employees' tax codes.

If an employer does not register by the start of the tax year they will need to agree with HMRC in writing that they can payroll informally for that year but will still need to complete form P11D at the end of the tax year.

www.gov.uk/guidance/paying-your-employees-expenses-and-benefits-through-your-payroll

Salary sacrifice - updated guidance for employers

On 31 August 2017, HMRC published updated guidance to reflect changes to the rules on calculating the value of benefits-in-kind from 6 April 2017.

As a general rule, if an employee can swap between cash earnings and a non-cash benefit whenever they like, any expected tax and NICs advantages under a salary sacrifice arrangement will not apply. There are some exceptions which are detailed in the Employment Income Manual at EIM42755 .

No- cash benefits

For any non-cash benefits, employers must calculate the value of the benefit which for new salary sacrifice arrangements from 6 April 2017 is the higher of the:

- amount of the salary given up;
- earnings charge under the normal benefit in kind rules.

Cars with CO_2 emissions of no more than 75g/km must use the earnings charge under the normal benefit in kind rules.

Arrangements involving cars with CO_2 emissions of more than 75g/km, accommodation or school fees will not be subject to the new rules until 6 April 2021 unless they are varied, renewed or modified.

Employees under existing arrangements

Salary sacrifice arrangements set up with employees before 6 April 2017, continue as before until the arrangement is varied, renewed or modified unless the change is:

- connected to an employee’s statutory sick pay;
- connected to an employee’s maternity, paternity, adoption or shared parental pay;
- out of the control of the employee and employer (like a damaged contract).

For new joiners, existing arrangements set up before 6 April 2017 will automatically be subject to the new rules from 6 April 2018.

HMRC confirming the tax and NICs

Once a salary sacrifice arrangement is in place, employers can ask the HMRC Clearances Team to confirm the tax and NICs implications. HMRC won’t comment on a proposed salary sacrifice arrangement before it has been put in place.

Effect of salary sacrifice on payments and benefits

A salary sacrifice arrangement reduces cash earnings and can impact on the amount of subsequent calculations or entitlement to:

- earnings related payments such as occupational pension contributions, overtime rates, pay rises;
- earnings related benefits such as Maternity Allowance and Additional State Pension;
- contribution based benefits such as Incapacity Benefit and State Pension;
- the amount of statutory pay an employee receives.

Workplace pension schemes

The employer decides whether salary sacrifice affects contributions into a workplace pension scheme. Often, employers will use a notional level of pay to calculate employer and employee pension contributions, so that employees who participate in salary sacrifice arrangements are not put at a disadvantage. However, employers should always check with their scheme provider to make sure any such arrangements are allowable.

Auto-enrolment

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

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

The world of pensions turned upside down (Lecture P1036 – 10.22 minutes)

Traditionally when withdrawing money from an owner managed business the taxpayer will take a small salary roughly equal to the personal allowance and the balance as dividends. With the dividend allowance decreasing are there any other options that can and should be considered? Taking interest on directors' loan accounts or charging rent on personal assets used in the business are both options. Often overlooked is the opportunity for the company to make contributions into directors' SIPPs or personal pensions, giving tax relief on the contribution paid while at the same time savings national insurance.

So cash extraction is one reason to consider pension contributions but what is likely to happen long term to Business property relief (BPR) and agricultural property relief (APR) as well as entrepreneurs' relief? With a change in government, the Labour party plan to review these reliefs and may well conclude that they are too generous. Indeed the current government is reviewing both BPR and APR to see how they are used when structuring lifetime and will planning. Is this a hint that they too may reform these reliefs? In July 2016 there were various meetings between the CIOT, the ICAEW

and HMRC that indicated that a review of the over generous entrepreneurs' relief was in point.

Currently a company gets these reliefs even if cash rich. Might it be sensible to consider removing surplus cash by making pension contributions ahead of any changes that might be made? Pension planning could be key when considering cash extraction, capital tax reliefs and uncertainty about the future.

Mind change needed

Pensions "A Day" was back in April 2006 when all the old complex rules on tax reliefs relating to pensions came to an end and the new rules came into effect. Whilst the rules have changed, has the attitude of the average advisor changed?

Historically there was an annual review with the client to assess:

- How well they were doing;
- How much they could afford; and
- Should money go into their pension scheme.

We should also consider what the effect of the pension contribution could be on the rest of their family's life. A contribution today could affect lifetime allowances in 20 years together with the amount that is passed down to the next generation tax free in the future.

As a caveat, remember to work with a suitably qualified IFA who is qualified to give tailored financial advice.

Taken from the seminar by Bob Trunchion

Employer pension contributions and annual allowance (Lecture P1037 – 13.45 minutes)

Prior to April 2006 contributions were capped at a figure equal to Net Relevant Earnings times a percentage based on the individual's age. From April 2006 tax relief was available on contributions up to 100% of relevant earnings but capped at an annual allowance. Initially this allowance was quarter of a million but over time this ha been reduced to its current level of £40,000. Tax relief was given at the taxpayer's marginal rate of tax.

Who can make contributions?

Contributions into an individual's pension can be made by:

- Scheme members;
- Third parties, such as grand parents, on behalf of a scheme member;
- Employers.

Employer contributions

To be tax deductible for corporation tax, the employer contribution made must be wholly and exclusively for the purposes of the company's trade. Relief will be given in the accounting period in which the contribution is paid and any accounting accruals are not eligible until paid.

Contributions made by the employer are not liable to income tax or national insurance and can be made irrespective of relevant earnings. However, you would not want total contributions to exceed the annual allowance of the current year and any brought forward from previous year's brought forward so as to avoid an annual allowance charge.

Example

The controlling director of a company draws a salary of £10,000 and the balance as dividends. He has made no pension contributions in the last three years.

The company pays £70,000 into his pension scheme. His current and brought forward annual allowances ensure that he does not exceed the maximum permitted for the year. With a total package of £80,000 (ignoring dividends), the company should get tax relief on the full £70,000 contribution and as such a package is likely to be an acceptable commercial package for a director.

Restricting contributions

In order to control the amount that was being put into pensions by companies, both the annual and lifetime allowance were reduced.

The annual allowance now stands at £40,000 but is restricted further by £1 for every £2 that income exceeds £150,000. Once income exceeds £210,000, the annual allowance is capped at £10,000. Clearly employers could be making contributions that would not form part of income and so we must look at adjusted income and threshold incomes.

Example

Roger has an income of £140,000. His employer makes a pension contribution of £35,000. Will his income lead to a restricted annual allowance?

His income exceeds the threshold of £110,000 (Income limit of £150,000 less annual allowance of £40,000). Therefore we must check to see if employer contributions take his total income over £150,000. Income of£140,000 plus employer contributions of £35,000 totals £175,000 and so the limit is exceeded and the annual allowance needs restricting by £12,500 (175,000 – 150,000)/2 giving an annual allowance of £27,500 (40,000 – 12,500). As the employer's contribution exceeds this amount, there will be an annual allowance charge on £7,500 (35,000 – 27,500) at his marginal rate of 40%.

For a money purchase scheme, it may be possible for the money to come out of the pension fund. For a final salary scheme, this decision is more complex. Any annual allowance charge paid from the scheme is likely to have an effect on the benefits that they will receive on retirement. Tax saved today would need to be weighed against the loss of benefits in the future which would be regulated advice as an actuarial effect would need to be considered.

Taken from the seminar by Bob Trunchion

Capital Taxes

Disposal of shares by family trust

Summary - Disposal of shares by trustees using a tax avoidance scheme amounted to a single composite transaction on which capital gains tax was chargeable.

Scottish resident trustees were trustees of three family trusts established by Morrison, between 1989 and 1992 for the benefit of his wife and their three children. From 8 November 2004, the Scottish trustees were his wife and two trust companies.

The trusts held shares representing about 2% of AWG Plc which in 2004 had a combined market value of around £14.5m. If sold, CGT would be payable of around £3 or £4 million. . The shares represented about 35% of the Morrison family assets.

Looking to diversify the trusts' holding, the trustees obtained advice involving the following tax avoidance scheme which if it worked would operate as follows:

- 3 Irish trusts were set up in November 2004, with terms mirroring the existing trusts then, using trust money and money borrowed by Lady Morrison, money was put money into the Irish trusts.

- The Irish trustees granted put options entitling the Scottish trustees to sell the AWG shares at base cost plus indexation; this would realise cash totalling nearly £4.5m. The Scottish Trustees would not incur any CGT as under s144ZA TCGA the disposal was through the exercise of an option and not at arm's length so the market value rule would be dis-applied.

- Having exercised the options, the shares were then sold by the Irish trustees to Merill Lynch; this realised a total of just over £14m net for the Irish trusts with the trustees incurring an Irish CGT liability of around €54,000. Merrill Lynch bought the shares as principal and sold the shares to the open market; and finally

- On 11 March 2005 the Irish Trustees retired and were replaced by the same persons who held the office of Scottish Trustees. The Irish Trusts were thereby repatriated to the UK. The repatriation would prevent a CGT liability arising on Lady Morrison (S 86 TCGA 1992).

The creation of the Irish Trusts had no purpose other than the avoidance of tax. They would not have been created otherwise. The trustees held the net proceeds on essentially the same trusts and for same beneficiaries as the Scottish trustees had previously held the AWG shares.

HMRC issued closure notices against the Scottish trustees and Morrison, amending their self-assessment returns so as to increase the chargeable gains accruing for CGT.

On appeal, the First Tier Tribunal held that, viewed realistically, the case involved a single composite transaction, namely the disposal by the Scottish trustees of the AWG shares to the market at or about market value.

The planned intermediate steps had simply been steps forming part of that transaction which had been artificially inserted for tax avoidance purposes. Accordingly, HMRC were correct to view the arrangements as a single disposal.

The Scottish trustees and Morrison appealed to the Upper Tribunal.

Decision

For transactions involving the disposal of assets to qualify as a single composite transaction subject to CGT, it was necessary that:

- the transactions had been, at the time when the intermediate transaction had been entered into, preordained in order to produce a given result;
- that transaction had no other purpose than tax mitigation;
- there was at that time no practical likelihood that the pre-planned events would not take place in the order ordained, so that the intermediate transaction had not even been contemplated practically as having an independent life; and
- the preordained events did in fact take place.

The Tribunal agreed with the First Tier Tribunal that there was no practical likelihood that the Irish trustees would not sell the AWG shares to the market at market value. The arrangement should be treated as a single composite transaction.

The decision of First Tier Tribunal was affirmed.

Trustees of Morrison 2002 Maintenance Trust and others v HMRC (Upper Tribunal)

IHT residence nil-rate band downsizing **(Lecture P1039 – 14.11 minutes)**

As a reminder**,** when a taxpayer sells, gifts or downsizes to a less valuable home before they die, their estate may benefit from an extra Inheritance Tax threshold. However to qualify, all of these conditions must apply:

1. the person sells, gifts or downsizes to a less valuable home, on or after 8 July 2015;
2. the home would have qualified for the additional threshold had they kept it until death;
3. their direct descendants inherit at least some of the estate.

Thus the preservation of the residence nil rate band may occur when the taxpayer moves to a smaller property, but also it can apply when they move to sheltered accommodation or to move in with relatives.

Where the deceased has simply replaced their home with a property of a lower value, the downsizing provisions provide relief based on the value of the former home provided the money is represented in the death estate.

HMRC has updated its guidance on the additional IHT nil-rate band available when such downsizing occurs. Key points to note are:

- The downsizing addition will usually be the same as the additional threshold lost when the former home is no longer in the estate;
- The relief will depend on the value of assets left to direct descendants;
- The addition cannot be more than the maximum amount of additional threshold that would have been available if downsizing had not happened;
- The estate's personal representative must make a claim for the downsizing addition within 2 years of the end of the month that the person dies, extendable at HMRC's discretion;
- Taxpayers are advised to keep details of the move, gift or sale so that the personal representative can get that information when they make the claim;
- Only one move, sale or other disposal of a former home can be taken into account for the downsizing addition. The personal representative can choose which to use to calculate the downsizing addition.

