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Personal tax

Advisory Fuel Rates from 1 September 2019

HMRC has published revised advisory fuel rates for company cars, applying from 1 September 2019.

Remember, the rates are only used for company cars where employers either:

- reimburse employees for business travel in their company cars; or
- require employees to repay the cost of fuel used for private travel.

These rates apply from 1 September 2019.

Engine size	*Petrol - amount per mile*	*LPG - amount per mile*
1400cc or less	12 pence	8 pence
1401cc to 2000cc	14 pence	10 pence
Over 2000cc	21 pence	14 pence

Engine size	Diesel - amount per mile
1600cc or less	10 pence
1601cc to 2000cc	11 pence
Over 2000cc	14 pence

Hybrid cars are treated as either petrol or diesel cars for this purpose.

Advisory Electricity Rate

The Advisory Electricity Rate for fully electric cars is 4 pence per mile.

Electricity is not a fuel for car fuel benefit purposes.

https://www.gov.uk/government/publications/advisory-fuel-rates/advisory-fuel-rates-from-1-march-2016

Travel expenses and commuting (Lecture P1156 – 18.40 minutes)

Summary –Travel to and from each site was ordinary commuting within s338 and so was not deductible from his employment income.

Paul Novak submitted self assessment tax returns for 2012/13 to 2015/16. HMRC considered that certain travel expenses were not deductible and issued the discovery assessments for the two earlier years and closure notices for the two later years.

Paul Nowak maintained he was entitled to deduct these travel expenses from his earnings under s338 ITEPA 2003, which allows an employee to claim travel expenses for journeys direct from home to a temporary place of work, but not in the case of ordinary commuting. Thus the issue in this appeal is whether the travel expenses claimed by Paul Nowak related to ordinary commuting.

During each of the relevant tax years Paul Nowak lived in Pontefract and for at least part of each year worked for Weir Engineering Services Ltd. He was employed to work with electrical motors at various nuclear power stations throughout the country. He was employed in such roles over a period of some 5 years.

He was separately contracted by Weir Engineering Services Ltd to work at a specific power station. Letters confirmed "offers of temporary employment" showing commencement dates and the site at which he would work. It was possible to identify the end date of each contract from P14s provided by Weir Engineering Services Ltd when he left each employment. However, the P14s suggested that Paul Nowak had further contracts where no written offers of employment were available as he worked at some sites on the basis of an oral agreement.

Weir Engineering Services Ltd paid Paul Nowak a mileage allowance for travel from home to and from each site at the start and end of each contract. Every second day off, he was also paid a mileage allowance to travel home and back to the site. The mileage allowance paid was 23p/mile. Paul Nowak contends that he is entitled to claim deduction for the difference between the mileage allowance paid and the 45p/mile that is HMRC's "approved amount".

HMRC argued that Paul Nowak's worked at each site under separate contracts of employment and, as such, each site was a permanent workplace within s339 ITEPA 2003 at the time he was working there. Thus his travel from home to the site lodgings was therefore ordinary commuting.

Paul Nowak appealed arguing that the sites were not permanent workplaces.

Decision

The First Tier Tribunal concluded that the only evidence to suggest that each site was a temporary workplace was the fact that Weir Engineering Services Ltd paid lodging allowances and mileage allowances without deduction of tax. That was not enough to satisfy the Tribunal that the sites were temporary workplaces.

The Tribunal concluded that Paul Nowak was employed by Weir Engineering Services Ltd under a series of separate contracts of employment. Each contract required the him to work at a particular power station that, for the purposes of each employment was a permanent workplace. In relation to each employment, the site was a place that he regularly attended in the performance of his duties for that employment. It was the base from which his duties were performed. As such, his travel to and from each site was ordinary commuting within s338 and so he was not entitled to a deduction for the travel expenses he has claimed.

Although not subject of this appeal, the tax assessed related to claims for different types of deductible expenditure and included student loan repayments, which HMRC said ought to have been included in Paul Nowak's self assessment returns, and small amounts that may relate to accountancy fees. At the request of the appellant, the Tribunal agreed that this appeal should remain open in the event that he might wish to challenge the amount said to be due by way of student loan repayment or his entitlement to deduct sums for accountancy fees. Any application to rely on further grounds of appeal should be made within 28 days of the date of release of the Tribunal's decision.

The appeal was dismissed.

Paul Nowak v HMRC (TC07307)

Loyalty bonus payments **(Lecture P1156 – 18.40 minutes)**

Summary – Payments of bonuses by an investment platform were 'annual payments' and that basic rate tax should have been deducted at source.

Hargreaves Lansdown Asset Management Ltd provides a platform for the distribution to investors of investment products offered by different fund providers, as well as administration services to investors.

In 2013, HMRC announced that financial intermediaries making specified payments to investors should deduct basic rate tax at source:

- HMRC considered that Hargreaves Lansdown Asset Management Ltd was required to deduct and account for income tax on loyalty bonuses paid to individuals who invested in funds through their platform because these payments were such 'annual payments';
- Hargreaves Lansdown Asset Management Ltd considered that this did not apply to the loyalty bonuses it paid to investors because these were a discount against management charges.

An annual payment has four characteristics:

1. it is payable under a legal obligation;
2. it recurs or is capable of recurrence;
3. it constitutes income in the hands of the recipient; and
4. it represents pure income profit to the recipient.

Both parties agreed that the bonuses paid constituted income in the hands of the recipient and Hargreaves Lansdown Asset Management Ltd had not challenged that it was payable under a legal obligation.

The First Tier Tribunal held that the loyalty bonuses were payable under a legal obligation and were recurrent or capable of recurrence. However, the payments did not represent pure income profit so they were not annual payments and so allowed Hargreaves Lansdown Asset Management Ltd's appeal. HMRC appealed arguing that the First Tier Tribunal had decided wrongly on condition 4 that the bonus was merely a cost reduction.

Hargreaves Lansdown Asset Management Ltd counter appealed, arguing the First Tier Tribunal was wrong on condition 2 and that the bonus payment was not capable of recurrence. They argued that each month's bonus was a "one-off" payment.

Decision

The Upper Tribunal stated that whether the bonus payments represented pure income profits should be determined by asking the key question as to whether the investor received the loyalty bonus without having to do anything in return, or whether the investor had to pay the annual management charge, so that the bonus reduced the expense the investor was obliged to bear. They concluded that the term 'loyalty bonus' was the correct description — it rewarded loyalty. In this case, the investor received a further income distribution from his investment as a result of remaining in the fund. The judges therefore concluded the loyalty bonus was pure income profit. The First-tier Tribunal had erred in its approach by failing to base its decision on the contractual arrangements so the Upper Tribunal remade the decision on this point.

Having considered the terms and conditions as well as the commercial position, the Upper Tribunal concluded that the bonus payments were capable of recurrence. The loyalty bonus was paid monthly under a single contractual arrangement that did not renew each month.

HMRC's appeal was allowed.

CRC v Hargreaves Lansdown Asset Management Ltd [2019] UKUT 0246 (TCC)

Adapted from case summary in Taxation (22 August 2019)

Transfer of assets abroad **(Lecture P1156 – 18.40 minutes)**

Summary - The transfer of assets abroad provisions did not apply and, in any event, infringed the principle of free movement of capital.

In 2005/16 and 2006/07 Andreas Rialas was UK resident and ordinarily resident, but domiciled in Cyprus.

Together with Gary Cressman, he founded Argo Capital Management Limited, carrying on a business as an investment adviser. Since each of them owned 50% of the issued share capital, neither had control of the company, but both worked for the company.

From around December 2004, relations between Rialas and Cressman deteriorated and Andreas looked for a way to sell the company. A UK company was found but they did not want to buy from Gary Cressman. So, in order to buy-out Gary Cressman’s shares, a shelf company, Farkland Ventures Inc, was incorporated in the British Virgin Islands and transferred to the Rialco trust, Andreas Rialas's family trust, which was governed by Cyprus law. Gary Cressman transferred his holding in Argo to Farkland Ventures Inc, which financed its acquisition with a loan. Following the sale of the Argo shares to Farkland, Argo paid dividends to Farkland of £1,076,936.50, being 50% of the 2005 dividend of £2,153,873 dividend, and £1,659,230, being 50% of the 2006 dividend of £3,318,460. Finally, Andreas Rialas and Farkland Ventures Inc sold Argo Capital Management Limited to Absolute Capital Management Holdings Limited, a UK listed company.

HMRC issued closure notices assessing Andreas Rialas to additional income tax of £430,774.40 and £663,292.00 in respect of 2005/06 and 2006/07. These amounts were calculated as personal income tax on these dividends paid by Argo that HMRC considered were due under s739 ICTA 1988, on the grounds that he was either the transferor, or had procured the transfer, of assets to a person abroad, as a consequence of which dividends on shares in Argo were received by a person abroad and that he had the power to enjoy that income.

Decision

S739-742 ICTA 1988 look to prevent UK residents from using foreign companies or trusts to avoid paying UK taxes. The provisions refer to situations where a UK resident individual undertakes a transfer of assets in favour of a non-resident person such that the income becomes payable to an offshore person/entity but the transferring individual (or transferor) has power to enjoy that income in some way.

The first issue was whether Andreas Rialas was a transferor for the purpose of s739 ICTA 1988. Although he had organised the purchase side of the transaction, he had not dictated to whom Gary Cressman sold his shares. Andreas Rialas was not the transferor or a quasi-transferor of Gary Cressman's shares.

The First Tier Tribunal added that most of the steps had been inserted for commercial reasons to facilitate the buy-out of Mr Cressman and the borrowing of the acquisition amount (the lender preferred to lend to a company incorporated in the BVI);

Although not necessary, the Tribunal went on to consider whether or not the provisions of s739 ICTA 1988 potentially infringe the principle of free movement of capital or are capable of so doing. They stated that if dividends paid by a company are, as a consequence of the legislation in question, treated differently in one Member State from how they would be treated in another Member State then that is a potential infringement of the right to free movement of capital. If Farkland had been established in the UK then any dividends it received from Argo would not have been subject to tax, being the receipt of dividends by one UK company from another UK company. However, because Farkland is resident in Cyprus, any dividends that Farkland receives from Argo would, if s739 applied, be subject to income tax in the hands of Andreas Rialas.

In their view the provisions of s739 did potentially infringe the right to free movement of capital and could not be justified because it was penal in its effect. in this case , it would put the taxpayer in a worse position than he would have been in had he formed Farkland in the UK; s 793 looks through the corporate veil so that he would be taxed on the income of his company, with no deduction for the interest paid by Farkland. The only effective remedy would be to disapply it.

The appeal was allowed.

Andreas Rialas v HMRC (TC07316)

Employment-Related Securities **(Lecture P1160 – 10.32 minutes)**

What is an ERS?

A security (i.e. shares, debt, derivatives and interests in investment partnerships) where the right or opportunity to acquire the securities (or interest in securities) is:

- available by reason of an employment of the person acquiring the securities (or interest) or any other person; or
- (under the "deeming provision" in s471(3) in ITEPA) made available by a person's employer (or a person connected with a person's employer), unless such right or opportunity is made available:
  - by an individual; and
  - in the normal course of the domestic, family or personal relationships of that individual.

"Employment" includes a former, current and prospective employment.

General earnings charge on acquisition

The employee or director will generally be treated as receiving employment income equal to the difference between:

- market value of the shares at the time of acquisition; and
- the amount (if any) paid (or required to be paid) for them
  - This is called the "Weight v Salmon" charge.

There are some exceptions, e.g. where founder shareholders, who also become directors, receive shares in their capacity as investors in the company rather than directors or employees.

Special rules apply to restricted securities and convertible securities. (The latter are not covered in this seminar.)

Restricted securities

Special rules apply upon the acquisition of ERS that are subject to restrictions. The latter may affect:

- an employee's ability to retain the securities

  e.g. the articles of association may oblige an employee to transfer securities to 'permitted transferees' on the occurrence of certain events such as resignation, or

- the general rights attaching to the securities

  e.g. restrictions on transfer, dividend rights or voting rights.

Restrictions typically have the effect of reducing the market value of ERS and hence any income tax and NIC charges upon acquisition. However, where the ERS rules apply, income tax and NIC charges can arise on subsequent chargeable events, including the:

- lifting, variation or expiry of the restrictions; or
- disposal of the restricted securities.

Election under s.431 ITEPA 03

- Can elect to be taxed initially on the unrestricted MV (UMV)
  - Subsequent chargeable events then produce a CGT charge, rather than income tax and NIC charges
- A good idea except where share price falls after issue!
  - Election has to be made within 14 days of share issue as part of the reporting on an ERS annual return.

Example

On issue (with no s.431 election):

- Edwina pays MV of £2 per share for 1,000 restricted shares in Major Ltd
  - Shares worth £5 each with restrictions lifted.
  - Difference between restricted and unrestricted values is 60% of UMV

On sale (£140/share), the gain is £138,000:

- Edwina is chargeable to:
  - CGT on 40% of the gain (£55,200), but
  - income tax on 60% of the gain (£82,800)

The shares will be readily convertible assets, so also Class 1 NIC to pay on the part taxed as income.

On issue, she signs a s.431 election:

- Income tax is due on the uplift from £2 to £5 (“dry” tax charge) of £3,000

On sale (£140/share):

- Edwina is charged to CGT on the whole gain of £135,000 (the cost is the unrestricted MV on which tax already paid, i.e. £5).

Contributed by Kevin Reed

Capital Taxes

PPR on two properties (Lecture P1156 – 18.40 minutes)

Summary – The taxpayer was not entitled to principal private residence relief on the disposal of his properties and so should have returned the relevant gains on his 2006/2007 self-assessment tax return.

Martin Fitzjohn has been an estate agent since 1993. In 2005, he moved out of the matrimonial home when he and his wife decided that they should have some time living apart to see if this would result in them resolving their matrimonial difficulties. Unfortunately, this ultimately resulted in a permanent separation in 2008 and stressful divorce soon after.

On moving out, he moved to "Regents Court" which he purchased on 31 December 2005 for £82,500. He sold Regents Court on 29 March 2006 £93,000 making a gain of £10,500. Mr Fitzjohn's evidence was that he found Regents Court unsuitable – it was a one-bedroom flat – because he wanted to have his children to come and stay with him. He returned a capital gain on Regents Court of £10,500 on his self-assessment tax return for the year 2005/2006. He did not seek to claim that Regents Court was his principal private residence, on the basis that it was only a temporary place to stay.

On 21 April 2006, he purchased another property "Silver Street" for £88,000 which he sold just four months later for £124,995, making a gain of £36,995. Before selling "Silver Street", on 2 May 2006, he bought another property in Peterborough, "Bringhurst", for £81,000 that he sold roughly six months later at the end of October, making a gain of £16,000. He did not return the gains in respect of Silver Street or Bringhurst on his tax return for 2006/2007 as he claimed that each property constituted his only or main residence for the purposes of section 222 TCGA.

In his letter to HMRC he explained that:

- Regents Court turned out to be far from ideal living space when he had his three young sons come to stay with him;
- Silver Street proved to be inconvenient in terms of taking his children to school.
- Bringhurst turned out to be a totally unsuitable location for life as the boys;

HMRC denied the PPR relief and so Martin Fitzjohn appealed.

Decision

The Tribunal confirmed that Martin Fitzjohn's disposal of Regents Court was not in dispute in this appeal as that property was simply a temporary stopgap in order to tide him over at the beginning of his separation.

The Tribunal stated that it was clear that Martin Fitzjohn had acquired both his Silver Street and Bringhurst properties at a time when he was hopeful of a reconciliation with his wife. It seemed to them, therefore, that he did not occupy those properties with the necessary expectation of permanence or semi-permanence required for the purposes of the principal private residence exemption.

Additionally, the Tribunal observed that Martin Fitzjohn had owned Silver Street for approximately four months and Bringhurst for six months. They found his explanation for the rapid purchase and sale of both properties unconvincing. As an experienced local estate agent, the Tribunal thought it more likely than not, that Martin Fitzjohn saw the opportunity to make quick profits.

The appeal was dismissed.

Martin Fitzjohn v HMRC (TC07291)

Lottery loss (Lecture P1156 – 18.40 minutes)

Summary – The loss suffered by the taxpayer when a loan became irrecoverable was a capital loss as the company had been trading prior to going into administration

Altala Group Limited, originally called Health Lottery Limited, was incorporated on 17 May 2007. Its aim was to launch an alternative to ‘The National Lottery’ that held a 97% share of the market in the UK. A concept of a lottery with fixed payouts and the beneficiary being a good cause, namely the National Health Service, was created. Upon commencement of trading Altala Group Limited undertook a share exchange agreement with NHS Lotteries Limited, which had developed the concept of such a lottery but had no funding. Altala Group Limited continued the development of ‘The Health Lottery’ concept. This was funded by an unsecured loan facility from Barclays Bank for £17.5m for a period of two years, maturing on 26 June 2009. This loan was secured by Credit Suisse. Michael Hunt acquired 22% of the company and through his nominee, the ABC Corporation, gave a guarantee for the loan facility.

The launch was delayed due to difficulties obtaining a gambling licence due to Michael Hunt’s past. Due to his previous conviction for fraud, the Gambling Commission had reservations over his suitability as a controller. The company was unable to secure new funding when the first loan ran out and entered administration. The assets were sold to another company, who proceeded to launch the lottery using the marketing materials and infrastructure developed by Altala Group Limited.

Michael Hunt suffered the full loss of £17.5million and sought to claim this as a capital loss, arguing that the company had been trading.

With no gambling licence, HMRC argued that the company was not trading, and that this was supported by the Administrator’s report that stated that there had been no actual trade.

Decision

The First Tier Tribunal accepted that the creation of marketing materials and infrastructure used by the subsequent company to launch the lottery were activities in the course of a trade and this was sufficient for it to have commenced trading. The preparation work undertaken was operational activity undertaken with a financial risk, and so trading.

The loan made to Altala Group Limited was a qualifying loan to a trader, and Michael Hunt's payment under the guarantee was a capital loss. The appeal was allowed.

Michael John Hunt v HMRC (TC07311)

Relief for loans to traders **(Lecture P1157 – 3.08 minutes)**

S253 TCGA 1992 offers a useful relief in respect of loans to traders. It applies where a loan is made to a company, sole trader or partnership for the purposes of an ongoing trade or the setting up of a trade, but the loan subsequently becomes irrecoverable. The word 'trade' in this context includes a profession or vocation.

Hitherto, in order to qualify for relief, the loan had to be to a borrower who:

- is resident in the UK; and
- uses the money wholly for trading purposes (or to set up a trade provided that trading actually starts).

Relief is only available if there is no reasonable prospect of the loan ever being repaid and, where claimed, it allows the lender to write the loss off against his chargeable gains. The rules cover both individual and corporate lenders, but the claimant and the borrower must not be spouses, civil partners or members of the same 75% group.

Legislation is being introduced to extend this relief, with effect from 24 January 2019, to borrowers who are resident outside the UK.

Contributed by Robert Jamieson

The widening of share loss relief **(Lecture P1158 – 6.44 minutes)**

In the context of income tax, the share loss relief regime can be found in Ss131 – 151 ITA 2007. It applies where an individual subscribes for newly-issued shares in a small or medium-sized unlisted trading company and those shares are subsequently disposed of at a loss.

The equivalent corporation tax rules are set out in Ss68 – 90 CTA 2010. They apply to investment company subscribers and broadly mirror the ITA 2007 requirements.

In order to be eligible for share loss relief, the shares disposed of must be those of a qualifying trading company, that is to say, a company which meets four conditions at the relevant time (this time varies depending on the condition):

1. The company carries on a trading activity which is not an excluded activity;

2. The company's gross assets did not exceed a limit of £7,000,000 immediately before the subscription and £8,000,000 immediately afterwards (the same limit is in point for the parent company of a group);

3. The company is unlisted; and

4. The company carries on its business wholly or mainly in the UK.

Relief is only due if the holder of the shares made a disposal which resulted in an allowable loss for the purposes of TCGA 1992. Relief for this loss is given against income rather than against gains, as would normally be the case. Share loss relief is particularly attractive to individuals, given that the top rate of income tax is 45% compared to a CGT rate of (usually) 20%.

In the case of individuals, relief is also available in respect of shares which attracted EIS relief.

With effect from 24 January 2019, share loss relief has been extended to cover companies which conduct their business wholly or mainly outside the UK.

Contributed by Robert Jamieson

Settlements and entrepreneurs' relief **(Lecture P1156 – 18.40 minutes)**

Summary – Settlement beneficiaries were entitled to entrepreneurs' relief on the disposal of shares by the settlements, even though they had only held their interests for less than 12 months.

On 30 July 2015, Ludovic, Rollo and Bruno Skinner were granted interests in possession in three separate settlements. The following month, Quentin Skinner gave 55,000 D ordinary shares in DPAS Limited to the three Settlements. The beneficiaries, his children, had each held 32,250 C class shares granting full voting rights since 2011. Each child also held shares that accounted for 5.78% of the Company's ordinary share capital in their own right. As such, DPAS Ltd was a "personal company" for each of them. On 1 December 2015, less than four months later, the settlements sold the shares with the taxpayers claiming Entrepreneurs' Relief.

On 1 June 2018 HMRC concluded that "Entrepreneur's Relief is not due in this case as the beneficiary…had not held an interest in possession in the shares held by the trust for the requisite 12 month period."

Section 169J TCGA 1992 provides that a trustee disposing of shares will qualify for entrepreneurs' relief if conditions A and B are satisfied.

Condition A is that there must be a "qualifying beneficiary". This was not in dispute.

Condition B, as defined by s.169(4), is that throughout a period of 12 months ending not earlier than three years prior to the disposal of the shares:

- The company is either a trading company or holding company of a trading group and the *qualifying beneficiary's* personal company. Again this was not in dispute as the beneficiaries satisfied the 5% of the ordinary share capital /voting power of the company;

- The *qualifying beneficiary* is an officer of employee of the company or (if the company is a member of a group of companies) of one or more companies in the group.

HMRC argued that the references to the "qualifying beneficiary" in Condition B meant that Condition A also had to be met during the same period. As the beneficiaries had only held an interest in possession in the trusts since July 2015, entrepreneurs' relief should not be available to the trustees.

The taxpayers appealed.

Decision

The First Tier Tribunal stated that, in their view, the focus of s169J(4)(a) is not on the "qualifying beneficiary" at all but rather on "the company".

The Tribunal concluded that when Parliament introduced entrepreneurs' relief the Explanatory Notes had stated that the requirements set out in Condition B were by reference to the qualifying beneficiary already identified by Condition A. If not, why was there a need for Condition A? Parliament's intention in imposing Condition B was to require an "entrepreneurial connection" between the Company and the underlying beneficiary and that this condition had been satisfied.

They stated that:

> "The possessive reference to the "qualifying beneficiary's" is simply identifying whose personal company it is i.e. it must be the personal company of someone who is 'a qualifying beneficiary'."

In the Tribunal's view it would be incorrect to conclude that the 'qualifying beneficiary' had to have the attributes for a period of one year during the three-year window. On a careful reading of the words used in s.169J(4), the Tribunal rejected HMRC's construction of that statutory provision.

The appeal was allowed.

The Quentin Skinner 2005 Settlement L & Ors v HMRC (TC07312)

Excluded property trusts **(Lecture P1159 – 13.31 minutes)**

The High Court decision in Barclays Wealth Trustees (Jersey) Ltd v HMRC (2015) examined a long-standing area of uncertainty relating to excluded property held in a trust.

S48(3) IHTA 1984 provides that, where settled property is situated outside the UK, it represents excluded property for IHT purposes unless the settlor was domiciled in the UK at the time when the settlement was made. Where a foreign-domiciled settlor establishes an excluded property settlement but subsequently becomes UK-domiciled (or deemed to be domiciled in the UK by virtue of S267 IHTA 1984) and then adds overseas assets to that settlement, are those added funds also excluded property?

The dilemma in this case was succinctly summarised by Mann J when he said at the start of his judgment:

> 'The facts are short, but it will help in understanding their significance if I distil the facts and issues to their simplest.
>
> Trust property in Trust No. 1 was "excluded property", settled by a non-domiciled settlor, and so would have been free from the 10-year charge had it stayed there.
>
> Some of it was transferred to Trust No. 2, which had the same settlor but who had by now become domiciled in the UK, and it became (at that point) not excluded property.
>
> It was then transferred back to Trust No. 1. The question, distilled to its simplest, is whether it has reacquired excluded status.'