Illustration

Beatrice is a divorcee and she married Ben, a bachelor with no children in 2003. She died in May 2018 leaving her whole estate to her husband. Her estate comprised a half share in their house in Leeds (£270,000) and personal savings (£50,000).

A year later in May 2019, Ben sold the house for £275,000, moving into a retirement home costing £130,000.

In May 2020 Ben died leaving:

Retirement home	£135,000
Two buy to let properties	£500,000
Investments	£345,000
	£980,000

His estate was to be divided equally between Beatrice's daughter from her previous marriage and his brother's two sons.

Beatrice's death

For 2018/19 the residential enhancement was £125,000. As she has not been pre-deceased by a spouse, there is no brought forward allowance.

On her death, her estate passes tax free to Ben together with her unused nil rate band and residence nil rate band.

Ben's estate

On Ben's death in 2020/21 he is entitled to:

- His ordinary nil rate band of £325,000;
- His wife's transferred nil rate band of £325,000;
- His maximum residential enhancement of £175,000 ;
- His wife's transferred residential enhancement allowance of £175,000.

His estate is valued at £980,000. One third of this is closely inherited as his step daughter qualifies as a lineal descendant while his nephews do not. The qualifying residential interest included in the estate is the flat worth £135,000.

Without the downsizing addition

His estate is valued as follows:

Retirement home	£135,000
Two buy to let properties	£500,000
Investments	£345,000
	£980,000

The residence nil rate band would be limited to the value of the property inherited by the daughter which is £ 45,000 (135,000/3). Adding to this the two ordinary nil rate bands that he is entitled to of £650,000 gives a total to deduct from his estate of £695,000.

Taxable estate	£980,000
Nil rate bands	(£695,000)
Taxable	£285,000

This gives IHT payable of £114,000.

With the downsizing addition

Step 1 - We start by working out the former allowance – the additional threshold that would have been available when the former home was sold or given away or when the move happened.

This is £325,000 calculated as:

Residential enhancement when the house was sold (May 2019)	150,000
Beatrice's unused allowance available (May 2019)	150,000
Additional allowance now available	25,000
	£325,000

Step 2 - We need to work out the lost relievable amount. This is done by dividing the value of the former home at the date of the move or when it was sold or given away by the former allowance calculated in Step 1. This is multiplied by 100 to give us a percentage. If the value of the former home is greater than the former allowance from Step 1 the percentage will be limited to 100%.

So in our example it is calculated as:

Value of property at date of the sale	275,000
Former allowance from Step 1	325,000

X 100 84.62%

Step 3 - If there's a home in the estate, divide the value of the home by the additional threshold that would be available at the date the person dies (including any transferred additional threshold). Multiply the result by 100 to get a percentage (again this percentage can't be more than 100%).

Value of retirement property owned at death	135,000
Residence enhancement available on death	175,000 + 175,000

X 100 38.57%

If there's no home in the estate at the time the person dies this percentage will be 0%.

Step 4 – to work out what has been lost we deduct the percentage in Step 3 from the percentage in Step 2.

Step 2	84.62
Step 3	(38.57)
	46.05%

Step 5 – By applying this percentage to the additional threshold that would be available at the time the person dies we arrive at the amount of the lost relievable amount that they are entitled to on death.

46.05% X (175,000 + B/F 175,000) £161,175

Using this lost relievable amount from downsizing, the calculation of the tax payable on death becomes:

Retirement home	£135,000
Two buy to let properties	£500,000
Investments	£345,000
	£980,000

The residence nil rate band based on the property in the death estate as calculated earlier is £45,000 (135,000/3).

To this we add the lost relievable amount as a result of downsizing before death that we calculated as £161,175. The total residence nil rate band is now £206,175.

In addition Ben had the two lots of ordinary nil rate bands that he is entitled to of £650,000 which gives a total to deduct from his estate of £856,175.

Taxable estate	£980,000
Nil rate bands	£(856,175)
Taxable	£123,825

This gives IHT payable at 40% of £49,530.

Restriction of the relief

The total available residence nil rate band is now £206,175 but this can only be used against the value of the estate that is left to Ben's step-daughter. As her one-third share of the estate is worth £326,667, it is all relievable in this example.

The guidance provides several useful explanations of common scenarios, supported by worked examples to help work out the additional relief that is available.

> *www.gov.uk/guidance/how-downsizing-selling-or-gifting-a-home-affects-the-additional-inheritance-tax-threshold*

Livery –wholly or mainly making investments?

Summary – while the livery land was not eligible for agricultural property relief, business property relief was available for the livery business as it was not land held only or mainly as an investment.

The late Maureen Vigne died on 29 May 2012 leaving an estate worth nearly £900,000. Included in that valuation was approximately 30 acres of land, Gravelly Way livery stables, valued at just over £300,000.

Her personal representatives claimed business property relief against the land on the grounds that the asset constituted ‘relevant business property’ under S105 IHTA 1984 and/or agricultural property relief on the grounds that the asset constituted ‘agricultural property’ within S116 IHTA 1984.

After his late father’s death in 2005 the land was initially let to John Lye but from 2008, John became the Yard Manager for the business that Maureen Vigne had decided to run.

The son explained that in the equestrian world there are commonly four levels of livery in this country, being:

- Grass livery – where a horse has a right to reside in a field, but is not provided with a stable;
- DIY livery- where the horse, in addition to having the right to reside 20 in a field, is additionally provided with a stable with day to day care wholly provided by the horse’s owner;
- Part livery - where day-to-day care for the horse is shared between the livery operator and the horse owner;
- Full livery - where the day-to-day care of the horse and all its 25 associated needs are supplied by the livery operator.

The son said that his mother’s livery activities did not fit neatly into any of the four categories mentioned above. In a bid to give the business a competitive advantage, services over and above those that would usually be included in grass livery and/or DIY livery would be included in the package offered by the business. The evidence was that the package was to and did include:

- The provision of worming products, including administering them where and when necessary (if an owner was unable and/or unwilling so to do), on a quarterly basis;
- Providing the horses with hay feed during the winter months when the 5 grass might not provide a sufficient food source. A hay crop was grown on part of the land referred to as the hayfield;
- Removing horse manure from the fields in which the horses spent most of their time; and
- Undertaking a daily check of the general health of each horse.

In the years up to Maureen Vigne’s death, several people undertook the role of Yard Manager, all on a self employed basis, working roughly 20 hours a week.

A Business Plan recorded that the business intended to expand so as to provide part livery as well as providing DIY livery for those who wished to care for their own horses. It records that although there were only 11 stables at that time, planning permission existed for further stables and storage rooms to be erected.

In 2009, the business applied for planning permission to erect a temporary dwelling for its yard manager but the application was rejected by the local Council.

Decision

The Tribunal held that Gravelly Way was a genuine livery business that, from 2008 onwards, was developed so as to be a recognisable livery business offering significantly more than the mere right to occupy a particular parcel of land.

The business was being run from and on the land which provided services to those who kept their horses on the land and that no properly informed observer could or would have said that the deceased was in the business of "*holding investments*". In their judgement the business was of enhanced livery, providing a level of valuable services to the various horse owners, which prevents it being properly asserted that the business was *mainly* one of holding investments.

The appeal was successful under section 105 IHTA 1984.

The appeal was also put on the basis that agricultural property relief should be available. In that regard, the appeal fails. A hay crop had not been taken from the "hayfield" in the two years prior to the deceased's death. Equine activities are not usually characterised as agricultural. That is the reason why Parliament enacted S115(4) IHTA 1984 providing that the breeding and rearing of horses on a stud farm and the grazing of horses in connection with those activities does, for the purpose of the statute, amount to agriculture.

The Personal Representatives Of The Estate Of Maureen W. Vigne (Deceased) v HMRC (TC06068)

SDLT due on planning scheme

Summary - The absence of information and documents relating to the taxpayers' transactions were reasonable grounds for HMRC not to issue a closure notice.

HMRC made enquiries into SDLT returns concerning transactions that were planned to avoid SDLT. The efficacy of the planning relied on the provisions of s 45(3) FA 2003 to exempt the purchase of the property from the vendors and s 71A FA 2003 to exempt the subsequent sale and leaseback transaction. There were a considerable number of participants in that planning and by agreement there was full disclosure of only a sample, which did not include the taxpayers in this appeal.

These arrangements were widely used with similar arrangements being the subject of litigation in Project Blue Ltd (formerly Project Blue (Guernsey) Ltd) v Revenue and Customs Commissioners [2016] STC 2168, and an appeal by HMRC to the Supreme Court is due to be heard in 2018.

In October 2013, following the First Tier Tribunal's decision in Project Blue Ltd, HMRC wrote to each of the taxpayers, informing them that that decision supported their view that that the scheme did not work and that as a result, SDLT was due on those respective transactions.

In an attached schedule was a list of documents and information that HMRC asked the taxpayers to supply. Neither taxpayer provided a substantive response and no documents or information were provided.

On receiving follow up letters from HMRC, the taxpayers subsequently submitted applications to the First-tier Tribunal asking it to direct the issue of closure notices. The Tribunal decided that the absence of information and documents provided reasonable grounds for HMRC not to give a closure notice and declined to direct that a closure notice be given within any specified period

The taxpayers appealed to the Upper Tribunal arguing that the First Tier Tribunal had erred in law:

1. In interpreting Para 24 Sch 10 FA 2003, the Tribunal should have decided that it had the power to set a specified period of its choice to direct a closure notice.

2. The Tribunal misdirected itself on the law, and that its inability to direct disclosure of documents is not a valid consideration in determining whether HMRC have discharged the legal burden to show that they have reasonable grounds for not giving a closure notice.

3. HMRC had completed the enquiry. The SDLT scheme did not work as planned and HMRC told the taxpayers they should withdraw from the arrangements; failure would involve a hearing before the First Tier Tribunal.

Decision

The Tribunal held that the First Tier Tribunal had erred in law in interpreting para 24 of Sch 10 to the FA 2003 as excluding any discretion on the part of the FTT unilaterally to set a 'specified period' for the Revenue to issue a closure notice. It is clear that the reference to “a specified period” in paragraph 24(3) is a reference to such period as the tribunal itself may specify. However, that did not mean that their decision would be set aside. The error had not been material to the conclusion reached by the First Tier Tribunal that it had been in any event premature to direct that a closure notice be issued.

On point 2 the Upper Tribunal said that the First Tier Tribunal’s conclusion did not display any error of law. Having concluded that it was reasonable for the enquiry not to be closed at that stage because of the outstanding documents and information, there was no scope for the tribunal to set a time frame which depended on the production of such material. A contingent, or open-ended period, such as would be required in those circumstances, would not in the Upper Tribunal’s judgment represent a “specified period” for the purpose of paragraph 24.

Nor, in their view, could it conceivably be reasonable, in circumstances where the documents and information reasonably required for HMRC to be able to close their enquiry had not been made available (and may continue not to be provided), for a tribunal to form the view that a period could be specified which would render it at the end of that period unreasonable for HMRC not to issue a closure notice.

Finally, although HMRC had informed the taxpayers that they believed that, following the Project Blue decision, the scheme did not work, in a letter explaining this to the taxpayers they stated:

> Our intention is to bring all similar cases before the Tribunal. ... If you do not withdraw from the scheme, in preparation for a Tribunal hearing, I need you to supply all the documentation detailed in the attached schedule by 29 November 2013."

The First Tier Tribunal was entitled to find that it was not unreasonable for HMRC, before closing their enquiries, to wish to establish the individual facts and circumstances pertaining to the appellants in circumstances where the appellants were not prepared to settle on the terms proposed by HMRC, and not to rely on sampled or generic information derived from other cases. The FTT made no error of law in that respect.

The FTT had made no error of law and the appeals were dismissed.

Frosh and others v HMRC (Upper Tribunal)

Administration

Online tax appeal service

Following a short trial of online filing of appeal forms that started in May 2017, online filing of appeals has become available to all appellants since the end of June 2017.

The online service is available for appeals which can be made direct to the tribunal (e.g. involving VAT and other indirect taxes or applications for enquiry closure notices) or for appeals that have been made first to HMRC, but on which the parties have not been able to reach agreement.

The online appeal form includes step-by-step guidance on completing an appeal. Benefits of using the new online service are said to include:

- one-step process for lodging an appeal and receiving an acknowledgement with a reference number;
- the option to upload documents online, saving on postal costs;
- 'save and return' function allowing the application form to be saved and completed at a later time; and
- information is validated when entered onto the system, making applications less likely to be rejected for incomplete or incorrect information.

Tighter rules on pension scheme registration

Following consultation, the government has decided that it will:

- introduce legislation in the second 2017 Finance Bill requiring all new pension scheme registrations to be made through an active company, while allowing HMRC to exercise discretion; and
- amend the scheme registration process to enable HMRC to check that sponsoring employers have consented to the opening of new schemes.

The statutory right to transfer will be limited to:

- schemes operated by firms authorised by the FCA;
- authorised master trust schemes; and
- schemes where a genuine employment link could be evidenced.

The government will bring forward legislation to introduce a ban on cold calling in relation to pensions, 'when Parliamentary time allows'. The ban will extend to all electronic communications about pensions, but exempting 'legitimate business', such as where consumers have expressly requested information from a firm, or where an existing client relationship exists.

Adapted from Taxation Journal (1 September 2017)

Wrong form submitted for SEIS

Summary – Despite being submitted in error, the compliance statement was not a claim and a so a supplementary claim under s42(9) TMA 1970 was not available.

The taxpayer submitted a compliance certificate enabling its investors to claim Seed Enterprise Investment Scheme (SEIS) relief at 50%.

Unfortunately Form EIS1 used for Enterprise Investment Scheme relief was used in error. When the taxpayer applied for a further compliance certificate, HMRC refused this on the ground that there was an earlier EIS investment, which prevented the company from using the SEIS.

On appeal to the First Tier Tribunal, despite being satisfied that the wrong form had been used, the First Tier Tribunal dismissed the case.

The taxpayer appealed to the Upper Tribunal claiming that Form EIS1 submitted in error was not a compliance statement because it had not intended to enable the investors to claim EIS relief. It was entitled to make a supplementary claim under s42(9) TMA 1970.

Decision

The Upper Tribunal judge said that Form EIS1 was a compliance statement for the EIS and HMRC should be able to rely on such a statement. The company's intention did not prevent it having provided such a statement.

A compliance statement was not a claim. It was a statement made by the company to obtain authorisation for compliance certificates under ITA 2007, s 204 or s 257EC. Section 42(9) had no connection with either s 204 or s 257EC. The legislation drew clear distinctions between statements, certificates, claims and relief.

The appeal was dismissed.

X-Wind Power v HMRC (Upper Tribunal)

Minor clerical error allowed

Summary – Reference to the tax year ended 6 April 2009 was a minor clerical error; DOTAS reference in the agent's letter made this 'perfectly clear'.

In January 2011, HMRC opened an enquiry into the taxpayer's 2008-09 return on the basis that he had taken part in a tax avoidance scheme. Two letters were sent: one to the taxpayer and one to his agent.

However, because of a clerical error, both letters referred to the year ended 6 April 2009. The letter to the agent referred to the arrangement that was registered under the disclosure of tax avoidance schemes (DOTAS) regime. HMRC concluded that a further £653,000 tax was due and issued a closure notice in July 2014.

The taxpayer appealed, saying no enquiry had been opened because no valid notice of enquiry had been given. As a result, there could be no valid closure notice. He said the enquiry notice had referred to his tax return for the year end 6 April 2009 instead of 5 April 2009.

The First Tier Tribunal allowed the taxpayer's appeal saying that due to the mistake the letter did not constitute a valid notice of enquiry compliant with section 9A 20 Taxes Management Act 1970 ("TMA") and that section 114 TMA could not rectify the situation.

HMRC appealed saying the First Tier Tribunal had erred in law and that the error was minor.

Decision

The Tribunal said this was a minor clerical slip and was clearly intended to refer to the return for the year ended 5 April 2009. The DOTAS reference in the agent's letter made it 'perfectly clear' that the relevant year was the one ended 5 April 2009.

Finally, on the taxpayer's cross-appeal that s114 TMA 1970 could not be used to remedy the situation, the judge disagreed.

HMRC's appeal was allowed and the taxpayer's cross-appeal dismissed.

HMRC v Michael Mabbutt,(Upper Tribunal)

Adapted form summary in Taxation (17 August 2017)

CIS late return

Summary – Taxpayer had a reasonable excuse for submitting late returns and so the appeal against the penalties was allowed.

This was an appeal against penalties for late filing of nine contractors' monthly returns, CIS 300, for periods between May 2014 and January 2015.

S55 FA 2009 provides that a penalty shall not arise if the person has a reasonable excuse for their failure. One of the directors, Alison Beck, argued that she had a reasonable excuse for the defaults as:

- She had just moved home, having just had a baby. The baby was not sleeping (day or night), and she also had an older child to take care of;

- She and her partner had suffered a burglary, and her car, and Ms Beck's partner's van (together with all of his tools) were stolen. In consequence, her partner could not work for months thereafter, and he became depressed;

- The business had recently started on a large new contract;
- They had problems with their accountant who was hard to contact and who did not respond promptly to them (they have since engaged a new accountant).

HMRC sympathised with Alison Beck's circumstances but argued that:

- her pregnancy and need to look after her child was not a reasonable excuse;
- for an ongoing condition, such as depression, she should have made arrangements for completing and filing tax returns on time; and
- reliance on the business's accountant cannot be a reasonable excuse, as reliance on a third party cannot be a reasonable excuse by virtue of paragraph 23 of Schedule 55.

Decision

Looking at all the factors in the round, the Tribunal was satisfied that the taxpayer had a reasonable excuse for the failure to file the CIS returns on time. While any one of the circumstances taken in isolation may not have amounted to a reasonable excuse, the Tribunal was satisfied that the cumulative effect of all of the circumstances overwhelmed Alison Beck, and amounted to a reasonable excuse.

Reliance on an accountant cannot be a reasonable excuse, unless the taxpayer has taken reasonable care to avoid the failure. In this case the Tribunal noted that Alison Beck followed-up with their accountant, but that he was difficult to contact and tardy in responding and in the end she appointed a new accountant. The Tribunal held that they took reasonable care to avoid the failure as far as her dealings with the accountant were concerned. For this reason, the exclusion in paragraph 23(2)(b) of Schedule 55 does not apply.

The appeal was allowed.

Scott Building Contracts Limited v HMRC (TC06066)

Senior Accounting Officer's duties under FA 2009 Sch 46

Summary – The First Tier Tribunal found that a senior accounting officer had not breached his main duty to take reasonable steps 'to ensure that a company establishes and maintains appropriate tax accounting arrangements'.

Kreeson Thathiah was the finance director of the Lenlyn group, which provided currency exchange and other financial services.

HMRC had imposed a penalty on Mr Thathiah, as Senior Accounting Officer, under FA 2009 Sch 46 for failing to comply with his main duty to take reasonable steps 'to ensure that a company establishes and maintains appropriate tax accounting arrangements'. HMRC contended that by failing to perform selective testing of the application of the partial exemption special method, Mr Thathiah had failed to take reasonable steps.

It was established that the tax accounting arrangements were not 'appropriate' but had Mr Thathiah taken reasonable steps?

Decision

The First Tier Tribunal noted that the existence of material or repeated errors did not necessarily mean that his main duty had been breached; this was not an absolute duty to ensure that the relevant arrangements exist. The Tribunal held that the matters to take into account when deciding whether reasonable steps had been taken include the size, complexity and nature of the business, as well as the resources available to the individual and their authority to bring about any required change.

They noted that he had made a number of improvements in processes and controls by increasing automation to reduce errors, expanding the tax risk register and introducing a comprehensive tax policy document. The Tribunal's overall impression was one of gradual improvement against a background of limited resources and repeated requests by him for additional resource.

The Tribunal criticised HMRC for denying Mr Kreeson any real understanding or knowledge of the errors identified by KPMG until a late stage in the appeal, and for not making any allowance for the fact that the SAO was not represented and not supported by his company.

Kreeson Thathiah v HMRC (TC06043)

Adapted from a case summary in Tax Journal (1 September 2017)

Deadlines

1 October 2017

- Corporation tax due for periods ended 31 December 2016 for small and medium-sized companies not liable to pay in instalments;

5 October 2017

- Advise HMRC of income tax or CGT liabilities for 2016-17;

7 October 2017

- VAT return and electronic payment due for 31 August 2017 quarter;

14 October 2017

- Form CT61 must be submitted and tax paid for quarter ended 30 September 2017;
- Quarterly corporation tax instalment for large companies depending on year end;
- Monthly EC sales list (paper return);

19 October 2017

- Pay PAYE/CIS liabilities for month ended 5 October 2017 if by cheque;
- File monthly CIS return;
- PAYE settlement agreement tax/class 1B liabilities if paying by cheque;
- Quarter ended 5 October 2017 PAYE due if average monthly liability < £1,500;

21 October 2017

- File online monthly EC sales list;
- Submit supplementary intrastat declarations for September 2017;

22 October 2017

- PAYE/National Insurance/student loan/CIS payments if being paid online;
- Electronic payment of PAYE for quarter ended 5 October 2017 if average monthly liability < £1,500;
- Electronic payment of PAYE settlement agreement liabilities;

31 October 2017

- Submission of 2016-17 paper self-assessment tax returns;
- Deadline for individuals with PAYE income to request a self-assessment tax return for 2013-14 under ITEPA 2003, s 711;
- Private companies' accounts to Companies House for y/e 31 January 2017;
- Public limited companies' accounts to Companies House for y/e 30 April 2017;
- File corporation tax SA returns for companies with 31 October 2016 period end.

News

Finance (No.2) Bill 2017

Finance (No 2) Bill 2017 was published on 8 September, called simply the Finance Bill of the 2017-19 parliamentary session as it is the first Finance Bill to be published in this current parliamentary session.

The Bill reintroduces most of the provisions dropped from the first Finance Bill 2017 and contains 72 clauses and 18 schedules, running to 665 pages.

Excluded from the Bill is one clause on landfill tax and two on Customs enforcement powers. The CIOT commented that 'we are expecting some significant proposals on landfill tax to be announced next week which will feed into the third Finance Bill of the year, in December.'

The government is legislating in the Finance (No2) Bill 2017 for the Making Tax Digital reforms affecting businesses. It includes primary legislation for Income Tax and VAT. On 13 September 2017, HMRC also made available for comment further secondary and tertiary legislation on Income Tax and VAT. The deadline for all responses and comments is Friday 10 November 2017.

Assuming that the Bill is passed as it is, it will be the second longest Finance Act in history, with the schedules on corporation tax loss relief and interest deductibility accounting for some 303 pages.

The Bill passed its second reading on Tuesday 12 September. A committee of the whole House will in due course consider:

- Clause 5 (termination payments etc: amounts chargeable on employment income);
- Clause 15 (business investment relief); and
- Clause 25 (trading profits taxable at the Northern Ireland rate).

The remainder of the Bill will go on to be considered by a Public Bill Committee, to be concluded by 26 October 2017.

An announcement about dates for the committee debates will follow.

services.parliament.uk/bills/2017-19/finance.html

www.tax.org.uk/media-centre/press-releases/press-release-new-finance-bill-set-become-second-longest-finance-act

www.gov.uk/government/consultations/making-tax-digital-reforms-affecting-businesses

Finance Bill 2018: draft legislation

The government has published a group of draft clauses for Finance Bill 2018, which will be introduced following the November 2017 Budget with consultation on these clauses closing on 25 October 2017.

Bank Levy

Following an announcement at Autumn Statement 2016 and subsequent consultation, from 2012, the government will exempt liabilities relating to certain funding for UK banks' overseas subsidiaries, as well as liabilities relating to the funding of UK banks' overseas branches from the bank levy.

Disguised Remuneration

The introduction of the close companies' gateway is intended to put beyond doubt when the disguised remuneration rules apply to the remuneration of owners of close companies. Delayed by a year, this latest draft of the legislation to be introduced from 6 April 2018:

- introduces an avoidance purpose condition;
- allows one year for the material interest condition must be met;
- requires a stronger link between the relevant transaction and relevant step;
- corrects an error in the definition of a distribution in a winding-up for the purposes of excluded transactions; and
- includes priority rules to clarify the interaction with the loans to participators legislation.