The answer is that it all depends on what is meant by the words 'at the time the settlement was made'. It can be forcefully argued that a settlement is made at the time when it was originally established, in which case the added funds – if overseas – should qualify as excluded property. However, HMRC take the opposing view by suggesting that a new settlement comes into being whenever funds are added. Accordingly, if the addition takes place when the settlor has become UK-domiciled (as happened here – the settlor became deemed domiciled in the UK from the start of 2003/04, having set up the original trust some two years earlier), the new trust assets will not rank as excluded property.

There are some very real difficulties with the HMRC interpretation. For example, S44(2) IHTA 1984 provides that, where more than one person is a settlor in relation to a settlement, the settled property is treated as being comprised in separate settlements. One might reasonably conclude that the principle in S44(2) IHTA 1984 is not in point where the original settlor adds property to a settlement – the legislation could, after all, easily have said so and one assumption would be that this was therefore deliberate. This would seem to be consistent with the wording in S67 IHTA 1984 which provides a detailed procedure for the calculation of a 10-year anniversary charge where further assets have been added to a relevant property settlement by the settlor. On the HMRC interpretation, S67 IHTA 1984 could be seen to be redundant. Can Parliament be presumed to have passed legislation which has no effect? This was a difficult judgment, especially given the High Court's words that Parliament could not have intended additions of foreign property to a settlement after the settlor had acquired a UK domicile to have the character of excluded property – Mann J described this conclusion as 'striking'.

His words were:

> 'This result is even more striking if one imagines a settlement which was seeded with a nominal sum (which frequently happens), with a massive subsequent contribution made when the settlor has become domiciled. Why should that subsequent contribution be able to acquire the characteristic of the original £100 in those circumstances?'

There can be no doubt (because S43(2) IHTA 1984 says so) that a settlement includes a disposition – and an addition is clearly a disposition – but that does not seem, in one commentator's mind, 'to get us past the express words of S48(3) IHTA 1984' as well as S67 IHTA 1984.

In a careful and detailed judgment (which, interestingly, contains no reference to S67 IHTA 1984), the High Court concluded that the words 'at the time the settlement was made' were capable of describing both the making of the original settlement and the later addition of property to that settlement. Accordingly, the subsequent addition to the settlement by the settlor did not have the character of excluded property.

However, this ruling was overturned by the Court of Appeal two years later, with all three judges finding in the taxpayer's favour. Henderson LJ, who delivered the leading judgment, stated:

> 'I cannot accept the (High Court) judge's view that the word "settlement" may have two different meanings in S48(3) IHTA 1984.'

As a result, a later addition of overseas assets to an excluded property settlement was regarded as an excluded property transfer, even if, in the meantime, the settlor had become UK-domiciled.

From HMRC's perspective, the Court of Appeal's decision had two possible outcomes:

1. An appeal to the Supreme Court (which may or may not have been successful); and
2. An amendment to the statutory wording in IHTA 1984.

In the event, HMRC have opted for the latter alternative. Following the publication of draft Finance Bill clauses on 11 July 2019, it has been decided that, when property is added to a settlement, the domicile of the settlor will be considered at the time of the addition rather than at the time when the settlement was first created. This will apply for any chargeable events taking place on or after the date of Royal Assent (which, it is assumed, will occur in early 2020).

For example, in S48(3) IHTA 1984, instead of 'at the time the settlement was made' one will now read 'at the time the property became comprised in the settlement'. This avoids the previous semantic uncertainties.

There is to be a similar rule for property moving between settlements.

Contributed by Robert Jamieson

£100 savings income concession

The August edition of HMRC Trusts and Estates Newsletter highlighted that the concession whereby trusts and estates with small amounts of savings income do not have to report this to HMRC has been extended to 2019/10 and 2020/21 and will be reviewed in the longer term.

This applies where the only source of income is savings income and the tax liability is below £100.

https://www.gov.uk/government/publications/hm-revenue-and-customs-trusts-and-estates-newsletters/hmrc-trusts-and-estates-newsletter-august-2019

Claim for SDLT refund **(Lecture P1156 – 18.40 minutes)**

Summary – The property bought, which included extensive grounds, was not a mixed-use property and so the repayment claim was not allowed.

David and Sally Hyman bought a property known as “The Farmhouse”, near St Albans on 23 October 2015 for £1,515,000. The property was bought with over 3.5 acres of land. On the date of purchase, they submitted an SDLT return and paid SDLT of £95,550, which was the correct amount of tax if the property was wholly residential.

Outside the garden, was a large barn in a bad state of repair. It was structurally unsound, had rotten timbers and holes in the roof and walls and birds nested in it. It would require planning permission to convert it to residential use. In addition there was a meadow and a bridleway separated from the main garden by hedges.

On 5 September 2017, their agent wrote to HMRC claiming a repayment of £34,950 SDLT on the basis that the purchase had been misclassified as a residential purchase, when it was in fact a mixed-use property as it included non-residential elements and so a lower amount was due as the 10% and 15% bands di not apply.

Following an enquiry, HMRC issued a closure notice on 26 March 2018 stating that there was no evidence to support a mixed use claim and that the claim was amended to show that no refund was due. HMRC argued that “grounds” are simply the land surrounding a house which are available as an amenity for the dwelling and the use (or non-use) to which the land is put is not relevant. HMRC acknowledged that the barn could not be used for residential purposes but contended that it fell within section 116(1)(b) as “a building or structure on such land”.

The Hymans appealed.

Decision

The Tribunal concluded that for SDLT purposes, “residential property” means a building that is used as a dwelling and land that is or forms part of the garden or <u>grounds</u> of the dwelling including a building on such land.

In their view “grounds” has, and is intended to have, a wide meaning. It is an ordinary word and its ordinary meaning is land attached to or surrounding a house that is occupied with the house and is available to the owners of the house for them to use.

The Tribunal concluded that the meadow and bridleway were part of the grounds of the Farmhouse within section 116(1)(b) and that the barn was a building or structure on that land.

Accordingly, the whole of the property owned by Mr and Mrs Hyman was residential property for the purposes of SDLT and the tax was correctly paid on that basis.

The appeal was dismissed

Mr David Hyman and Mrs Sally Hyman v HMRC (TC07271)

Administration

Submission receipt received

Summary – The taxpayer supplied the necessary information to his accountant enabling his accountant to complete his tax return online within the applicable filing deadline.

HMRC claimed that it had sent a notice to file an individual tax return to Andreas Georgiou for the tax year 2016/17 on 6 April 2017.

Andreas Georgiou instructed an accountant to prepare and file his tax returns on the basis of information supplied by him. The accountant submitted an online return on behalf of Andreas Georgiou at 0900 on 5 September 2017. By way of evidence for this, Andreas Georgiou submitted a letter from his accountant dated 22 April 2019 in which he confirmed these details and supplied an alphanumeric "Submission Receipt Number", which says he received on submission of the taxpayer's tax return. HMRC states that it has no record of that filing.

HMRC went on to issue various penalty notices, but with accountant argued that such penalties were not due as the online return had been submitted on time. Part of the evidence supplied at the hearing included an extract from a letter sent to HMRC by the accountant stating:

> "I have spoken today to a Mrs Weir of your Cumbernauld office who has confirmed receipt of the Tax return 2016/17. She has suspended collection of penalties and agreed that the verify.gov identification system is extremely cumbersome.
>
> In view of this I request that all legal proceedings be halted. You should be able to find my client's return on your systems."

This exchange was not discussed in HMRC's statement of case.

On 31 July 2018, daily penalties amounting to £900 were raised by HMRC. On 10 August, a £300 six-month penalty was raised by HMRC.

In response to those penalty notices, a paper tax return was submitted on 30 August 2018, explaining stating that "I made an additional non-electronic filing in order to cease HMRC's continued (albeit unjustified) pursual of late filing penalties. It is important to note that this second filing was made by way of a non-electronic submission as the verify.gov website only enables individuals to make one electronic filing per year."

Finally, Andreas Georgiou appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal concluded that Andreas Georgiou's belief that his return had been filed was a genuine and reasonable belief given the circumstances:

- He relied on his accountant to file his tax return promptly, indicating a desire to comply with his obligations;
- His accountant believed that the electronic return had been accepted by HMRC;
- Andreas Georgiou believed at all material times that his accountant had submitted his tax return online on 5 September 2017 and that HMRC's system was incorrect in suggesting otherwise.

The Tribunal stated that there was no evidence before them to suggest that Andreas Georgiou was generally dilatory or careless in his approach to tax compliance. In fact, the evidence suggested otherwise.

The Tribunal allowed the appeal, concluding that no penalties were payable.

Mr Andreas Georgiou v HMRC (TC07243)

HMRC took too long

Summary -Assessments sent out more than three years after being made were out of time and so invalid.

The six named taxpayers entered into stamp duty mitigation schemes, paying no SDLT on the acquisition of land.

HMRC raised, or claimed to have raised SDLT assessments on all six parties, on the basis that the SDLT mitigation scheme was ineffective to reduce liability to SDLT, slightly before the expiry of the four-year time-limit for making discovery assessments.

HMRC investigated several thousand purchasers who had implemented this and similar schemes and tasked a team of officers to make and issue discovery assessments. HMRC claimed that the assessments relating to these six taxpayers were dated 18 February 2013, close to the end of the four-year assessing window. The taxpayers all claimed that they were unaware of the assessments for some years after they were purportedly made. Wilkinson finally received a copy assessment in July 2016, as did the others in early 2017. After becoming aware of them, they all sought to appeal on the basis that the assessments were not validly made, and even if they were, they were not validly issued.

Decision

The First Tier Tribunal concluded that the assessments had been validly made as it was clear that HMRC had placed copies of the notice on every taxpayer's file and the figures were entered into their computer system.

However, something had gone wrong during the postal process. No notices were ever returned as undelivered, consistent with none ever having been posted! Eventual delivery some three years later was not good enough. The assessments were unenforceable and the appeals were allowed

The Tribunal questioned why it took until 2015 to follow up the assessments; had HMRC acted sooner, then the assessments may well have remained enforceable.

Mitesh Kumar Kothari, Michael and Helen Cutler, Annette and Paul Wilkinson and Daniel Fox V HMRC (&C07238)

EBT loan discovery

Summary – The discovery assessment in this tax avoidance case was found to be valid and HMRC's decision were entitled to disapply certain aspects of the PAYE regulations making the individual taxpayer, not the end user of his employment service liable to the tax due.

Stephen Hoey is an IT specialist. Initially he provided his services through a personal service company but had found the complexities of running his own company too much for him to deal with. Consequently, he had engaged the services of an intermediary, Dynamic Management Solutions Ltd who in 2007/08 introduced him to Penfolds, a company resident in the Isle of Man, at which time he entered into employment with Penfolds. In September 2009 Penfolds suggested he should transfer his employment to Hamilton Trust, a Guernsey based trust company, which he duly did. Through Penfolds/Hamiltons he participated in various iterations of a marketed tax avoidance scheme, the aim of which was to avoid tax on earnings by providing loans to users of the scheme, instead of earnings.

Stephen Hoey was paid a basic wage for his work for Penfolds/Hamilton with tax paid in full on those earnings. In addition, Penfolds/Hamilton then made substantial contributions to an Employee Benefit Trust that in turn made interest-free loans. These were repayable on demand but Stephen Hoey did not expect to be required to repay the loans at any time.

Both the Penfolds and Hamilton schemes had been disclosed to HMRC under the DOTAS legislation and both had been allocated a Scheme Reference Number.

Before the appeal was heard, Stephen Hoey agreed that the sums paid to the trust to be paid back as loans should be taxed as his earnings. The issues before the First Tier Tribunal were whether:

- the discovery assessment was valid;
- HMRC were allowed to recover the tax due from the employee r; and
- the Transfer of Assets Abroad provisions applied.

Decision

The First Tier Tribunal found that the discovery assessment had been validly made by HMRC. The Tribunal concluded that HMRC had made a discovery when the HMRC officer had calculated the tax actually due, even though the necessary information had been in HMRC's possession prior to that time as the information provided in Stephen Hoey's tax returns was not sufficient to alert the hypothetical reasonably competent officer to an insufficiency of tax.