The draft legislation includes a requirement for all employees to report additional information to HMRC before 1 October 2019 in relation to the new loan charge.

Changes to ensure the tax and NICs from a disguised remuneration employment income charge are collected from the appropriate person will be set out in detail later in 2017.

Traded On A Multilateral Trading Facility

New rules will remove the requirement to withhold tax on interest for debt issued on a multilateral trading facility operated by a recognised stock exchange regulated in the EEA, by extending the definition of a 'quoted Eurobond' to include such securities. This will have effect for payments of interest made on or after 1 April 2018.

Following responses to the consultation on this area, the clause widens the definition of alternative finance investment bonds (Sharia-compliant financial instruments) to include securities admitted to trading on multilateral trading facilities regulated in the EEA from April 2018.

Landfill Tax: Disposals Not Made At Landfill Sites

New rules will:

- extend the scope of landfill tax to disposals made illegally at sites without an environmental disposal permit;
- introduce new exemptions so that landfill tax is not charged at permitted sites on material currently outside the scope of the tax.

Offshore Trusts: Anti-Avoidance

New legislation ensures that payments from an offshore trust intended for UK resident individuals do not escape tax when they are made via an overseas beneficiary or a remittance basis user.

Capital payments to a non-resident made from 6 April 2018 will not be matched against the pool of trust gains for the purposes of the attribution of gains rules in s87 TCGA 1992 regardless of the domicile status of the settlor and whether or not the recipient of the payment is the settlor or another beneficiary of the trust.

The rules will be amended so that where a benefit is provided to a close family member of a UK resident settlor, the benefits are taxable as if they were received by the settlor.

Other amendments will ensure that capital payments or benefits, received by non-resident or non-domiciled individuals who then gift them to a UK resident, will be taxable on that UK resident as if they had received an equivalent capital payment or benefit from the trust.

Partnership Taxation

Draft clauses clarify partnership rules and return requirements in respect of:

- partners in nominee or bare trust arrangements;
- partnerships with partnerships as partners;
- investment partnerships (relaxing information requirements for overseas partners where the partnership reports under the CRS); and
- partnerships that are partners in another partnership.

The legislation makes clear that partnership profits for tax purposes must be allocated between partners in the same ratio as the commercial profits and that the allocation of partnership profits shown on the partnership return is the allocation that applies for tax purposes.

New rules for the allocation of partnership profits and losses and the relaxation in respect of overseas partners in investment partnerships will have effect from the date of Royal Assent to the Finance Bill. Other changes will have effect for 2018 to 2019 returns.

Pensions Tax Registration

New rules widen the circumstances in which HMRC may refuse to register a pension scheme, to include where the scheme is a master trust pension scheme and has not been authorised by the Pensions Regulator, or where a sponsoring employer of an occupational pension scheme is a dormant company. Similar changes will also be made to the circumstances in which HMRC can de-register a pension scheme.

Termination Payments: Removal Of Foreign Service Relief

This draft clause removes foreign service relief on termination payments for UK residents, ensuring that all employees who are UK resident in the tax year their employment is terminated will be taxed in the same way as others who have not worked abroad. The change will apply to those who have their employment contract terminated on or after 6 April 2018. Foreign service relief is retained for seafarers.

The Chancellor will publish his Autumn Budget on Wednesday 22 November 2017.

There will now only be one fiscal event in each year, held in the Autumn. From 2018 there will be a Spring Statement, responding to the forecast from the OBR, but no major fiscal event.

http://www.gov.uk/government/collections/finance-bill-2017-to-2018

Scottish programme for 2017/18

In its ‘Programme for Scotland 2017/18’, the Scottish government sets out policy and legislative plans for the year which includes plans to publish a discussion paper on income tax and possible options for using the government’s devolved powers to ensure ‘the sustainability of our public services and give long-term certainty to taxpayers’.

16 new Bills, including a:

- Budget Bill (covering matters such as spending plans and setting devolved taxes); and
- Land and Buildings Transaction Tax Bill—giving retrospective effect to the application of the LBTT (Additional Amount – Second Homes Main Residence Relief) (Scotland) Order, SSI 2017/233, enabling taxpayers to claim repayment of the LBTT additional dwelling supplement on relevant transactions which occurred prior to 30 June 2017, the effective date of the order.

The government also intends to seek additional powers and ‘explore how responsibility for a broader range of taxes would enable the Scottish Parliament to take more balanced budget decisions, grow the economy and tackle poverty more effectively’.

www.gov.scot/Publications/2017/09/2470/0

Employer bulletin – August 2017

Optional Remuneration Arrangements

Optional Remuneration Arrangements (OpRAs) are where benefits are provided through arrangements in which the employee gives up the right to an amount of earnings in return for a benefit which include flexible benefit packages with a cash option, cash allowances and salary sacrifice.

Any arrangements entered into since 6 April 2017, or arrangements that have been varied or renewed, are now under the new FA 2017 Benefit in Kind rules.

All arrangements covered by OpRA will move into the new rules on 6 April 2018 apart from those in respect of cars above 75g CO2/km, school fees and accommodation which will come in to force from 6 April 2021.

Where the benefit falls under is under the new OpRA rules, the taxable value is now the higher of the:

- cash foregone; or
- taxable value under the normal BiK rules.

The new rules do not however, affect arrangements in respect of pensions, childcare vouchers, workplace nurseries, directly contracted childcare, Cycle to Work, or cars with emissions of 75g CO2/km or less. A full list of BiKs not affected can be found in the Employment Income Manual.

OpRA and Voluntary Payrolling:

Provided an employer deducts the tax due on the revised taxable value of the benefit for the full year and return the information through your RTI submission, they will not need to complete a P11D for the 2017/18 tax year. This concession has been introduced to mirror the regulations so you won't be faced with two sets of changes and is only available for the tax year beginning 6 April 2017.

PAYE penalties – continuation of the risk-based approach to charging penalties

HMRC has again reviewed the effectiveness of the risk-based approach to late filing PAYE penalties and have decided to continue this approach for the tax year beginning 6 April 2017. This means that late filing penalties will continue to be reviewed on a risk-assessed basis rather than be issued automatically. The first penalties for the tax year beginning 6 April 2017 will be issued in September 2017.

Simplifying PSAs from 6 April 2018

From 6 April 2018.HMRC plans to:

- Provide an online digital service for PSA submissions and payment;
- Remove the need for an annual upfront PSA agreement;
- Improve and clarify PSA guidance.

The latest on Making Tax Digital (Lecture P1038 – 14.45 minutes)

As we know, from April 2019 Making Tax Digital will go live for VAT, sole traders will commence no earlier than 2020 and we are still awaiting an announcement for companies. HMRC are keen for sole traders to become Making Tax Digital compliant prior to it becoming compulsory for Income Tax but will businesses want to be HMRC's guinea pigs or would they rather wait until they know that the system is working effectively?

We are now starting to see some more of the detail of how things will work. HMRC have published draft Regulations for consultation:

- The Income Tax (Digital Requirements) Regulations;
- Income Tax Notice: Retail sales, Upfront Information, End of Period Information and Partnership Information;
- The Income and Corporation Taxes (Electronic Communications) (Amendment) Regulations; and
- Making Tax Digital for VAT: Legislation Overview.

These can be found at www.gov.uk/government/consultations/making-tax-digital-reforms-affecting-businesses.

It seems slightly strange that these draft Regulations largely cover Income Tax; we might have expected more detail on VAT that already has a go live date. Presumably the VAT Regulations will be similar.

VAT basics

From April 2019 businesses with turnover exceeding the VAT threshold will have to:

- keep digital records;
- provide quarterly updates via approved software.

If turnover falls below the registration threshold, a business remains within Making Tax Digital for as long as they are registered for VAT.

Businesses that have registered for VAT on a voluntary basis but are below the VAT threshold can choose whether or not they want to comply with Making Tax Digital.

Digital record keeping

This will be compulsory and we now have some detail on what this means. The Regulations say that businesses will have to keep a digital record for each transaction, using software that is Making Tax Digital compatible. Expenditure will be allocated within the software to appropriate expense categories of the P&L account. On a quarterly basis, summary information will be extracted and sent to HMRC.

There is no requirement for businesses to take a photograph of or scan every invoice and receipt. Currently there is no detail of when that record needs to be made. Does that mean that digital records need to updated in real time as transactions happen or can we keep a record on a piece of paper or spread sheet in the normal way and then say weekly or monthly convert that to a digital record? Hopefully the final Regulations will clarify this point.

There is an exemption for retail businesses who are allowed to keep a digital record of turnover rather than each transaction on an item-by-item basis. This will be provided in the form of a daily summary of turnover. However to follow this approach, the retailer will need to make an election to do so. If no election is made, then this approach cannot be adopted.

One question that needs to be answered is 'Will it still be possible for clients to provide information on a quarterly basis to their agents for them to process electronically?' It is questionable as to whether the client is keeping a digital record.

Functional compatible software

This is defined as a software program or set of compatible programs the functions of which include:

a) Recording and preserving digital records in a digital form;

b) Providing to HMRC quarterly digital updates and if applicable, end of period statements or Schedule A1 partnership returns in a digital form using the API platform; and

c) Receiving information from HMRC using the API platform in relation to a relevant entity's compliance with obligations under these Regulations.

Spread sheets are acceptable as digital records provided that they can be fed into software to enable information to be sent quarterly to HMRC.

Action needed

In the very short term no major changes are needed. However it is important to start discussing with your clients how to take things forward so that by April 2019 they are digitally able and can deal with VAT going live.

Taken from the seminar by Andrew Hubbard

Annual HMRC stakeholder conference (Lecture P1040 – 19.51 minutes)

HMRC's annual conference took pace on 12 September 2017. They invite members of relevant professional bodies, representatives from different sizes of accounting and tax practices, tax charities and others that are involved in the work of HMRC.

Keynote speech

This year, Andrew Jones MP, Exchequer Secretary to the Treasury gave this speech as Mel Stride, the Financial Secretary to the Treasury, was occupied with the Finance Bill that was going through Parliament.

He set out the main priorities for HMRC over the next year:

Customer service – looking to provide more online self service capability as well as real time access to HMRC to sort out issues out of normal office hours. He confirmed that quarterly digital submissions will be starting for VAT from April 2019.

Fairness – Every taxpayer must pay what is required by law. HMRC will support this by introducing easier to use systems that are fit for purpose, to ensure that the correct tax is paid the first time around. In 2016/17 HMRC collected an extra £29 billion through strengthening their activities against evasion and organised crime.

Competitive tax environment – It is good for the economy that the tax system helps companies grow. This attracts investment into the UK which drives activity and ultimately taxes that are collected. HMRC will soon be rolling out a new 'Growth Support Unit' providing dedicated tax specialists to support growing businesses with a turnover exceeding £10 million or are employing 20 or more staff. Additionally he mentioned the intention to create 'frictionless trade' with Europe and no border with Ireland.

Address by Edward Troup, Executive Chairman of HMRC

Mr Troup opened by stating that HMRC's aim is to maximise revenues that they are entitled to collect under the law. He acknowledged that there is still a lot of work to be done on reducing the 'tax gap', the tax they collect compared to the tax that they believe should be collected.

He moved on to say that, together with the stakeholders at the conference, HMRC have a collective responsibility to ensure that the public has confidence in the tax system. Writing in *Taxation* on this, Andrew Hubbard commented:

> "I took it to mean that everybody had a role to play in the public discourse about taxation and that we all had a responsibility to conduct that discourse responsibly. A loss of public confidence in the tax system would be a disaster for everybody."

Next Mr Troup talked about transforming customer service. Large amounts of money are being invested in Making Tax Digital with most development work being insourced, thus ensuring that they have the capability from within. Once launched HMRC will be in a strong position to maintain the systems.

He continued by discussing a number of other areas including:

- Monthly PAYE coding adjustments through digital tax accounts;
- Application of tax free childcare applications and how taxpayers decide what is right for them;
- His ultimate aim that everything will be fully digital so simplifying compliance but he does recognise that that may not be possible for all;
- New ways of working. HMRC have just opened their first regional processing centre based in Croydon.

He concluded by considering the challenges facing HMRC. Securing resources in terms of technology and people was top of the list. He stressed the importance of building the culture and staff development to ensure that staff had the appropriate skills required. He recognised the importance of continually building confidence in HMRC to deliver for taxpayers, Parliament and the media.

Penny Ciniewicz, Director General, Customer Compliance Group

Penny set out the biggest challenges that she is currently facing:

- Ensuring that HMRC remains connected to the digital world by using new technologies and that the systems that are introduced are in line with how people are using such platforms;
- Using the huge volumes of data that HMRC have access to in order to identify non- compliance;
- Making sure that there is good collaboration between the 13 new centres.

Chris Jones' question

Chris welcomed the introduction of the new 'Growth Support Unit' to give support to growing businesses. He reminded HMRC that tax legislation includes a significant number of tax incentives to help businesses, such as EIS, SEIS, EMI options schemes, R&D tax credits and so on, which are designed to help these growing businesses. He asked how this new incentive to drive business growth tied in with Edward Troup's objective to maximise revenues.

Jim Harra, Director General, responded by saying that HMRC would like to see a higher take up on these incentives schemes. HMRC are looking at what is working well and not so well and makes changes where needed, perhaps because they are too complicated. They want to make it easier for taxpayers to access these schemes.

HMRC's website states that their strategy is to 'Maximise revenues and bear down on avoidance and evasion". Is the word 'maximise' helpful in building a brand of trust with the public? Does it not give the message that HMRC are just looking get the most rather than helping the taxpayer find the best solution for them?

Tax incentives for businesses are deliberately set by government to target and promote growth in the economy. Their impact is either to reduce or defer a liability.

As stakeholders should we not be focussing our attention on the 'right' amount of tax? Perhaps HMRC should be stating that their aim to taxpayers is ' we help you get your tax right'.

Business Taxation

New corporate loss rules (Lecture B1036 – 11.33 minutes)

In his Budget on 16 March 2016, the then Chancellor announced that there was to be a reform of the corporation tax rules governing the carry-forward of trading losses and certain other items with effect from 1 April 2017. This reform is of considerable significance to both single companies and groups.

The losses included in this reform comprise:

- trading losses;
- management expenses of investment companies;
- non-trading loan relationship deficits;
- UK property losses; and
- non-trading losses on intangible fixed assets.

The relevant legislation is found in Cl 29 and Sch 9 FB 2017. The main focus of these notes is on trading losses.

The details of the Government's thinking were originally set out in a consultation document published in May 2016 which was entitled 'Reforms To Corporation Tax Loss Relief: Consultation On Delivery'.

The Government say that this reform is in line with one of their key policy objectives, namely the 'modernising' of the tax system, in view of the fact that the existing rules on the carry-forward of company losses are 'not consistent with international best practice, overly restrictive and not reflective of the way in which businesses operate'.

At the same time, the Government state that the absence of any restriction on the profits which can be relieved by carried forward losses can also have 'undesirable outcomes' for the Exchequer, in that businesses making substantial UK profits may not pay any corporation tax due to losses incurred from earlier activities. In response, one might argue that, however 'undesirable' this may be for the Exchequer, such a consequence is a perfectly logical one. The Government counter this line by pointing out that the majority of G7 countries have various forms of restriction in place for the carry-forward of losses.

Considering the two main reforms, the first one is beneficial to the taxpayer, given that the new regime will allow greater flexibility in the way in which loss carry-forwards can be used. That is to say, trading losses, for example, no longer have to be carried forward against future profits from the same trade – they are able to be offset against other sources as well. On the other hand, the second one gives a cash flow advantage to the Government, in that the amount of losses being carried forward that can be utilised each year will, in some cases, be the subject of a restriction.

Elaborating on the trading loss position in more detail, FB 2017 provides that:

- when corporate losses arise on or after 1 April 2017, they can be carried forward and set against other profits such as income from interest or property (alternatively, they can be surrendered to other group companies and set against their trading and non-trading profits); and
- with effect from 1 April 2017, the amount of a company's profits which can be relieved by losses carried forward will be limited to a figure of 50%, subject to an annual allowance of £5,000,000 which will apply per company or per group (as the case may be).

The vast majority of businesses are going to be unaffected by the 50% restriction, given that it will only be the very largest companies or groups which have loss carry-forwards of more than £5,000,000.

Note that relief for capital losses is completely unaffected by this reform.

FB 2017 goes on to provide a comprehensive pro forma for the calculation of a company's trading loss position. The basic model works as follows:

1. Calculate the company's taxable profits after all reliefs (including in- year losses and group relief), but exclude:

– carried forward losses;

– carried back reliefs; and

– post-31 March 2017 carried forward losses to be claimed from other group companies;

2. Allow up to £5,000,000 of these profits to be relieved in full by carried forward losses;

3. Allow up to 50% of the remaining profits to be relieved by the remaining carried forward losses (note that pre-1 April 2017 losses do not have to be used in priority to later ones, as was originally going to be the case); and

4. If there are still profits which can be relieved within the 50% limit, allow them to be relieved by post-31 March 2017 carried forward losses which have been claimed from other group companies.

Carried back losses are not taken into account in calculating the amount of profits to which the 50% restriction applies. Instead, carry-back relief will be allowed and set against any profits which remain after this restriction has been applied.

In relation to these new rules, there are three further matters which should be mentioned:

- A company is allowed to allocate in-year losses and group relief against its trading and non-trading profits as it sees fit. HMRC's initial proposal was that, where a company's profits were derived from both trading and non-trading sources, current year reliefs had to be offset on a pro rata basis. The subsequent relaxation in FB 2017 is a welcome change.
- In the case of a group of companies, the group will have absolute discretion as to how it should allocate its £5,000,000 limit between its members (and then within the chosen company or companies, between the different categories of profit). The meaning of the word 'group' for this purpose is based largely on the group relief definition.
- Pre-1 April 2017 losses which are carried forward are always subject to the existing streaming rules, ie. they can only be carried forward against profits of the same trade.

Example

C Ltd makes accounts up to 31 March and as at 1 April 2017 it has:

- Trading losses brought forward of £120,000;
- Capital loss brought forward of £15,000.

In its year to 31 March 2018 it generated a £90,000 trading loss of which £30,000 is set against its 2018 property income of the same amount, leaving £60,000 to carry forward.

So at 1 April 2018 it has:

- Pre 1 April 2017 trading losses brought forward of £120,000;
- Post 1 April 2017 trading loss brought forward of £60,000;
- Capital loss brought forward of £15,000.

The year to 31 March 2019 is a better year and the company achieves a £50,000 trading profit, generates property income of £37,000 and crystallises a capital gain of £30,000. The pre 1 April 2017 losses are offset against the £50,000 trading profit, leaving £70,000 to carry forward. The £15,000 capital loss brought forward is set against the capital gain. £52,000 of the post 1 April 2017 losses are set against the £37,000 property income and remaining £15,000 capital gain, leaving £8,000 post 1 April 2017 losses to carry forward.

Other significant changes

1. On a cessation of trade, there is an improvement to the terminal loss relief rules in that brought forward losses can now be carried back and used – without the 50% restriction – against profits arising in the final 36 months of trading. This is subject to the proviso that they are not carried back to a period prior to 1 April 2017. Post-31 March 2017 losses in these circumstances can be set against the company's total profits, whereas the

utilisation of any pre-1 April 2017 losses is restricted to profits of the same trade.

2. Another new constraint is being introduced to deal with the situation where a company's trade, having once flourished, has become small or negligible. Hitherto, such companies – other than on a change of ownership – have been able to continue to carry forward their accumulated trading losses, but the Government are concerned about the possibility of the trade being kept alive purely to enable the group to access its post-31 March 2017 losses. Accordingly, it is provided that the offset of any remaining trading losses in these circumstances should be limited to future profits from the same trade.

3. In order to counter what HMRC call 'loss buying', there is anti- avoidance legislation to the effect that, where a company suffers a major change in the nature or conduct of its trade within three years either side of a change of ownership, any unrelieved trading losses at the date of the ownership change are sterilised (see Ss673 and 674 CTA 2010). The Government are worried that, with the greater flexibility in the use of losses, the potential for 'loss buying' will increase. As a result, they have decided to widen the scope of these rules so that:

    - the time period over which a major change in the acquired company's activities can occur goes up from three to five years; and

    - on a change of ownership, any pre-acquisition losses in the acquired company cannot be group relieved for a period of five years.

Dealing with participators **(Lecture B1037 – 10.30 minutes)**

Where a loan to a participator in a close company is either repaid by the participator or released or written off by the company, tax previously paid under s.455 will be refunded to the company.

The refund is made by reducing the company's tax liability for the chargeable accounting period in which the loan is repaid, released or written off. As most close companies are small, this will normally be nine months and one day from the end of the accounting period in which the repayment or release of the loan is made. Claims for relief should be made within 4 years of the end of that accounting period.

The rules have been exploited in the past by a participator repaying a loan before the due date for payment of the s.455 tax, and then very shortly afterwards borrowing the same amount again. In this way, the participator only lost the use of the money for a few days, but the company did not have to pay the s.455 tax. This was known as 'bed and breakfasting' the loan.

With effect from 20 March 2013, if within any period of 30 days:

- one or more repayments totalling £5,000 or more are made by a participator to a close company in respect of a loan to a participator, and
- the participator borrows a total of £5,000 or more from the company in a subsequent accounting period,

the repayment of s.455 tax will be restricted. In effect, any repayments within that 30 day period are treated as a repayment of the subsequent loan, not the original loan.

If the amount subsequently borrowed equals or exceeds the repayment, no s.455 tax will be repaid. If there is an excess of borrowing over the repayment and this amount is still outstanding at the due date of the accounting period in which the borrowing occurs, further s.455 tax will be due on the excess over the repayment.

If the amount subsequently borrowed is less than the repayment, some s.455 tax will be repaid but only in respect of the amount of the repayment that exceeds the amount borrowed, as this amount of the original loan is treated as repaid.

In addition, if:

- immediately before a repayment there is a loan outstanding of £15,000 or more from the company, and
- at the time of the repayment there are arrangements to draw further advances of money from the company to replace some or all of the amount repaid, and
- the amount borrowed under the arrangements is £5,000 or more,

repayment of s.455 tax will be restricted as above, even if the further amounts are borrowed more than 30 days after the repayment.

Loan waivers

If a company writes off or releases a loan to a participator the company will receive a repayment of the s.455 tax. The participator will be treated as receiving a dividend equal to the amount of the loan written off or released.

The date of receipt of the dividend will be the date the loan is released or written off. An individual will pay any tax via self assessment.

This treatment also applies if the participator is also an employee. The release or writing off is still treated as a dividend and not employment income.

However, it is not a dividend from the company's point of view. The release or writing off gives rise to a debit under the loan relationship rules, but this is not an allowable deduction for corporation tax purposes.

Where the participator or associate is an employee, the loan release or write off is treated as earnings from employment for NIC purposes. It will be subject to Class 1 NIC, so the employee will pay 12% or 2% of the amount released or written off depending on the level of their employment income, and the company will pay Class 1 NIC at 13.8%. The NIC paid by the company is a deductible expense for the company.

The case of Stewart Fraser offers hope of an alternative argument where the loan is written off by the shareholders rather than the directors but in many family businesses they are one and the same so NIC is likely to be due on the loan write off.

Loans excluded from s.455 charge

There are various exclusions from the s.455 charge but by far the most useful is an exclusion for loans of no more than £15,000 made to a full-time director or employee, who does not have a material interest in the company. A material interest is more than 5% of the ordinary share capital, or entitlement to more than 5% of the company's assets on a winding-up. When calculating this 5%, we must also take account of holdings owned by his associates.

A company's ordinary share capital comprises all of its issued share capital (however described) except for any share capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits.

Any share capital that carries no dividend rights is regarded by HMRC as part of a company's "ordinary share capital". Their view is supported by the First-tier Tribunal's decision in Castledine (2016) (although in the case of McQuillan (2016), another First-tier Tribunal decided that such share capital was not "ordinary share capital").