The Tribunal stated that the PAYE Regulations contain a number of specific provisions that allow HMRC to collect tax due from the employee rather than the employer. They stated that they did not have the power to consider HMRC's use of its discretion to recover PAYE from an employee.

Finally, the Transfer of Assets Abroad provisions were found to be potentially applicable to this case. The entry by a UK resident into an employment contract with the offshore employer, meant that the provisions could apply but as no income was actually transferred to the offshore employer the rules had no effect.

The appeal was dismissed.

Stephen Hoey v HMRC (T0C7292)

Scope of form 64-8

Summary –Notice of enquiry sent to the taxpayer's agent was not validly sent to the taxpayer, it followed there was no enquiry notice issued.

HMRC opened an enquiry into the taxpayer's 2003/04 tax return and later issued a closure notice disallowing a loss claimed in the return.

The taxpayer appealed against the notice, saying it was invalid because he had never been told that the enquiry was being opened.

HMRC disputed this, saying it had posted the notification letter to him and had sent a copy of it to BDO, his accountants. It was agreed that BDO had received a copy of the notice of enquiry with a covering letter in July 2005 and that BDO was the taxpayer's agent as indicated on form 64-8. The dispute concerned BDO's authority to receive the notice of the enquiry on his behalf.

Having failed at the First Tier and Upper Tribunal, the taxpayer appeal to the Court of Appeal.

Decision

The Court stated that the dispute depended on the 'proper interpretation of form 64-8' that allowed HMRC to deal with the agent on any matter within its responsibility including forms. However, the section dealing with forms specifically states that some forms 'need' to be sent to the taxpayer 'instead of' the agent. HMRC's website contains a list of forms that it sends to agents. On enquiry forms, it says HMRC will correspond with the agent but the formal notice must be given to the taxpayer, rather than the agent.

The Court concluded that form 64-8 did not give BDO authority to receive a notice of enquiry on the taxpayer's behalf. Therefore, since no notice was validly sent to the taxpayer, it followed that none was given.

The appeal was allowed.

W Tinkler v CRC, Court of Appeal (Adapted from case summary in Taxation 15 August 2019)

Sanctions for the late payment of tax (Lecture B1157 – 10.26 minutes)

As part of its Making Tax Digital (MTD) initiative, the government is proposing to simplify and harmonise the penalty regimes for both the late filing of relevant returns and the late payment of tax.

In response to consultations, the government has published draft legislation to facilitate the introduction of:

- A new "points based" penalty system for the late filing of returns; and
- A new harmonised penalty regime for the late payment of tax.

These notes will look at the new proposals to charge penalties for late tax payments.

The current regime – a quick recap

Penalties apply for both the late filing of self-assessment (SA) returns and late payment of income tax under SA. The current regime has applied since the tax year 2010/11.

The current penalties for the late payment of income tax are:

Degree of lateness	Penalty
0 – 30 days	Nil
31 days – 6 months	5% of the outstanding tax
6 months – 12 months	A further 5% of the outstanding tax
More than 12 months	A further 5% of the outstanding tax

Interest is also charged on unpaid income tax (at the prevailing HMRC interest rate). Late payments on account of income tax will suffer an interest charge but are not subject to the penalty regime.

Late payment penalties must be paid within 30 days of the date the notice assessing the penalty is issued. Interest is charged if penalties are paid late.

Taxpayers who fail to make payments of tax by the due date may enter into an agreed 'Time To Pay' (TTP) arrangement with HMRC. Tax payment will then be deferred and no late payment penalties will be charged. The taxpayer will become liable to late payment penalties if the TTP agreement is broken.

There are currently no penalties for late payment of corporation tax. [Provisions for penalties for late paid corporation tax were laid down in Sch 56 FA 2009 but have never been implemented.] There are however penalties where companies fail to make payments (or deliberately understate payments) due under the quarterly payment regime. Interest is charged on any corporation tax paid late.

There is no standalone late payment penalty regime for VAT. Instead the default surcharge regime applies. This is a combined sanction for late submission of VAT returns and late payment of VAT.

The new regime for late tax payments – the background

In July 2018, HMRC published a Policy Paper entitled “Interest Harmonisation and sanctions for late payment”.

The paper lays out the government’s proposals to replace the existing late payment penalties with shiny new ones. The intention is that the new regime will dovetail more comfortably with Making Tax Digital (MTD) by “simplifying and harmonising late payment penalties and interest” and “making the tax administration system clearer and simpler for taxpayers, ensuring that it is as easy as possible for them to comply with their obligations across taxes”. Fine words indeed.

The new system will replace the existing multiple late payment penalty regimes with one harmonised system to apply for income tax, corporation tax and VAT. This will result in increased penalties for companies who pay their corporation tax late, as late payment penalties are not currently charged under the existing CT regime.

The proposals were originally included in Finance Bill 2019 but have since been temporarily shelved. These draft clauses will now reappear in a future Finance Bill. Despite its best intentions, it is not anticipated that the government will be able to roll-out the new system any earlier than April 2021. It is understood that VAT is the designated guinea pig and will have the honour of being the first to be migrated across to the new system. Income tax and corporation tax will follow.

The new late payment penalty rules

Under the new proposals, no late payment penalties will be charged if the taxpayer has a reasonable excuse for late payment. A penalty charge notice will be issued against which the taxpayer will appeal within 30 days. The appeal will include his excuse for late payment. HMRC will review that appeal objectively before deciding whether the excuse is ‘reasonable’ in the context of the delay that has triggered the penalty.

HMRC's view of “reasonable excuse” is that it should involve an "unforeseeable and exceptional event" beyond the taxpayer's control. If HMRC does not uphold the appeal, the taxpayer has a right to appeal to the Tribunal. The Tax Tribunal normally has a slightly wider interpretation and generally takes criteria such as postal delays, adviser errors and illness into account.

For taxpayers with no reasonable excuse, the new late payment penalties will consist of 2 penalty charges:

- The first charge (an initial late-payment penalty) which is based upon payments and TTP agreements made in the first 30 days after the payment due date; and

- A second charge (a 'penalty interest' charge) which is based upon how long the debt remains outstanding after the initial 30 days.

Taxpayers who pay their tax late can still avoid a penalty if they either:

- Pay in full before the end of the 15-day period starting the day after the due date. This means that for tax payable on (say) 31 January, a penalty is avoided if full payment is made by midnight on 15 February; or

- Organise a Time To Pay (TTP) arrangement. 'Organise' means that the taxpayer should have submitted a TTP proposal to HMRC within the 15 days (rather than it being actually accepted in this period).

If a payment is made or a TTP is organised outside the 15-day period, a late payment penalty will be charged. The penalty is the "applicable percentage" of the outstanding tax. The penalty will be halved if either full payment is made within 30 days of the due date (i.e., between days 16 and 30) or if a TTP is organised in this 16-to-30 day period.

The "applicable percentage" will be set by statute in due course but suggestions are that this, like its predecessor, will be 5%.

If the tax remains outstanding 30 days after the day following the due date (i.e., on day 31), a second charge will kick-in. This will be an additional penalty, calculated in a similar way to interest, accruing from day 31.

In addition to the first and second penalty charges outlined above, interest at the prevailing HMRC rate will continue to be charged on any late paid tax. This will apply to all late payments (even those made within 15 days of the due date).

All this can be summarised in the Table below:

Number of days the payment is made late	Initial late-payment penalty	Penalty interest charge	'Standard' interest charge
1 - 15	No	No	Yes
16 - 30	Yes (50% penalty reduction)	No	Yes
31 and above	Yes	Yes	Yes

Penalty notices will be issued to taxpayers in respect of both the first and second penalty charges. Amounts shown as payable on the notice will be required to be paid, or appealed, within 30 days of the date of that notice.

Contributed by Steve Sanders

Deadlines

1 October 2019

- CT due for periods ended 31 December 2018 for small and medium-sized companies not liable to pay in instalments

5 October 2019

- Notify income tax /CGT for 2018/19 if a tax return or notice to file not received

7 October 2019

- VAT return and payment for 31 August 2019 quarter due for electronic payment

14 October 2019

- Submit form CT61 and pay tax for quarter ended 30 September 2019.
- File monthly EC sales list paper return

19 October 2019

- Pay PAYE/CIS liabilities for month to 5 October 2019 if by cheque
- File monthly CIS return
- PAYE settlement agreement tax/class 1B NIC liabilities if paying by cheque
- Payment of PAYE for quarter to 5 October 2019 if average monthly liability < £1,500

21 October 2019

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

22 October 2019

- PAYE payments if paid online
- PAYE electronic payment for quarter to 5 October 2019 if monthly liability < 1,500
- PAYE settlement agreement liabilities due

31 October 2019

- Deadline for submission of 2018-/9 paper self assessment tax returns
- Accounts to Companies House:
    - private companies with a 31 January 2019 year end
    - public limited companies with a 30 April 2019 year end
- File CT self-assessment returns for companies with periods ended 31 October 2018

News

IR35 attack on GSK contractors (Lecture B1156 – 18.06 minutes)

An article in AccountingWeb written by Mark Taylor at Chartergate Legal Services states that HMRC has sent generic, unsigned letters to around 1,500 personal service companies that did work for GlaxoSmithKline last year stating:

> "After looking at the information we have for the 2018 to 2019 tax year, our view is that the contract between your PSC and GlaxoSmithKline (GSK) comes under the off-payroll working rules 'IR35'."

As Mark Taylor questions in his article, why do HMRC now think some 1500 other personal service companies have fallen foul of the IR35 rules, especially as back in 2011, HMRC failed in their attempt to class a GSK contractor as a deemed employee under the IR35 rules? In Primary Path Limited v HMRC case (TC 01306), the company Primary Path Limited had been set up to provide software development services to the pharmaceutical industry and in this case, GSK was the end client. The Tribunal concluded that the level of control did not go beyond that expected when hiring an independent contractor and in addition, the ability to supply a substitute was inconsistent with a contract of service.

Mark Taylor believes that HMRC are targeting this group of companies by sending a vague but threatening letter and then waiting to see what happens. HMRC are hoping that taxpayers will simply accept these unsubstantiated letters and will collect additional taxes with minimal effort from them.

It is important for the 1500 companies check that they did not fall foul of the IR35 rules, and are able to defend their position should HMRC come knocking by issuing a formal enquiry letter or request for information. Until that time, there is no need to respond to the letters.

https://www.accountingweb.co.uk/community/blogs/marktaylor/hmrc-launches-ir35-attack-on-gsk-contractors

Salary sacrifice cycle-to-work scheme limits

Employers are permitted to operate loan agreements under salary sacrifice arrangements for the cycle-to-work scheme without full FCA authorisation provided the total value of the goods subject to the agreement does not exceed £1,000 (by virtue of SI 2001/1201).

Revised department for transport guidance makes it clear that the £1,000 limit will not apply where the employer offers the salary sacrifice scheme through a third-party provider, who is already authorised by the FCA for consumer hire of cycles (see section 6 of the guidance). Employees will usually enter into a consumer hire agreement directly with the scheme provider.

www.gov.uk/government/publications/cycle-to-work-scheme-implementation-guidance

EORI numbers issued automatically

As we have previously reported, obtaining an EORI number is one of the steps that businesses need to take to be prepared for leaving the EU

EORI numbers are a unique ID number allocated to businesses that enables them to be identified by Customs authorities when doing business with other traders. Without an EORI number, post-Brexit, businesses will be unable to continue to trade with EU Member States.

72,000 companies have already registered for EORI numbers. With Brexit fast approaching, the Chancellor has announced that HMRC has automatically enrolled 88,000 companies, who should have received a letter informing them of their automatically allocated EORI numbers.

Remember, after obtaining an EORI number businesses:

- will need to decide whether to complete customs declarations themselves, or employ a customs agent to do this;
- must decide whether to apply for Transitional Simplified Procedures to make it easier to import goods from the EU.

If businesses have been issued a UK EORI number by HMRC and then apply online, they will receive a message to say that they already have one

www.gov.uk/government/news/chancellor-accelerates-brexit-preparations-for-businesses

Trial volunteers for extended Trust Registration Service

HMRC is asking for volunteers to take part in a trial of extended features of the trust registration service.