If the employee acquires a 5% holding at a time when the whole or part of the loan remains outstanding, then he will be treated as receiving a loan at that time.

Benefits to participators

Where a shareholder is an employee or director of a close company, any benefits he receives are taxed under the earnings rules. Therefore, in the absence of any special rules, where shareholders are not directors or employees, they would not pay any tax on benefits they receive. We therefore treat those benefits as dividends paid to those shareholders. The dividend is calculated using the normal benefit rules for earnings. The rules apply to any expense incurred by the company in connection with the provision of living or other accommodation, entertainment, domestic or other services or other benefits or facilities of whatever nature.

Base Erosion Profit Shifting action plan (Lecture B1038 – 11.11 minutes)

The OECD were behind the idea of Base Erosion Profit Shifting (BEPS) and we are now at a stage where agreement regarding cross border transactions has been reached between a significant number of the world's jurisdictions.

BEPS recognised that each jurisdiction has its own rules and mismatches which historically has resulted in companies being able to treaty shop for the best tax outcome available for them.

The OECD wanted an agreed framework that provides clear guidance and rules. Following detailed consultations they have managed to achieve some globally recognised rules across tax jurisdictions.

The take up varies from country to country. Some countries have whole-heartedly embraced the idea, others are taking things more slowly and going step by step with a number saying that they are already doing it.

The Multilateral instrument

This came into play in June 2017. Over 70 jurisdictions have agreed that 1100 bilateral tax treaties will be modified in line with BEPS. This makes it far harder to treaty shop. BEPS has made it far easier to amend bilateral treaties.

Each jurisdiction sets out what aspects of BEPS it is prepared to accept within its tax treaties and then jurisdictions are matched up with other similar jurisdictions, so linking like-minded countries. It is looking to make it difficult for companies to route taxable income to jurisdictions recognised as tax havens, of which these days there are fewer and fewer.

The following areas have been covered to date:

- Definition of permanent establishment;
- Hybrid mismatches; and
- Treaty abuse.

The instrument touches all sorts of root causes of disputes with tax authorities as well as lots of differences that lead to double taxation. It also contains a defined procedure that helps to resolve tax disagreements between companies and tax authorities. If authorities cannot agree the dispute can be made mandatory, with binding arbitration led by a third country representative. Over 25 countries have signed up to this resolution procedure. It looks like it could be a massive improvement of what we have now. Disputes are likely to be resolved quicker

For the multilateral instrument to become part of a country's legislation, countries must sign up to it.

In practice not all areas covered by the agreement will be taken on. Countries are determining which parts they want to take on and which they want to reject. A telling example relates to commissionaire arrangements, through which agents sell goods and services in a number of different countries. In the past they could operate in markets outside their home country without activating the permanent establishment designation rules provided they did not routinely conclude the contracts. However under the terms of this new multilateral instrument, the trigger for when permanent establishment happens could be when playing the principal role in negotiating contracts.

Not everyone is embracing everything. For example, the UK are embracing the majority of the instrument but have stated that they will not amend their permanent establishment rules as they consider that these are already robust.

For now, be aware of what is going on. The rules are changing and beginning to be implemented. It is important to review existing structures and make changes where needed.

Created from a seminar by Francesca Lagerberg

Notifying HMRC of country-by-country reports

Relevant multinational groups with UK entities must have notified HMRC by 1 September 2017 about the group's first country-by-country report, including who will file the report and where.

The reporting requirements apply to multinational groups with a consolidated revenue of €750 million or more in the relevant accounting period or equivalent.

Groups must send HMRC their group's country-by-country report if they are any of the following:

- based in the UK, and you're the group parent business of the group in question;

- the highest level UK business of a group whose group parent business is based in a country that either:

    - doesn't require that group parent business to file a country-by-country report;

    - has entered into a tax information exchange agreement, but with no country-by-country reporting requirements;

    - has information exchange agreements already in place between it and the UK, but HMRC has notified you that they aren't working effectively.

Detailed guidance on notification and reporting obligations is contained in HMRC's International Exchange of Information Manual, although the OECD guidance remains the definitive source.

Relevant groups must notify:

- whether their group intends to file a full report with HMRC or with another jurisdiction which will exchange the report with HMRC;

- who will be sending the report;

- which country the report will be sent to;

- the names and unique taxpayer references of all your UK businesses.

Once registered, groups will need to upload a valid, completed XML file as part of the country-by-country reporting process. HMRC recommends registering at least 1 day before needing to send the report as they will need the country-by-country ID number received from registering.

Reports must be sent within 12 months from the end of your relevant reporting period and have 3 years from the end of the relevant reporting period to amend or correct information supplied.

Penalties may be charged as follows:

- £300 for failing to notify HMRC by the notification deadline, with a daily penalty of up to £60;
- £300 for failing to report by the reporting deadline, with a daily penalty of up to £60;
- up to £3,000 for an inaccurate report.

www.gov.uk/guidance/check-if-you-must-send-a-country-by-country-report

VAT

No supply

Summary – the Upper Tribunal found that input tax incurred by a company, before its business was taken over by its directors, was not recoverable by the directors.

KFM was a partnership with Mr And Mrs Kelly as partners providing exempt, financial advice and so was not registered for VAT.

In February 2002 Mr and Mrs Kelly bought Ludbrook Manor and lived there with their family, while Happy Holidays Limited, of which Mr and Mrs Kelly were the only directors and shareholders, carried on the business of letting parts of the former stables to holidaymakers. Happy Holidays Limited became registered for VAT in August 2004 and its supplies to holidaymakers were standard- rated.

In September 2010, the taxpayers decided that the house should also be let to holidaymakers and Happy Holidays Limited embarked on an extensive refurbishment programme undertaken by arm's-length contractors. Happy Holidays Limited incurred substantial amounts of VAT that it treated as recoverable input tax.

In March 2013, the taxpayers were advised to form Ludbrook Manor Partnership to undertake the holiday letting of the property that was registered for VAT from 1 April 2013.

Subsequently, on 28 March, the taxpayers were advised that while Happy Holidays Limited had incurred expenditure relating to the upgrading of the main house the revised plan was for the holiday letting to be undertaken by the taxpayers in partnership and that therefore Happy Holidays Limited had to assume the role of 'a main contractor' and that the costs incurred by Happy Holidays Limited would be 'recharged to the partnership'.

Happy Holidays Limited and the taxpayers subsequently sent an invoice to Ludbrook Manor Partnership for the work done over the relevant period. The invoice was settled according to its terms by a reduction in the taxpayers' directors' loan account with Happy Holidays Limited.

Ludbrook Manor Partnership submitted its VAT return for the period to 30 June 2013 on the following day. The return included a claim for repayment of £107,861.13, of which part consisted of the VAT charged by the Happy Holidays Limited invoice.

HMRC denied the input tax claimed by Ludbrook Manor Partnership on the invoice submitted by Happy Holidays claiming that

- there had been no supply at all by Happy Holidays Ltd to Ludbrook Manor Partnership; rather, Happy Holidays Ltd had consumed the supplies it had received from the arm's length contractors in its own business, and could not sell them on to Ludbrook Manor Partnership.

- Happy Holidays Ltd had not declared the VAT as output tax, and its insolvency report had not reflected the invoice. HMRC rejected Ludbrook Manor Partnership's other claims.

- HMRC imposed various penalties amounting to £46,238 for deliberate and careless errors.

The taxpayers appealed only against the refusal of input tax credit for the June invoice on two grounds:

1. The Tribunal were wrong to conclude that Ludbrook Manor Partnership had to have been in existence when Happy Holidays Ltd had incurred the cost of the building and refurbishment costs

2. The Tribunal had erred in finding as a fact that there had been no partnership in existence at that time. Ludbrook Manor Partnership argued that the Tribunal had wrongly limited itself by assuming that the supply to Ludbrook Manor Partnership by Happy Holidays Ltd could only have been of project management services.

Decision

The Upper Tribunal found that when Happy Holidays Ltd had acquired and had paid for supplies of goods and services, it had intended to use these for its own holiday letting business. It had consumed those supplies in putting itself in a position to start letting the manor house to holidaymakers.

When the plan changed, there was no reciprocity of obligation between Happy Holidays Ltd and Mr and Mrs Kelly; and there was no supply by Happy Holidays Ltd to the Kellys. It could not 'sensibly be said' that Happy Holidays Ltd had, historically, been making supplies of project management services to Mr and Mrs Kelly, as its invoice claimed. *Serebryannay* (Case C-283/12) made it clear that the requisite reciprocity of obligation must exist at the time the supplies are made; it cannot be introduced later.

Sadly for the Kellys, the change of plan was badly timed. Had Happy Holidays Ltd had made supplies of accommodation over a sufficient period of time, it could have recovered the input tax incurred on the construction works.

The appeal was dismissed.

Ludbrook Manor Partnership v HMRC (Upper Tribunal)

Bingo participation fees

Summary – recalculation of the participation bingo fees paid by customers on a session-by-session basis rather than game-by-game basis, as stated in Brief 07/2007 was correct and output tax was reclaimable.

K E Entertainments Ltd is the lead case in relation to cash bingo participation fees. If successful, operators would make claims for over-declared VAT of around £40 million, of which KE Entertainments Ltd would be entitled to around £460,000.

In summary HMRC issued a Brief directing taxpayers to follow a particular calculation that would reduce taxable consideration. In that Brief, taxpayers were invited to reclaim output tax previously overstated. In this case, somewhat bizarrely, HMRC then appealed against part of such a reclaim, arguing that the guidance in their Brief was not relevant, and that you cannot change the value of a supply retrospectively. Let's take a look at the detail.

K E Entertainments Ltd had been calculating the VAT due on participation charges on a game-by-game basis. However, on 1 February 2007, HMRC issued Brief 07/2007 Cash Bingo: Accounting for VAT on Participation and Session Fees.

This briefed operators that when apportioning income between taxable participation fees and the stake that was outside the scope, they should adopt a session-by-session basis. (To clarify the participation fee gives the customer to right to play the bingo while the stake is the customer's contribution towards the cash prizes paid out to the winner in each game of the session.)

While the session fee will generally be the same fixed sum, the split between the participation fee and the stake for each game will vary depending on the number of customers participating in a session and the amount of prize money to be paid out for each game. The manager decides what the prize money will be after the sale of tickets and before the start of the game. The smaller the number of participants, the lower the amount of total stake available for the winner. In such circumstances, the promoter will top up the stake money to enable any guaranteed cash prize for a game to be paid out

The amount of VAT due is different depending whether it is calculated on the game-by-game basis or the session basis.

- On the game-by-game basis the participation fee for the session is arrived at by simply adding up the participation fee for each game within the session.

- On the session basis, the total participation fee is calculated by adding up the ticket prices for all the games within the session, and then deducting all the prizes within the session.

So under the session-by-session basis, customers contribute a higher proportion of the winnings than they do under the game-by-game basis. As a result, the output tax due would be lower than under the game-by-game basis. Brief 07/2007 invited operators, who had calculated the VAT due on a game-by-game basis, to make a claim for repayment of any resulting over-declarations. So KE Entertainment Ltd made such a claim because HMRC required them to do so but HMRC then challenged this!

The recent Carlton Clubs case (TC 1389) has made it clear that in these circumstances a taxpayer is entitled to reduce the consideration paid for participation fees. Our client has therefore reduced the consideration received for participation fees and calculated output tax due thereon on a session basis for the period from 1996 to September 2004 and this has resulted in a reduction of £460,626.36 in output tax due.

K E Entertainments Ltd made a successful claim for repayment under S80 VATA 1994. However, there is a four-year time limit on S80 claims and so K E Entertainments Ltd made a claim under regulation 38 of the Value Added Tax Regulations 1995 claiming £460,626 for the period from 1996 to September 2004.

Decision

HMRC's main argument was that there had been no reduction in the amount that KE Entertainments Ltd had received from its customers, the bingo players. They argued that, despite a recalculation of the participation fee and stake split, the total amount of consideration had stayed the same.