Volunteers with new Will trusts will be invited to register them in a controlled environment, where the trusts meet the following criteria:

- the lead trustee is UK based;
- individuals or classes of beneficiaries exist; and
- sole assets of the trust are cash or shares.

The controlled environment will enable HMRC to track the registration process through its systems to successful completion, or identify any issues stopping submission.

www.tax.org.uk/policy-technical/technical-news/hmrc-digital-services-update-–-august-2019

Doctors' pension tax rules

A survey by the BMA has revealed that 42% of GPs and 30% of consultants have lowered their working hours due to pension tax charges. In order to encourage them to take on more work and delay retirement this issue needs to be addressed.

The Department of Health and Social Care plan to open a new consultation asking people what they think about the set of proposals, which includes giving senior clinicians full flexibility over the amount they put into their pension pots. Under these proposals new rules would allow doctors to set the exact level of their pension accrual at the start of each year and give employers the option to recycle unused contributions back into salaries. The new proposals replace the '50:50' option set out in a consultation in July, now withdrawn.

https://www.gov.uk/government/news/nhs-pensions-for-senior-clinicians-new-changes-announced-to-improve-care

NHS Employers, an advisory body to NHS trusts, has warned of the potential tax avoidance risks for doctors who set up limited liability partnerships (LLPs) as a way of mitigating their problems with the pension tax annual allowance.

In its Pension tax guidance for employers: Local measures to support staff and service delivery during the 2019/20 financial year, published on 2 September, the body has outlined a number of options, including using 'existing flexibilities' to enable employees to remain in the NHS pension scheme. These include:

- managing pensionable pay by determining certain elements of pay as being non-pensionable;
- using non-pensionable local clinical excellence awards;
- designing time off in lieu arrangements;
- using multiple contracts of employment, one or more of which can be outside the NHS pension scheme; and
- establishing new organisations for service delivery, such as LLPs.

The guidance says the option involving LLPs, which some doctors are pursuing, is 'not generally supported' by government or NHS bodies, as it 'introduces potential tax avoidance risks and, from a practical perspective, it may not be possible to take the necessary professional advice and to implement the arrangement during this financial year, before national solutions are available'.

The guidance also points out that while income from the LLP would not be pensionable, it would count towards threshold income and adjusted income for the purposes of determining if individuals are subject to a tapered annual allowance.

Tax Journal (6 September 2019)

Business Taxation

LLPs and film production (Lecture B1156 – 18.06 minutes)

Summary – The First Tier tribunal had erred in law. Trading loss relief was denied as the LLPs were not considered to be trading with a view to making a profit.

This appeal concerned three LLPs of the Ingenious Group. Each had a number of members, subscribing 30% to the LLP, with the balance provided by a corporate member. The amount invested was used to produce a film, the production of which was outsourced to a production services company.

Not knowing whether a film will be successful or not, on completion of the film it was valued at its net realisable value, typically giving rise to a loss at that time. If the film proved successful, this loss would be reversed and future profits would be taxable. Overall there would only be a tax deferral for investors, rather than a tax saving. Crucially, the initial loss was expected to be a trading loss that could be offset against other income. Unsurprisingly, HMRC argued that this was an investment activity and denied the sideways loss relief claims.

In addition to arguing that LLPs were not trading, HMRC challenged in a number of other ways:

- were they carrying on their activities with a view to profit?
- the extent and deductibility of expenses incurred by the partnerships?
- whether the accounts were computed correctly under GAAP?
- whether the expenditure incurred by the LLPs was revenue or capital?

On appeal to the First Tier Tribunal, they concluded that the LLPs were trading, but only to the extent of the 30% contributed by the members. However, they held that the expenditure incurred was capital so trading loss relief was denied.

Decision

The Upper Tribunal concluded that the key issue was whether this was a trading activity, concluding that it was not. Interestingly, the Upper Tribunal rejected using the badges of trade as they did not believe that these were appropriate to this case. They stated that focussing on the badges of trade ‘may have led the First Tier Tribunal into error by obscuring the key significance of the nature or character of the activity undertaken, as opposed to the manner in which it was undertaken.’ They focused instead on the facts of several other film cases, taking the view that if a business operates in a commercial way that is common to similar businesses it is likely to be trading, unless the activity as a whole represents a complex tax scheme. The Upper Tribunal commented that when 'account is taken of the reality of the insignificance of the LLPs' ownership rights of the films, what is left is negotiation of and entry into a series of speculative investment in financial assets, and little serious ongoing involvement in the production of the films'.

The Upper Tribunal concluded that the LLPs had acquired and held rights in a potential income stream and so were not trading. With no trading activity, loss relief was denied. The First Tier Tribunal had erred in law.

Ingenious Games LLP Inside Track Productions LLP Ingenious Film Partners 2 LLP v HMRC [2019] UKUT 0226 (TCC)

Plant or premises? (Lecture B1156 – 18.06 minutes)

The First-tier Tribunal has recently considered yet another case on the meaning of plant. In fact, this was a dual appeal from two connected companies: Cheshire Cavity Storage 1 Ltd and EDF Energy (Gas Storage Hole House) Ltd.

The case looked at whether the asset in question is merely or primarily part of the premises within which the business is performed, or whether it is apparatus with which the business activities are carried on i.e. is the asset functioning as plant or as premises? Although in this case the asset was very specific being gas storage facilities the decision is of relevance to businesses that involve storage. In deciding that the cost of preparing the cavities was not a qualifying cost on plant, the FTT made the following points:

- the gas cavities were central to the appellants' business, but that would not in itself make them plant: premises and plant can both be essential;

- the cavities were not merely fixed to the land, but were clearly a part of it, similar to an underground reservoir;

- that did not rule out the possibility that they were plant: the matter depended on whether the cavities functioned as premises or as plant;

- the function of the cavities was to store gas in such a way that it did not dissipate and that it remained in a suitable condition;

- despite the tribunal's finding that the cavities did perform a plant-like function (equivalent to pumps/compressors, but using natural forces), this was held to be an 'incident of the construction' and not the reason they were constructed in that manner;

- a plant-like function 'does not necessarily make premises plant, in circumstances where the premises also functions as premises. It is a 'matter of degree':

    - the water tower in Margrett v The Lowestoft Water and Gas Company (1935) 19 TC 481 was used to store water, but its purpose was to increase pressure;

    - the silo in the case of Schofield [1975] STC 353 was used to store grain, but had the purpose of discharging the grain at speed, for the business was one of distribution not storage;

    - here, by contrast, the purpose of the cavities was to store gas, for however short a period, so as to profit from price fluctuations. Storage is a premises-like function and not a plant-like function;

- so, the ‘significant and predominant’ function of the cavities was the premises-like function of shelter and containment

- an analogy with a cold room did not help because the main function of the cold room was to reduce the temperature of what was stored, whereas altering the temperature of the gas was not a function of the cavity

- the fact that the cavities could be used to store gas at high pressure merely meant that they were very good at performing their premises-like storage function

The FTT went on to consider the restrictions of the items listed as structures, assets and works in CAA 2001, s 22 which are prevented from qualifying for allowances as plant and machinery, unless specified elsewhere in the legislation. In summary, the tribunal concluded that allowances were also prohibited by s 22. In reaching this conclusion, it had to consider whether the cavities were ‘in use for the purposes of an undertaking for the extraction, production, processing or distribution of gas’ (under list B, item 7(b) at s 22). The tribunal decided that an ‘undertaking’ in this context meant a task or action, rather than an entity (such as a company or partnership). In its view, the task or action was to store gas and not to extract, produce, process or distribute it. So this exemption did not help the companies.

In considering whether allowances were prohibited by s 22, the tribunal also gave consideration to the meaning of ‘the alteration of land for the purposes only of installing plant or machinery’, which would provide an exemption from the statutory restrictions (per item 22 at list C, CAA 2001, s 23 which sets out items unaffected by s 22). There was no disagreement that the land was being altered. However, the tribunal took issue with the conclusion of last year’s First-tier Tribunal decision in SSE Generation (TC6618) as to the meaning of ‘install’. In this instance, the tribunal held that install carries the implication that something that already exists is put in place. In this case, the leaching and de-brining activities created a cavity suitable for gas storage, but did not install such a cavity. So this exemption, too, was of no help to the appellant companies.

The tribunal supported the long-held HMRC view that the relieving provisions of list C (in s 23) cannot be applied to other assets by analogy (based on function) except in particular circumstances that are made clear in the list. So list C must be seen as complete in its own right, and it is not possible to argue that another asset is saved by list C because it has the same function as one that is specifically included. Thus, because the tribunal determined that the cavities were not in fact storage tanks (which are included at item 28 of list C), it was not possible to argue that the cavities were exempted from statutory restriction by analogy to such tanks.

Adapted by Joanne Houghton from “Recent FTT definition of plant” in Taxation, 19 August 2019

Cheshire Cavity Storage 1 Ltd and EDF Energy (Gas Storage Hoe House) Ltd v HMRC [2019] UKFTT 0498

Capital allowances on a building (Lecture B1156 – 18.06 minutes)

The *Urenco* case involves a specific construction in the nuclear industry business but provides some useful discussion about what is a building for capital allowance purposes.

The buildings formed part of a facility which deconverted the bi-product of a uranium enrichment process (known as Tails) into a product which could be stored more easily. What was in dispute was whether various structures at the site functioned within the trade as plant and qualified for capital allowances rather than being buildings which were the setting within which the trade was carried on. The assets in question operated as safety structures as the product being dealt with, the Tails, was very hazardous.

Urenco submitted that although the buildings did not do the deconversion of the Tails they did provide an essential function in the processing of the Tails in much the same way as containers would which had been accepted as being plant.

The FTT noted that the trade was to deconvert Tails and store the end result at the facility and in this respect the buildings were part of the setting in which this trade was carried on. In contrast to *Wangaratta Woollen Mills,* an Australian case, where a dyehouse structure was treated as part of the overall dyeing process, in this situation the process could be carried on without the safety structures being in place. Although the regulatory environment would not allow this to happen the FTT stated that the regulatory environment was not relevant to whether an asset performs a function in the trade.

The FTT went on to state that there had to be some other function performed by the structures in the trade and not just a safety function. Therefore, the only items which were considered to operate as plant were in the kiln and condenser facilities and various plinths in the buildings as these provided necessary support for items of plant and ensured they were in the correct position and height to be used in the processing function. However, the FTT then concluded that these items could not qualify as plant as the structures were buildings within the meaning of CAA 2001, s 21.

Lastly the Tribunal dealt with whether any items were plant by virtue of being within CAA 2001, s 23, specifically items 1 and 4 and item 22. The FTT took the view that the meaning of 'plant or equipment' in the excluded items listed means the expenditure on the cost of these items and not the costs of installing such plant and equipment. If a piece of plant or equipment is incorporated into a building, then the cost of its installation is part of the provision of the building and not the provision of the plant and equipment.

Item 22 of s 23 excludes items which are on the alteration of land for the purpose only of installing plant and machinery and the FTT concluded that this was not the case here as the items in dispute were not solely constructed for the purpose of installing plant and machinery, they were also built to protect operatives, the public and to provide premises to house the equipment.

Therefore none of the items qualified for capital allowances as they were all buildings and not saved by being included within CAA 2001, s 23.

Urenco Chemplants Ltd and Urenco UK Ltd v HMRC [2019] UKFTT 522

Contributed by Joanne Houghton

Rollover relief (Lecture B1156 – 18.06 minutes)

The case of Oriel Developments Ltd related to a discovery assessment but also made important points on rollover relief. Oriel carries on a business of letting and developing business units. Oriel disposed of a piece of land under compulsory purchase and put a provisional rollover relief claim in its tax computation for the year to 31 August 2010. In 2012 the company reinvested all the proceeds of sale into the construction and erection of two industrial workspaces on land that the company already owned. The company claimed rollover relief on compulsory purchase under TCGA 1992, s 247 and understood that this superseded the provisional claim.

The issue in question was whether the reinvestment was applied in acquiring other land where other land is defined as 'the new land' (TCGA 1992, 247(1)(c)).