The Upper Tribunal held that the consideration is the amount that the bingo operator can take for himself, which is the participation fee. It does not matter that the participation fee is not a fixed percentage of the session fee

The law recognises that there may be circumstances where the consideration increases or decreases after the supply, and makes provision in Regulation 38 for a corresponding alteration in the amount of VAT due.

The Tribunal said that the effect of the Business Brief was that it altered the amount that the operator was allowed to keep for itself. On a change from a game-by-game basis to a session basis the participation fee is reduced because a larger proportion of the total amount paid by the customer is now being used to fund winnings. The participation fee had been reduced and therefore the consideration had been reduced. The overpaid output tax was repayable.

The First-tier Tribunal's decision was affirmed.

HMRC v K E Entertainments Ltd (Upper Tribunal) [2017] UKUT 328 (TCC)

Two associated companies carrying out one business?

Summary – Store services supplies were not made at below open market value and Temple Finance Ltd was correct to use the standard method for calculating how much input VAT was recoverable for their partially exempt business.

Under an Intra-Group Services Agreement Temple Retail Ltd was the tenant under the showroom leases and was responsible for acquiring goods to be sold, stocking showrooms and delivering goods. In the 2% of cases where no Hire Purchase was required, Temple Retail Ltd effected the sale direct to the customer. In other cases Temple Retail Ltd first sold the goods to Temple Finance Ltd for 97% of the advertised price and Temple Finance Ltd entered into the HP agreement to supply the goods and extended warranty (both standard-rated) and supply credit and theft and damage insurance cover (both exempt). In all cases Temple Retail Ltd delivered the goods including goods sold under HP. Temple Finance Ltd paid Temple Retail Ltd 5% of the purchase price of the goods to deliver goods on its behalf (a standard-rated supply of services by Temple Retail Ltd). Temple Finance Ltd was responsible for servicing and repairing goods, but sub-contracted the work to Temple Retail Ltd (standard-rated supply by Temple Retail Ltd).

In summary:

- Temple Retail Ltd made only taxable supplies and so recovered 100% of its input tax;

- Temple Retail Ltd was partially exempt and adopted the standard method when calculating its input tax recovery.

HMRC issued a direction to Temple Retail Ltd under para 1, sch. 6 VATA 1994 that the value of the services supplied by Temple Retail Ltd to Temple Finance Ltd for occupying and use of the shops and in respect of shop advertising and launch costs had been made at below open market value and should be treated as made at open market value. They assessed Temple Retail Ltd to additional output tax on that basis. The effect of that approach would be to increase the quantum of the irrecoverable input tax incurred by Temple Finance Ltd.

HMRC made assessments against Temple Finance Ltd on the basis that it should apply the standard method override in determining the proportion of input tax recoverable on its overheads. This resulted in less input tax being recovered. The taxpayers appealed to the First Tier Tribunal.

The Tribunal concluded that although the companies operated under a single brand, they carried on separate businesses. It held that:

- supplies of 'store services' had not been made at below open market value

- the open market value of advertising services supplied by Temple Retail Ltd should be determined by reference to their respective operating profits rather than in the manner proposed either by HMRC or by the taxpayers; and

- Temple Finance Ltd’s recoverable input tax should be determined using the standard method, no SMO being required.

The Revenue appealed.

Decision

Here, the choice had been made to carry on the PerfectHome activities through two separately VAT registered companies, Temple Finance Ltd and Temple Retail Ltd , and not through a single company or VAT group. It did not matter that customers may consider that they were dealing with the PerfectHome business and not draw any distinction between Temple Finance Ltd and Temple Retail Ltd.

In the absence of abuse, HMRC could not rely on the principle of fiscal neutrality to seek to impose a VAT cost on the group that might have arisen if a different structure had been chosen.

HMRC v Temple Finance Ltd ; Temple Retail Ltd (Upper Tribunal [2017] UKUT 315

New Build student accommodation

Summary – HMRC's VAT policy on new build student accommodation was successfully challenged, potentially bringing substantial cash flow savings for student accommodation contractors.

Summit Electrical Installations Limited is an electrical contracting company that undertakes electrical installations in commercial buildings, schools, public buildings and larger residential blocks.

In this appeal, the company acted as sub-contractor, supplying electrical services in connection with the construction of new build student accommodation in Leicester. The accommodation consisted of self-contained units providing bedrooms and living accommodation including kitchenettes and en-suite bathrooms. The planning consent restricted use to students but there was no clause preventing each unit from being separately used or sold.

The main contractor, Create, has received a zero rating certificate from the developer on the basis that the developer of the site intended to use the buildings for student living accommodation, a relevant residential purpose. Ordinarily sub-contractors working on relevant residential purpose buildings are not entitled to zero-rate their services but must instead charge VAT at 20%, with the main contractor then reclaiming the VAT charged on their VAT return.

On the basis that the zero rating certificate was evidence of Create's intention to zero rate its supplies to the developer, as the buildings were to be used for a relevant residential purpose, HMRC refused to permit Summit Electrical Installations Limited to zero rate its supplies to Create. HMRC argued that restricting occupation to students was a restriction on the separate use of each unit.

Summit Electrical Installations Limited approached Create, proposing to issue VAT only invoices. Create refused to accept the invoices on the basis that, in its view, the VAT was not properly chargeable. They believed that the project was the construction of zero rated dwellings and refused to pay the VAT on Summit's services.

With its customer refusing to accept and pay the VAT only invoices, Summit Electrical Installations Limited was left with little choice but to obtain a judicial determination of the liability of the supplies. In summary the issue was whether Summit Electrical Installations Limited's supplies were:

- zero rated as supplies in the course of construction of buildings designed as a series of dwellings; or

- standard rated as supplies in the course of construction of a relevant residential building.

Decision

The First Tier Tribunal determined that the building was a building designed as a number of dwellings within note 2 to Group 5 Schedule 8 VATA 1994 with the consequence that any supply made by a person in the course of construction of it, including Summit Electrical Installations Limited, is required to zero rate their

supplies. As a consequence HMRC's assessment to output tax by way of adjustment to the return was inappropriate.

They said that any subcontractor can establish for itself whether a building that it is constructing meets the conditions of note 2. If the building meets those requirements, the sub-contractors supplies will be zero rated.

The tribunal then considered HMRC's published policy that subcontractors must charge VAT if a certificate has been issued to the main contractor claiming zero-rating under the relevant residential purpose relief, even if the construction would also meet the definition of dwellings. The judge dismissed that policy as entirely wrong. The position of the contractor is that their supplies may be zero rated either as a consequence of the application of note 2 or where the contractor's client issues a certificate, as a consequence of note 4 (relevant residential purpose). The contractor probably cares little whether it receives a certificate or not as it knows that the supplies are zero-rated. A certificate will, of course, be critical where the building is not designed as a dwelling or number of dwellings but is to be used for relevant residential purposes. In those circumstances only the contractor benefits from zero rating but that is entirely understandable in the functioning of a self assessing tax as in those circumstances the zero rating arises as a consequence of factors known and certified only as between the developer and the contractor and not the subcontractors.

Summit Electrical Installations Limited v HMRC (TC06006)

DIY House Builder Scheme – 'separate use' of the dwelling

Summary – Input VAT was not recoverable under the DIY House - Builder Scheme as a planning condition prohibited "separate use" of the dwelling.

Duncan Lichfield had constructed a dwelling in 2012/13 and claimed a VAT refund of £10,981.27 under the DIY House - Builder Scheme. HMRC had denied the claim and so Duncan Lichfield appealed.

Duncan Lichfield traded in partnership with his wife as proprietors of a garage in Somerset. They were living in rented property about 3 miles from the garage.

On 9 October 2012 Duncan Lichfield was granted conditional planning consent to build "a dwelling, double garage and associated works for site manager" at on land next to the garage. The dwelling was constructed in accordance with that planning consent and on 11 September 2013, the taxpayer moved into the dwelling.

On 25 September 2013 Duncan Lichfield submitted an application to recover £10,981.29 of input tax under the DIY House-Builder Scheme but the claim was rejected by HMRC

To be eligible for a refund under S35(1A)(a) VATA 1994, a building subject to the claim must be "designed as a dwelling" with note 2(c) of Group 5 to Schedule 8 to the Act. stating that:

> "A building is designed as a dwelling ... where in relation to each dwelling the following conditions are satisfied -
>
> (c) the *separate* use or disposal of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision; ... "

Condition 3 of the planning consent read:

> "3 The occupation of the dwelling shall be limited to a person solely or mainly working at the property currently known as St Audries Garage, West Quantoxhead as shown on Drawing No. 2365.04B and to any resident dependants."

The issue in this case was the relationship between use (the term used in the relevant legislation) and occupation (the term used in the planning consent); and more specifically, when can a planning condition that restricts occupation become a prohibition on use for the purposes of note 2(c).

Decision

Note 2(c) does not mention the word occupation, only use. There is no express prohibition on use in the taxpayer's planning consent but, as HMRC assert, and as is clearly set out in HMRC v Shields [2014] UKUT 0453, there is a link.

In *Shields*, the Upper Tribunal said:

> "In our view, a condition of planning permission for a dwelling that requires it to be occupied by a person who works at a specified location prohibits the use of the dwelling separately from the specified location."

In *Shields* the relevant planning condition was that:

> "*The occupation of the dwelling shall be limited to a person solely employed by the equestrian business at 274 Bangor Road, Newtownards, and any resident dependents.*"

The Tribunal here agreed with the sentiments expressed in the extract from *Shields* set out above. The condition in *Shields* tied the occupation to a specific business. A similar condition existed in this case. The requirement that the occupation of the dwelling may only be by a person who works at St Audries Garage prohibits the use of that dwelling separately from that specified location. The dwelling at St Audries can only be properly used to provide accommodation for a person employed in the garage business carried on at St Audries Garage. Any use of that dwelling "separate from" that garage business is, in our view, prohibited by the appellant's planning permission. And that prohibition, which falls within the meaning of Note 2(c), means that the dwelling is not a building designed as a dwelling for the purposes of the scheme.

HMRC rightly accept that generally occupancy restrictions do not prevent the separate use or disposal of a dwelling but do so once the restriction goes beyond identifying a particular class of person, and "ties use of a dwelling to, say, a commercial activity being carried on in another building".

Where the restriction applies to businesses generally, or to a broad geographical location, then separate use is not prohibited. But where the occupation is linked to a specific location, as is the case here, then a prohibition on occupation is also a prohibition on separate use.

The appeal was dismissed.

Duncan Lichfield v HMRC (TC06040)

Fraudulent trader – input tax recovery denied

Summary - Input tax incurred in transactions connected with the fraudulent evasion of VAT that the taxpayer knew or should have known about could not be recovered.

Navee was incorporated on 9 January 2014. Its sole director was Mr Akhtar. Its accounting reference date was 31 January. No accounts had been filed. The company claimed a deduction for input tax relating to the purchase of oud oil totalling £99,783 for the period December 2014 to June 2015.

Following investigations HMRC concluded that the proprietor of the company knew or should have known that its transactions were connected with fraudulent evasion of VAT. Contributing factors included:

- All transactions were made on the same day or within a very short period of time, for the same amount of goods and the same product. The fact that customer requirements could be instantly matched on the day they were required without stock being held suggested that the transactions were artificially contrived;
- Payment for all the transactions was made and received in Bitcoin. There is no audit trail to prove payment had ever been received;
- The business had no premises but traded from an accommodation address;
- There is no documentary evidence that trade had ever taken place, nor were there any delivery notes;
- Trade was extremely sporadic. A lot of trade took place on one day and then there was no trade for long periods afterwards;
- Despite the value of the goods being purchased and sold Navee Ltd did not enter into written contracts with its suppliers or customers;
- Despite the value of the goods being purchased and sold Navee did not insure the goods;

- Navee Ltd did not pay its suppliers until it had received payment from its customers;
- No account appears to have been taken of market fluctuations; no discounts were given and no negotiation seems to have taken place;

Despite declaring on the VAT registration form that its main business activity was to be 'flat pack furniture/household furniture (retail)' Navee failed to undertake any transactions for this activity, concentrating instead on the purchase and sale of oud oil. This appears to show that Navee gave a false picture of its intended business activities when registering for VAT in order that it would not alert HMRC to the probability that it was connected with fraudulent evasion of VAT.

On 26 January 2016, HMRC advised Navee that a decision had been made to refuse Navee's entitlement to deduct their input tax.

On 1 March 2016 Navee Limited was dissolved

Following a review of the decision, in November 2016 Navee Ltd appealed the decision.

HMRC made a cross application for the appeal to be struck out under rule 8(2)(a) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on the basis that the tribunal does not have jurisdiction to hear the appeal and is therefore obliged to strike out the appeal.

Decision

The Tribunal concluded that Navee Ltd having been dissolved on 1 March 2016 is no longer a legal entity, has no legal status and cannot appeal either HMRC's decision to deny the input tax or impose the penalty.

In case there is an application to restore the Company to the register the Tribunal also confirmed that they agreed with HMRC for the periods considered.

The appeal was dismissed

Navee Ltd v HMRC (TC06044)

Private fuel and under-declared output tax

Summary – The company's appeal against under-declared output tax in respect of returns was allowed in part while the appeal against fuel scale charges was dismissed.

Best Buy Communications Ltd is a VAT registered business selling second hand mobile phones and accessories.

In 2012, during a corporation tax enquiry HMRC decided in the absence of prime records it needed to investigate the company's till rolls and later raised concerns over till printouts.

The company's accountants advised that the:

- till was used as a cash box with daily gross takings recorded upon cashing up at the end of the day; daily gross takings would consist of money in the till less £100 float;

- till readings could not be relied upon due to mistakes by the director and staff (For example HMRC's reports showed two cancelled sales of £350,045 that were clearly errors);

- company was operating the VAT margin scheme for second-hand goods.

HMRC argued that the company was not operating the second hand margin scheme and so were within the retail point of sale scheme and so should have kept, in accordance with VAT Notice 727 section 4.4, "details of any adjustments made to this record", that is to say where goods have been returned. There were no such records. HMRC concluded that sales have been under declared because they have been mis-described as returned goods and, the appellant not having kept sufficient records, were entitled to assess the appellant under section 73 in respect of these errors.

In reviewing the company's records, HMRC noticed that the company had recovered input tax on diesel purchased for a Mercedes car but there was no evidence of road fuel scale charges, detailed mileage records or any apportionment calculation between business and non-business use. HMRC took the view that the journey from home to business and vice versa was a private journey and, as the business premises were located away from where the director lived and the Mercedes was available to him to get to and from home to the shop the vehicle could not have been used 100% for business purposes. There was no evidence that the car was garaged at the business premises and, the company refused to supply any insurance documentation to prove business use only.

In 2015 HMRC assessed the company as follows:

- £405.36 for road fuel scale charges; and

- under declared output tax in relation to sales mis-recorded as returned goods of £3,388. This was calculated based on an average return price during the period of £242 and this figure was then extrapolated over the periods under assessment.

Decision

As regards the fuel scale charges, the First Tier Tribunal found that HMRC had exercised best judgment and the company has not produced any evidence to discharge its burn of proof in appeal. This part of the appeal was dismissed.

HMRC is only entitled to raise an assessment in connection with the returned sales if one of the conditions within section 73 were satisfied. The company failed to show any records for returns for the relevant periods and so the Tribunal found that HMRC were entitled in principle to issue a Section 73 assessment.

However, HMRC's calculation of the average value of a return of £242 in a shop that sells second hand phones and accessories is extremely high. The company did not produce any evidence to positively assert any value.

The Tribunal did not think the errors justified setting aside the assessment but instead amended the assessment to reflect a return value of £50, a figure closer to the likely true average value of returned goods.

Best Buy Communications Ltd v HMRC (TC06080)

Input tax claims – winning the 'business argument' (Lecture B1039 – 12.21 minutes)

Introduction

Why is it important to be clear about what is a business activity? The reason is because as far as output tax is concerned, if a source of income is non-business, then it cannot be subject to VAT

VATA1994, s4

VAT shall be charged on any supply of goods or services made in the United Kingdom, where it a taxable supply made by a taxable person <u>in the course or furtherance of any business carried on by him.</u>

A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply.

If an expense is not for the purpose of a business, then input tax cannot be claimed.

VATA1994, s24

Subject to the following provisions of this section, 'input tax' in relation to a taxable person, means the following tax, that is to say-

- VAT on the supply to him of any goods or services;
- VAT on the acquisition by him from another member State of any goods; and
- VAT paid or payable by him on the importation of any goods from a place outside the member States being (in each case) goods or services used or to be used <u>for the purpose of any business carried on or to be carried on by him.</u>

In EU law, the key phrase is 'economic activity' which basically is the same thing as 'business', so there should be consistency with UK legislation.

The six business tests

VAT enthusiasts will be familiar with the *Lord Fisher* (QB [1981] STC 238) and *Morrison's Academy Boarding Houses Association* (CS 1977, [1978], STC 1) tribunal cases from many years ago, which had to consider whether certain activities eg farming shoots constituted a business.

Most importantly, the cases led to six key questions being raised that need to be considered about whether a business is evident

1. Is the activity a serious undertaking earnestly pursued?

2. Is the activity an occupation or function, which is actively pursued with reasonable or recognisable continuity?

3. Does the activity have a certain measure of substance in terms of the quarterly or annual value of taxable supplies made?

4. Is the activity conducted in a regular manner and on sound and recognised business principles?

5. Is the activity predominantly concerned with the making of taxable supplies for a consideration?

6. Are the taxable supplies that are being made of a kind which, subject to differences of detail, are commonly made by those who seek to profit from them?

Pat Willis Eco Ltd (TC5972)

Was company trading as a public relations (PR) business finding clients in Nigeria?

HMRC accepted that the company traded as a taxi business but saw no evidence that it also operated as a PR agent, finding deals for 'household names' in the UK with clients in Nigeria, earning a commission for its services. It had no customers since 2011 when it first registered for VAT.

HMRC therefore used its powers of 'best judgment' (s73, VATA1994) to disallow input tax of £20,679 claimed on expenses supposedly relevant to the PR business, mainly on building materials and clothing.

The tribunal and HMRC received no evidence from the director of retainers, contracts, potential customers or correspondence to indicate there was a PR business in place. The tribunal supported HMRC's assessment and dismissed the appeal:

> "We consider the Appellant had failed in its obligation to maintain sufficient records to support the claims for repayment of input tax in respect of the PR business………There were no records at all to support the claim for input tax deduction in respect of the PR business……We consider the Officer's judgment to be correct." (para 23)

Comment:

The taxpayer told HMRC that he could not produce purchase invoices to support his input tax claims because the information was on two laptops that had supposedly been lost. HMRC did not accept this argument and to misquote Oscar Wilde: "to lose one laptop could be considered unfortunate but to lose two indicates carelessness."

Even if the laptops had been lost, there was still the opportunity for the taxpayer to get copies of major purchase invoices from his suppliers to support his input tax claims, an option he had not taken. The biggest surprise in the case is that there was no mention of any careless error penalties being issued by HMRC.

Will Woodlands (TC6021)

Did charity's woodlands activities wholly relate to taxable sales of timber?

The case considered the input tax claimed by the charity on costs relevant to woodlands – an area based method adopted by the taxpayer gave a split of 93.6% for business of which 99.02% related to taxable activities. So the charity was recovering most of its input tax, which HMRC thought was unfair because the aim of the charity was linked to the environment and to "establish and protect woodlands" rather than making taxable sales of timber from the trees.

The taxpayer's advisers argued that "any conservation benefit was passive" and therefore there was no non-business activity. An income based method preferred by HMRC showed that less than 11% of total income came from timber sales, with the woodlands mainly funded by investment income from rent and grants from various forestry bodies. They issued two assessments for £36,866 (subsequently increased by £205) and £37,501.

The taxpayer treated all costs of planting, maintaining and improving the woodlands as linked to future taxable sales of timber whereas HMRC considered them to be subject to a business/non-business apportionment with a high emphasis on charitable aims. HMRC felt that the fact that timber might be sold in the future does not create a direct and immediate link to taxable supplies.

The tribunal agreed with the taxpayer and felt that HMRC's approach of trying to apply a non-business/business split based on income was flawed.

> "The appellant is carrying on an economic activity of operating woodlands on a commercial basis with a view to the sale of timber and incurred costs such as purchasing young trees with the intention of using them in that activity." (para 128)

Comment:

I always emphasise that there is no time deadline between the date a business registers for VAT with an intention to make taxable sales and the date it makes its first sale. This case highlights that point very well – some of the trees will not be suitable for timber for about 150 years! HMRC's main argument was that the charity's VAT returns gave a very good result in terms of input tax recovery that was not fair but they were unable to convince the tribunal that this was the case or that their income based method gave a fairer result.

Contributed by Neil Warren

Practical tips with the option to tax rules (Lecture B1040 – 14.10 minutes)

Two important rules

Here are two important principles with the option to tax rules in relation to land and buildings:

1. An option to tax election is only ever done by a taxpayer in order to produce an input tax benefit that would not be otherwise available without the option; and

2. Always be clear that there is no such thing as an 'opted property'. Each taxpayer with an interest in a property (including land as well as buildings) makes his or her own decision as to whether an option is in their best interests. So just because a client has bought a property from Builder Owner A and been charged 20% VAT on the purchase price, this does not mean that the client must also make an option to tax election with HMRC.

Example 1

ABC Accountants Ltd has bought the freehold of offices in the High Street for £300,000 + VAT. ABC will only use the premises for its trading purposes as accountants and tax advisers. In this situation, there is no need for the directors to opt to tax the property because it is wholly used for taxable purposes. Input tax can be claimed on the property purchase in the same way that the business claims input tax on its telephone bills and stationery costs.

Example 2

The directors of ABC Ltd (Alan, Bill and Charles) have purchased the property in their own names (1/3 each) and will rent it to ABC Accountants Ltd on a commercial basis. They must register for VAT as a partnership and then charge VAT on the rent to the company.

Note – this process is not a problem because the trading business is fully taxable ie not partly exempt. But if the trading business was, say, a children's nursery (or a business where more the owners would need to consider anti-avoidance legislation. This legislation is intended to prevent a property being bought in a separate legal entity (and input tax claimed) with the entity making an option to tax election and charging a rent to the trading business.

The legislation applies if the tenant and landlord are connected (CTA 2010, s 1122); the property is within the capital goods scheme ie cost the landlord more than £250,000 excluding VAT; the tenant has more than 20% exempt income.

Two stages to an election

In order to make a successful option to tax election, a taxpayer must go through two hurdles:

1. The decision – there will be a moment in time when the business owners (or their advisers) make the decision that it will be necessary to make an option to tax election with HMRC on a property (land and buildings) in order to achieve an input tax benefit. I explained in my previous article for AW that the 'decision' to opt to tax is always based on an input tax motive.

2. The notification – HMRC should be notified of an option to tax election within 30 days of the 'decision' being made.

Residential property

The option to tax regulations are overridden in the case of residential property. So what happens if your client buys a property that is partly residential and partly commercial?

Example 3

Jane is buying a property for £500,000 that consists of a ground floor shop, from which she will trade as a florist, and a first floor flat which she will rent out to help with her mortgage repayments. The seller has opted to tax the building. The seller should apportion the proceeds on a fair and reasonable basis so that no VAT is charged on the market value of the flat. This is exempt from VAT because his option is overridden in relation to residential property. Jane does not need to opt to tax the property because she is using it for taxable purposes, so can claim input tax as long as she is VAT registered.

Belated notifications

The key question here is as follows: did you make the decision to opt to tax but then forgot the notification stage ie the decision was made to opt but the paperwork not submitted to HMRC? Or did you not make a decision to opt to tax a property until now, and are therefore trying to backpedal with a retrospective election date? In the first situation, HMRC should be provided with evidence that the decision was made regarding an election. (HMRC Notice 742A, para 4.2.1).

The best evidence that an option was made is copies of sales invoices charging VAT on the rent to tenants and also showing that input tax was claimed on related expenses because the costs relate to taxable rather than exempt supplies. In the case of the second situation ie a retrospective election before the decision date, this will always be refused.

Contributed by Neil Warren