HMRC raised an enquiry into the company's tax return to 31 August 2010 and concluded this by stating they did not agree that the rollover claim was valid because new land cannot include the cost of buildings or additions to buildings on land that is already owned. HMRC made an amendment to the return in 2015 that was appealed and a statutory review requested. The review period was extended in order to allow the case of HMRC v Benham (Specialist Cars) Ltd [2017] UKUT 389 (TCC) to be decided in the Upper Tribunal. This case was released in October 2017 and determined that an amendment was not appropriate in a case such as this.

Therefore HMRC raised a discovery assessment in May 2018 that was noted as being based on a discovery in May 2018. The FTT found that the discovery assessment was stale because the only discovery in 2018 was that HMRC had adopted the wrong mechanism for dealing with the invalid claim to rollover relief, the information on the rollover claim was the same as it was in 2015.

Although this decision decided the case in favour of Oriel, the FTT went on to look at the rollover relief point. They noted that to describe the construction of buildings on existing land as falling within the phrase 'acquiring…land' would run counter to the general approach in the legislation and to established principles of land law. In the view of the tribunal, the construction of buildings on land already owned enhances the existing interest the owner has in the land they already own, there is not an acquisition of a new interest in the land. The FTT felt that this was supported by TCGA 1992, s 248 which includes within the definition of a dwelling house the land which the house is situated on. Therefore if HMRC had succeeded on the discovery assessment issue they would have succeeded on the rollover point.

Oriel Developments Ltd v HMRC [2019] UKFTT 503

Contributed by Joanne Houghton

Tax reconciliation disclosures (Lecture B1158 – 13.58 minutes)

FRS 102 requires a note to the financial statements that reconciles the total tax expense (income) included in profit or loss to the profit or loss on ordinary activities before tax multiplied by the 'applicable tax rate'.

This allows users to understand the reasons why the actual tax expense is not equal to the profit before tax figure multiplied by the corporation tax rate in force at the reporting date.

'Applicable tax rate' is not defined by FRS 102. The same phrase is, however, used in International Financial Reporting Standard IAS 12 Income Taxes.

"an entity uses an applicable tax rate that provides the most meaningful information to the users of its financial statements. Often, the most meaningful rate is the domestic rate of tax in the country in which the entity is domiciled, aggregating the tax rate applied for national taxes with the rates applied for any local taxes which are computed on a substantially similar level of taxable profit (tax loss). However, for an entity operating in several jurisdictions, it may be more meaningful to aggregate separate reconciliations prepared using the domestic rate in each individual jurisdiction. The following example illustrates how the selection of the applicable tax rate affects the presentation of the numerical reconciliation."

So there would seem to be a choice of using the domestic (i.e. UK) rate of tax or an average rate of tax for all the jurisdictions in which the entity is liable to tax.

Example

A company operates in the UK and the US and is liable for corporate tax in both jurisdictions. It makes accounting profits of £2,000 in the UK and £1,500 in the US. The UK Tax rate is 19% and the US tax rate is (say) 30%. In the UK, £100 of expense is not tax deductible.

Reconciliation 1 – using UK domestic rate

Accounting profit		£3,500
Tax at domestic rate of 19%	665	
Non-deductible expenses (£100 x 19%)	19	
Effect of higher tax rates in US (£1,500 x 11%)	165	
Tax expense	£849*	

* UK adjusted profit	£2,100 @ 19%	399
US profits	£1,500 @ 30%	450
		£849

Reconciliation 2 –using average applicable rate

Accounting profit		£3,500
Tax at domestic rates in the country concerned		
(£2,000 @ 19% + £1,500 @ 30%)	830	
Non-deductible expenses (£100 x 19%)	19	
Tax expense	£849	

Examples of reconciling items

- Foreign income taxed at different rates to the UK rate
- Disallowable expenditure (including depreciation and amortisation of assets not eligible for capital allowances such as buildings and some goodwill)
- Income which is exempt from tax (such as most dividends received by UK resident companies)
- Effect of unutilised losses where a deferred tax asset has not been recognised
- Other timing differences where a deferred tax asset has not been recognised
- Effect on opening deferred tax balances of a change in tax rate
- Adjustments to prior years' current tax liabilities (assets)
- Utilisation of brought forward losses
- Other taxes levied on the entity which are taxed on profits (such as Petroleum Revenue Tax and the North Sea Supplementary Charge)

Example 1 – total tax reconciliation under FRS 102

A company reports a profit before tax of £190.6 million. The total tax expense in the income statement is £37.35 million (an effective rate of 19.60%), broken down as follows:

	£m
Current corporation tax payable*	31.37
Deferred tax expense	5.98
Total tax expense	37.35

Assume that the applicable tax rate for the company is 19%. Analysis of the accounts and tax computations show the following:

1. The company benefited from capital allowances of £35 million
2. Depreciation expense totalled £3.5 million
3. Tax–exempt dividend income of £20 million is included in the profit
4. Other disallowed expenses totalled £26 million

* Adjusted profits are (£190.6 + £3.5m - £35m - £20m +£26m) £165.1m, so corporation tax payable is (19% x £165.1m) £31.37m.

Tax reconciliation	£m	
Profit on ordinary activities before tax	190.60	
Profit before tax multiplied by applicable tax rate (19% x £190.6)		36.21
Tax exempt income (19% x £20m)		(3.80)
Expenditure not allowable for corporation tax purposes (19% x £26m)		4.94
Total tax expense		37.35

The £35m qualifying for 100% capital allowances does not affect the reconciliation as deferred tax would have been provided against it in arriving at the total tax expense.

The deferred tax expense of £5.98m is also included in the total tax expense and so is irrelevant to the reconciliation.

Changes in tax rates

Normally, deferred tax would not feature in a tax reconciliation, but where the rate of tax used for deferred tax is different to the applicable rate for the current period, the effect of the change in tax rates needs to be included in the reconciliation.

Example

In its year ended 31 March 2020 a company makes a profit before tax of £150,000. This includes customer entertainment expenses of £22,000 and accrued pension costs of £10,000 which were paid in April 2020.

The total tax expense under FRS 102 and the tax reconciliation are as follows:

Current tax

Adjusted profit (150,000 + 22,000 + 10,000) = £182,000

Current tax @ 19% = £34,580

Deferred tax

Timing difference on pension accrued, deferred asset/ P&L credit (17% x £10,000) £1,700 Cr

Total tax expense (34,580 – 1,700) £32,880

Effective rate (32,880 ÷ 150,000) = 21.92%

Tax reconciliation

Tax on profit before tax (150,000 x 19%)	28,500
Disallowed expense (22,000 x 19%)	4,180
Effect of change in tax rate on DT asset [10,000 x (19% - 17%)]	200
Total tax expense	32,880

Investment properties

Where tax rates are changing, the tax reconciliation requires extra care as seen above. It used to be more intricate for investment property gains and losses (which are recognised in profit and loss account under both FRS 102 and IFRS).

Deferred tax on investment property is a function of:

1. Change in FV recognised in P&L; and

2. The indexed cost (which has no link to FV and is not recognised in P&L).

The reconciliation needs to be broken down into its component parts:

1. Change in opening DT due to rate change;

2. Effect of future tax rates on DT on FV change;

3. Effect of change in indexed cost of properties (for periods up to December 2017).

As the indexed cost no longer changes, 3. above should no longer feature in the tax reconciliation which is now much simpler as a result.

Contributed by Malcolm Greenbaum

VAT

Legal proceedings against a borrower (Lecture B1156 – 18.06 minutes)

Summary – The company was not entitled to input tax recovery on the legal costs as they related to an exempt supply.

Newmafruit Farms Limited is a fruit farming and packaging business based in Kent. In January 2018, the company submitted to HMRC a Notification of Errors in VAT Returns form in respect of periods 03/15 to 01/17.

The company had lent accumulated profits on a short-term basis to unconnected third parties to earn interest. Subsequently, following legal proceedings, the company was able to partially recover the loan capital but was unable to recover any interest.

Initially, the company had not claimed any input tax relating to the professional services undertaken in connection with those legal proceedings but in February 2018, they submitted a Notification of Errors in VAT Returns form in respect of period 11/17.

HMRC rejected the claim for input tax, on the ground that the company had not shown how the input tax claimed was directly linked to its other taxable supplies.

HMRC's review decision concluded that the claimed input tax was not recoverable because the legal fees incurred were linked to an exempt supply (the making of loans). It concluded also that in any event, the legal fees were not a general overhead of the company's business and were not linked to any taxable supply made by the company.

Newmafruit Farms Limited appealed.

Decision

The First Tier Tribunal agreed with HMRC and concluded that:

> "a lender's costs of bringing legal proceedings against a borrower for breach of a loan agreement is a cost component of the supply of the loan itself."

This meant that there was a direct and immediate link between the legal fees and an exempt supply, so input tax could not be claimed.

The appeal was dismissed.

Newmafruit Farms Limited v HMRC (TC07254)

Salary sacrifice for travel and subsistence (Lecture B1156 – 18.06 minutes)

Summary – The First Tier Tribunal erred in law when concluding that Pertemps Ltd made a supply of services to certain employees but they were correct when concluding that the company was not carrying on any economic activity.

Pertemps Ltd provides permanent and temporary workers to clients, although in this case we are only concerned with those employees who were working on temporary assignments for Pertemps Ltd's clients.

These employees were given the choice of being paid a salary, out of which they would have to meet any travel and subsistence expenses, or participating in the Mobile Advantage Plan (MAP) under which they would be paid their travel and subsistence expenses but receive a reduced salary. The amount of the reduction was equal to the amount of the expenses payment plus a fixed amount that was, at different times, 50p or £1 per shift.

The advantage conferred by using the MAP was that the expenses were reimbursed free of tax and national insurance contributions so that, even after the payment of the MAP fixed amount, the employees were better off. Pertemps Ltd also benefitted as it did not pay Class 1 NICs in relation to those employees using the MAP.

HMRC took the view that the MAP involved a taxable supply of services by Pertemps Ltd to its participating employees. The payment for these services was the fixed fee of £1 or 50p and that Pertemps Ltd was liable to account for VAT on those amounts. Accordingly, HMRC assessed Pertemps Ltd for VAT of £715,918 in two assessments covering periods 07/09 to 07/14. There were further assessments standing behind these appeals.

Pertemps Ltd appealed to the First Tier Tribunal who concluded that Pertemps Ltd did supply services to the employees but that the supply was not within the scope of VAT because the operation of the MAP was not an economic activity for VAT purposes and allowed the appeal. The Tribunal also held that, if there had been a supply, it would have been exempt.

HMRC appealed against the First Tier Tribunal's decision.

Decision

The Upper Tribunal agreed with the First Tier Tribunal that Pertemps Ltd was not carrying on an economic activity when it operated the salary sacrifice scheme. The Upper Tribunal concluded that the economic reality was that Pertemps Ltd offered its employees two methods of being remunerated in its employment contract, each of which had slightly different tax consequences. As a result, Pertemps Ltd agreed to pay slightly different salaries. The Upper Tribunal did not regard that arrangement as showing that there was any service supplied by the employer even where an employee chooses the method that provides a greater weekly or monthly take home amount but a lower salary element.

However, the Upper Tribunal concluded that the First Tier Tribunal had erred in law when it held that Pertemps Ltd provided any service to participating employees and, therefore, there was no supply of services for VAT purposes. The company was merely ensuring that it met the legal requirements for processing pay under PAYE legislation for which ever of the two options the employees selected.

The Upper Tribunal could not see that Pertemps Ltd had supplied anything at all which might be regarded as a service to the employees.

HMRC's appeal was dismissed.

HMRC v Pertemps Ltd [2019] UKUT 0234 (TCC)

Book or stationery? (Lecture B1156 – 18.06 minutes)

Summary – The planner sold by the taxpayer was correctly classed as a zero-rated book and so the assessments to tax and penalties should be withdrawn.

Thorsteinn Gardarsson resides and operates his business from Iceland. He is an Amazon market place trader and began selling his product into the UK on 26 July 2013.

On 19 July 2017, as part of a routine check on what are known as non-established taxable persons, HMRC began an enquiry into his VAT registration status and concluded that the Action Day Planner that he was selling was not a book but was unused stationery falling outside the eligibility to be zero rated and thereby subject to VAT at the standard rate. It was a diary, not a book.

HMRC believed that he should have been VAT registered in the UK from when he started trading and so they issued an assessment for the long first prescribed accounting period 26 July 2013 to 30 June 2017, when he actually registered, for the sum of £158,024.77. A late notification penalty of £33,188.98 and an inaccuracy penalty of £1,915.43 were also issued.

Thorsteinn Gardarsson described the Action Day Planner as a time management tool developed to teach and instruct people time management skills. The first 16 pages of the planner contained text setting out a narrative of the ethos for effective time management. The remainder of the planner was taken up with 52 double page planners. The layout followed the methodology advocated in the first 16 pages with space to set out "tasks to execute" "delegation and teamwork" a column for each day of a week and "goals/projects I am going to work on this week". Thorsteinn Gardarsson submitted that the planner was a zero rated book and not a standard rated diary.

Decision

The First Tier Tribunal considered that within the ordinary meaning of the word book is any item with the physical characteristic of a book (i.e. as a minimum covers, pages, text and/or illustration) which has as its main function informing/educating or recreational enjoyment.

The Tribunal took the view that the section at the start of the planner was educational and set out both the theory and a guide for the practical application of effective time management and prioritisation skills. They commented that had there been a single example of the weekly page inviting readers to photocopy and complete the template they believed that HMRC would not have even questioned the liability of the planner.

The Tribunal concluded that the main function of the planner was to teach the user how to better or more effectively manage time and that it was correctly classed as a book and should therefore be subject to VAT at the zero-rate. As a consequence the taxpayer was not liable to the assessment raised by HMRC.

The Tribunal went on to consider the issue of registration stating that where a non-established person meets conditions A – D as set out in Schedule 1A VATA 1994, there is a liability to be registered for VAT with no turnover threshold unless, at the request of that person, HMRC consider it fit to exempt that person from the liability to be registered. On that basis, and with no request for exemption from registration, the correct VAT registration date was 26 July 2013.

The Tribunal stated that they have no power to require that HMRC exercise their discretion to exempt the taxpayer from registration. They merely observed that on the basis of the conclusion reached as to the liability of ADP the taxpayer met the requirements for exemption subject to a formal request being made.

They concluded by stating that failure to register as required under Schedule 1A strictly renders the taxpayer liable to a penalty for failure to comply with an obligation specified in Schedule 41 Finance Act 2008. However, the penalty payable is a tax geared penalty and, with no tax due, the penalty in this case was therefore nil.

Thorsteinn Gardarsson T/A Action Day A Islandi v HMRC (TC07255)

Decrease in consideration for a supply

Summary – As there was no actual repayment and it was not at all clear that there would be any repayment, the price had not been reduced in any commercial or economic sense.

The appellants in this case were four companies that between 2008 and 2013 carried on tax consultancy businesses that involved selling SDLT avoidance schemes to their customers.

"Letters of Instruction" provided that the companies should receive a fee from their customers. The companies charged standard rate VAT on fees that they received and accounted to HMRC for output tax on these amounts. The Letters also contained an undertaking by the companies to refund fees to their customers if the SDLT schemes were unsuccessful.

Facing the prospect of having to make these refunds, two companies went into liquidation and the other two into administration. All four companies issued credit notes to their customers as evidence of each customer's entitlement to a refund of the fee charged for the SDLT avoidance scheme services. However, no amount was actually paid to those customers at the time the credit notes were issued (or has been paid subsequent to the issue of those credit notes). The companies considered that there had been a "decrease in consideration" and so they made adjustments to the VAT payable portion of their VAT accounts and claimed repayments of the output tax accounted for on their supplies.

HMRC initially paid some of these claims but subsequently issued assessments to recover these amounts and refused all outstanding claims.

The First Tier Tribunal dismissed the appeals stating that the right to a repayment would arise only if and when the companies paid the refund to their customers or their customers actually used credit that the companies had given them.

Decision

The Upper Tribunal referred to Article 90 of the Principal VAT Directive that says:

"In the case ……. where the price is reduced after the supply takes place, the taxable amount shall be reduced accordingly under conditions which shall be determined by the Member States."

The Upper Tribunal said that it could be said that there was a price reduction in the sense that the companies' customers had a contractual entitlement to repayment. However, the commercial reality was that the companies made no actual refunds. Indeed, the Upper Tribunal stated that it was not clear that there would be any distribution to any unsecured creditor even if the VAT refund claim was successful. The Tribunal considered that this meant that there was no reduction in price for the purposes of Article 90. The purported reduction was just a paper one with no commercial substance. The First Tier Tribunal's decision was upheld.

Inventive Tax Strategies Limited (In Liquidation) and others v HMRC [2019] UKUT 0221 (TCC)

Revenue & Customs Briefs

R&C Brief 7/2019:

VAT on lost space of bathroom and washroom conversions for disabled people

The purpose of this brief is to announce a reinstatement of guidance on restoring lost space into VAT Notice 701/7).

There is a zero rate for works to install, extend or adapt a bathroom, washroom or lavatory which are necessary because of a person's disability. This includes associated works to restore space lost in the property as a result.

For example, a disabled person needs to extend the size of an existing bathroom to accommodate changes needed because of their condition. In order to facilitate this, 25% of the adjoining room is used to create the extended bathroom. The law zero rates the extension works, including restoring the adjoining room to its original size where it becomes necessary as a result of the extension.

Until 18 December 2014, HMRC's published guidance provided an explanation of this relief. However, from that date, the guidance no longer made any reference to the zero rate for works to restore the lost space.

The lack of specific guidance has led to a degree of uncertainty about the scope of the relief, and restoration of lost space. As a consequence, HMRC has included specific guidance in VAT Notice 701/7.

Points worth noting

- Where, as a result of the works, it becomes necessary to restore the 'lost space', that work can be regarded as part of the work essential to the provision of the bathroom, washroom or lavatory. The restoration of that 'lost space', but only that 'lost space', by restoring the room itself to its original size, can also be zero-rated. This can be done through internal works or by extending outwards or upwards;

- The zero rate does not extend beyond the reinstatement of the 'lost space', so everything else, including converting another room in the residence to replace the lost room, will be standard-rated;

- The 'lost space' amount that can be zero-rated must follow the exact specifications in floor measurements, or room volume, of the space lost;

- The application of the zero rate in these circumstances only applies to the reinstatement of 'lost space' in terms of building works. It does not extend to fixtures, fittings, units, and so on. However, the zero rate does apply to the provision of utilities that were available in the original converted room.

Where works were started prior to 18 December 2014, and progressed after that date, builders and their customers may continue to rely upon the guidance that was in place up to 18 December 2014.

In cases where works commenced after 18 December 2014, when guidance made no reference to works to make good lost space, and builders and their customers were unaware of the relief for such works, the zero rate may be applied retrospectively, based on the new guidance, and thus adjust the VAT charged on the works.

It is important to note, however, that such adjustments are subject to the 4-year cap – which starts from the accounting period in which the error was made.

www.gov.uk/government/publications/revenue-and-customs-brief-7-2019-vat-on-lost-space-of-bathroom-and-washroom-conversions-for-disabled-people

R&C Brief 8/2019

Retention of VAT cost-sharing exemption in the social housing sector

Revenue and Customs Briefs 3/2018 and 10/2018 detailed various changes that have already been incorporated in the VAT Cost Sharing Exemption (CSE) Manual. In that, HMRC announced that it would be carrying out a review of the application to social housing organisations.

The Court of Justice in DNB Banka AS (Case C-326/15) concluded that the CSE only applies to independent groups of persons whose members carry on an activity in the public interest. The court was concerned specifically with financial services and did not consider the treatment of social housing associations that make rental supplies which are also in the public interest.

In the absence of a court judgement relating specifically to them, HMRC considers that the existing arrangements should continue for social housing associations.

The CSE allows persons who carry on activities covered by certain exemptions to join together to form a Cost Sharing Group (CSG) so they can acquire services and recharge their members for their use of the services at cost without incurring any additional non-recoverable VAT.

Conditions for application of the CSE to CSGs in the social housing sector

The conditions set out in the VAT Cost Sharing Exemption manual (CSE 1250) apply equally to the social housing sector.

Further to those conditions:

- there must be no uplift of internal or external costs (for example, resulting in a margin or profit on actual costs being recharged) within the CSG
- there must be no uplift of the costs being shared within any VAT group including either, the CSG itself, and or the members of the CSG
- there must be no uplift of costs by a VAT group member supplying a CSG in the same VAT group
- there must be more than one member of the CSG, the count does not include members that are in a VAT group either with the CSG, or with other members
- the CSG only applies to providers of social housing (registered social landlords) and not to private housing providers

www.gov.uk/government/publications/revenue-and-customs-brief-8-2019-review-of-the-vat-exemption-for-cost-sharing-groups-in-the-social-housing-sector

R&C Brief 9/2019

This Brief entitled "VAT on retained payments and deposits under TOMS" corrects an error introduced into HMRC's guidance in VAT Notice 709/5 on the tour operators margin scheme (TOMS), following changes to the VAT treatment of retained payments and deposits from 1 March 2019.

The March update indicated that tour operators should include all forfeited deposits and cancellation fees in their margin scheme calculations. However, the scheme only requires tour operators to account for such payments where they exceed 20% of the full sale price.

HMRC has corrected VAT Notice 709/5 (paragraph 6.1) and invites claims from traders who have overpaid VAT since 1 March as a result of relying on the incorrect guidance.

www.gov.uk/government/publications/revenue-and-customs-brief-9-2019-vat-tour-operators-margin-scheme-and-retained-payments-and-deposits

R&C Brief 10/2019

There have been a number of requests by relevant parties to delay the introduction of the VAT reverse charge for building and construction services that was due to be introduced from 1 October 2019. Indeed, at the beginning of August, the Chartered Institute of Taxation stated that they believed that small and medium size construction firms have not had adequate opportunity to prepare for this major change in accounting for VAT, and called for a delay of six months.

Clearly HMRC has listened. To help businesses prepare, and to avoid the new rules starting at the same time as our possible exit from the EU, the reverse charge rules have been delayed by 12 months.

In Revenue & Customs Brief 10/2019, HMRC has announced that the implementation of the VAT reverse charge for building and construction services has now been postponed until 1 October 2020, so by a full year.

HMRC recognise that some businesses will have already changed their invoices to comply with the new rules and are unable to easily change them back in time. HMRC say that they will take this delay into account where businesses have already changed invoices to comply with the rules, and those who have opted for monthly VAT returns ahead of the planned start in October 2019 may now reverse that option.

www.gov.uk/government/publications/revenue-and-customs-brief-10-2019-domestic-reverse-charge-vat-for-construction-services-delay-in-implementation

Partial exemption problems (Lecture B1159 - 22.09 minutes)

The lecture reviews a number of historical precedent cases on partial exemption and business/non-business activities to set out the principles that have been applied in three recent cases:

- BLP Group plc v C & E Commrs, ECJ Case C-4/94 [1995]: if input tax was directly and immediately linked to an exempt transaction (the sale of shares in a subsidiary company) it was blocked, and it was not permissible to recover it based on an indirect link to future taxable activities of the entity as a whole.

- Kretztechnik AG v Finanzamt Linz, ECJ Case C-465/03 [2005]: input tax incurred on the issue of new shares was not linked to an exempt transaction, because the issue of shares does not involve making a supply; the input tax was therefore linked to the activities of the business as a whole, and as the business was wholly taxable, it was wholly recoverable.

- HMRC v Mayflower Theatre Trust Ltd, CA [2007]: the link between the cost of putting on a theatrical production and the sale of refreshments was a mere ‘but for’ link that did not justify recovery under the rules of partial exemption – the cost of the production was not a cost component of the sale of ice cream. However, there was a link between the production cost and the sale of programmes, because the contract with the production company included the right to print photographs of the production in the programmes.

- Sveda UAB v Valstybin mokesi inspekcija prie Lietuvos Respublikos finans ministerijos, CJEU Case C-126/14 [2015]: the cost of building a tourist attraction was sufficiently linked to taxable supplies to be made by the trader to justify recovery, even though it would not charge for admission for the first five years and even though the cost was subsidised by a grant.

- Direktor na Direktsia Obzhalvane i danachno-osiguritelna praktika Sofia v Iberdrola Inmobiliaria Real Estate Investments EOOD, CJEU Case C-132/16 [2017]: the cost of upgrading a local authority's infrastructure, without charging the local authority for the work, was directly linked to the future taxable supplies of the trader because it was essential to those supplies.

- HMRC v Volkswagen Financial Services (UK) Ltd (No 3), CJEU C-153/17 [2018]: a company that supplied HP finance for cars was entitled to some recovery of input tax on overheads, because it made taxable supplies of the cars, even though it sold them on at cost and its overheads were therefore entirely financed by the exempt finance charges that it levied.

The three recent cases are described in detail below:

- Royal Opera House, a FTT decision that appears to go against the Mayflower judgment described above and may be appealed by HMRC;

- Cambridge University, a CJEU decision on the link (or absence of a link) between management of an endowment fund and taxable activities of a charitable institution;

- Glasgow School of Arts, an illustration of possible VAT planning in the area of partial exemption, in this case ineffective because it was not implemented early enough in a building project.

Production costs

HMRC refused a claim by the Royal Opera House to recover £530,000 of tax associated with the costs of staging productions between June 2011 and August 2012. It was common ground that the production costs were residual because of direct and immediate links to some taxable supplies that the ROH made (e.g. programme sales and production specific commercial sponsorship), while the ticket sales were exempt. HMRC considered that the standard method override significantly reduced the amount of recoverable input tax.

Before the hearing, ROH conceded that there was no direct link between the costs and third party commercial income, licensing income and service recharges, and sales of CDs etc. of non-ROH productions; while HMRC conceded that there was a direct link with backstage tours. What remained at issue were the following taxable supplies:

(1) Catering income (bars and restaurants);

(2) Shop income;

(3) Commercial venue hire;

(4) Production work for other companies; and

(5) Ice cream sales.

Judge John Brooks listed a large number of precedent cases to which he was directed by counsel, but he noted from the Mayflower judgment of Carnwath LJ that the principles were well established:

(i) Input tax is directly attributable to a given output if it has a "direct and immediate link" with that output (referred to as "the BLP test");

(ii) That test has been formulated in different ways over the years, for example: whether the input is a "cost component" of the output; or whether the input is "essential" to the particular output. Such formulations are the same in substance as the "direct and immediate link" test;

(iii) The application of the BLP test is a matter of objective analysis as to how particular inputs are used and is not dependent upon establishing what is the ultimate aim pursued by the taxable person. It requires more than mere commercial links between transactions, or a "but for" approach;

(iv) The test is not one of identifying what is the transaction with which the input has the most direct and immediate link, but whether there is a sufficiently direct and immediate link with a taxable economic activity; and

(v) The test is one of mixed fact and law, and is therefore amenable to review in the higher courts, albeit the test is fact sensitive.

He added two more principles, one from College of Estate Management, and one from the A-G's opinion in Abbey National:

(vi) It may be necessary to determine whether, for tax purposes, a number of supplies are to be treated as elements in some over-arching single supply. If so, that supply should not be artificially split;

(vii) A transaction which is exempt from VAT will "break the chain" of attribution.

The judge examined the way in which the "direct and immediate link" test had been applied in a long string of cases, including Mayflower, Dial-a-Phone, Lok'n'Store, Roald Dahl Museum and Story Centre, Chester Zoo, Sveda and Associated Newspapers. The most recent cases cited were the Cambridge University case, where the CA has referred questions to the CJEU, and the CJEU decision in VW Financial Services. After quoting extensively from these precedents, the judge turned to the facts of the present case.

The production costs were those specific to each production, and not the costs of the ROH permanent staff or overheads. They included the fees for guest performers and conductors, creative teams, music copyright costs where relevant, the cost of sets, props, costumes, transportation, extras and actors. The costs varied considerably from one production to another, depending on the scale of the show and on whether it was an original production or a revival.

The essential argument for ROH was that the commercial and economic reality was that it could not incur production costs on the scale it did without those costs generating a level of income from the disputed sources. There was a "virtuous circle" that enabled the business to operate. HMRC dismissed this as the kind of "but for" link that was referred to in Mayflower Theatre Trust.

The judge listed a further ten points to apply in reaching a decision. Key among these were the need for an objective, fact-specific analysis of the extent of the link between the inputs and output supplies; a chain transaction that was exempt would "break the link" between inputs and outputs, but if there were separate chains linking to exempt and taxable outputs, there would be no break.

The judge considered that the link between the catering income and the production costs was similar to that between sales of ice cream and production costs in Mayflower. However, he was mindful of the more recent case law, in particular Sveda and Associated Newspapers, in which the question was whether there was a "necessary economic link between the initial expenditure and the economic activities which follow". The productions were central to everything that ROH did: they brought the customers into the bars and restaurants. This was, according to the judge, more than a mere "but for" link. The production costs were essential to the catering supplies; objectively, the purpose was not merely to sell tickets, but to enable ROH to maintain its catering income. The judge noted that Patten LJ had appeared to come to a similar conclusion when commenting on Mayflower in the Associated Newspapers decision; and this extended to the sale of ice cream as well as catering.

The same could not be said of the shop income, apart from sales of recordings of ROH productions. Similarly, venue hire was only to be taken into account where it specifically related to a production. For example, the Wimbledon Champions' Gala Dinner of 2014 was not sufficiently linked to any production. Production work for other companies was also not related to the costs of ROH productions.

The appeal was allowed in part; the financial effect of recalculating the standard method override, taking into account only the "linked" revenues, is not set out in the decision.

First-Tier Tribunal (TC07157): Royal Opera House Covent Garden Foundation

Investment management costs

The University of Cambridge has an endowment fund in which it invests donations. It pays professional fees to managers to look after this money, and the income and capital growth on the investments are used to support the various activities of the university, amounting to some 6% of its operational expenditure. As a charity, the university has activities that are business and non-business, and the business activities are taxable (mainly commercial research, sales of publications, consultancy and hire of facilities) and exempt (education).

The university generally claimed input tax in accordance with the 'CVCP guidelines' agreed between HMRC and higher education institutions. These enabled it to avoid preparation of detailed partial exemption calculations. For some years it did not include the investment management costs as residual input tax in the CVCP workings. It made a claim in 2002 which was refused and not pursued, but then claimed again in March 2009 following Fleming. The amount claimed was £182,500.

HMRC argued that the investment activity should be regarded as a 'free-standing activity' and therefore 'a supply made not by a taxable person acting as such', in line with the decisions in NSPCC and Wellcome Trust. Overheads relating to a non-economic activity undertaken for the purpose of an economic activity should not be regarded as recoverable.

The FTT (TC02836) did not agree. In line with the decision in Kretztechnik, something that did not involve the taxable person making a supply – whether the issue of shares, or in this

case the receipt of dividends – should be related to the activities of the entity as a whole. As the endowment fund financed all the activities of the university, the management fees were residual, and the input tax was partly recoverable.

The FTT decision reviewed each of the major precedents in turn and comments on the reasons for following or not following them. In particular, HMRC's reliance on BLP Group was rejected: in that case, the sale of shares was held to constitute an economic activity, whereas the university was not engaged in such activity in relation to its investments.

HMRC appealed to the Upper Tribunal (Mr Justice Simon and Judge Sinfield, 2015). Their counsel's argument was summarised as follows in the decision:

In order to be regarded as overheads, the costs incurred in acquiring the input transactions must be cost components (in the sense of being incorporated in the price) of all the taxable person's economic activities. Putting it another way, the input transactions must 'burden' the cost of the taxable person's economic activity as a whole. Mr Singh contended that the costs of F&CM's investment management services do not burden the cost of all of the University's economic activities. He submitted that F&CM generates investment income from the Fund and that income subsidises the University's economic activities, thereby reducing the cost to the University of making supplies of education, research, catering, bar sales and conferencing services. He submitted that, in principle, the costs of generating investment income from the Fund do not have a direct and immediate link with and cannot be cost components of the price (or burden the cost) of the University's economic activity as a whole.

Mr Singh submitted that the correct analysis was that the costs of the investment management services are cost components of the price of the University's disposals of its investments for consideration and are thus directly and immediately linked with those disposals. He further contended that it is not permissible to 'look through' the disposals of investments for consideration in order to attempt to attribute the costs of the investment management services to the University's economic activity as a whole.

By contrast, the taxpayer's counsel put forward a simple question based on Kretztechnik: for what purpose is the outside the scope activity carried out? He submitted that, in the present case, the answer was straightforward: the investment activity is not carried on for its own sake, but for the benefit of all the University's activities.

The Upper Tribunal reviewed BLP Group, Abbey National and Kretztechnik for authority on the treatment of overheads. The principle of BLP Group was that an exempt supply to which costs were directly attributable "broke the chain" between overheads and taxable activities of the business as a whole. Here, there was no such chain-breaking event, because the sale of investments was outside the scope investment activity rather than exempt economic activity.

The judges also considered Securenta and AB SKF for VAT on costs relating to investment activities and the sale of shares. The costs of the investment activity did not "burden the investment activity in the sense that fees were incorporated into the price of investments that were sold". According to AB SKF, then, they could be overheads of the business as a whole. HMRC's counsel tried to find a distinction between the raising of capital and the generation of income, but the judges considered that this only arose in the CJEU cases because of their facts, not as a principle of law.

The FTT had found that the investment activity was not carried out for its own sake but for the benefit of the University's economic activity in general. It followed that the costs associated with that investment activity were part of the University's overheads. HMRC's appeal was dismissed.

HMRC appealed again to the Court of Appeal. Patten LJ set out the leading judgment. He reviewed the facts, the law and the precedents. He summarised the issue as the need to choose between two different ways of looking at the attribution of inputs to taxable outputs: one, favoured by HMRC, that required a direct transactional link to a particular taxable output, and ruled out deduction for something that was directly linked to a non-taxable investment "activity"; and the other, which took a more general view of inputs that were associated with the business activity as a whole, and did not regard the investment transactions as an end in themselves.

He discussed the different lines of reasoning as set out in a number of CJEU cases, including BLP, Midland Bank and Abbey National. In the last, the CJEU had not ruled out deduction of VAT incurred in relation to the transfer of a business as a going concern, even though the law regarded it as a "non-supply". That implied, even though it did not spell out, a distinction between something that was directly attributable to making exempt supplies (as in BLP) and something that was attributable to activities outside the scope of VAT. The Court's decision in AB SKF also supported a distinction between the "magnetism and chain-breaking effect" of exempt outputs on the one hand and non-taxable activities on the other.

The judge accepted HMRC's submission that a finding of a direct link to such a supply will render the input tax irrecoverable just as in the case of an exempt output supply. However, he considered that the appropriate question was whether one can link the expenditure to the ultimate economic activity by treating it as a cost component of a specific taxable supply or as an overhead of the business, i.e. are the costs incorporated in the cost of the taxpayer's economic activities.

Finally, he noted the *Iberdrola* decision, and the fact that the CJEU had overruled the A-G's view that the input tax incurred on a benefit provided to someone else without charge should be irrecoverable. He described the decision as the application of a "but-for test of causation to the works themselves".

The university's counsel sought to rely on the CA judgment in Associated Newspapers, which he contended related to a similar question. However, the judge said that in that case it was difficult to treat the purchase of an incentive to buy the newspapers as anything but part of the promotion of the taxpayer's business. In this case he considered that the link in transactional terms was more remote and that the decisions in cases like Kretztechnik may have depended on a difference in tax treatment between exempt and non-taxable supplies which later CJEU decisions appear no longer to follow. There was some force in HMRC's comparison with the Wellcome Trust case, in which the VAT on the costs of selling a large investment holding was held to be wholly consumed in the selling operation, rather than being capable of attribution to wider economic purposes of the charity concerned.

Overall, the law was not acte clair, and the Court of Appeal decided it was appropriate to make a reference to the CJEU. The questions referred were as follows:

(1) Is any distinction to be made between exempt and non-taxable transactions for the purpose of deciding whether VAT incurred for the purposes of such transactions is deductible?

(2) Where management fees are incurred only in relation to a non-taxable investment activity, is it nonetheless possible to make the necessary link between those costs and the economic activities which are subsidised with the investment income which is produced as a result of the investments, so as to permit VAT deduction by reference to the nature and extent of downstream economic activity which carries an entitlement to deduct VAT? To what extent is it relevant to consider the purpose to which the income generated will be put?

(3) Is any distinction to be drawn between VAT that is incurred for the purposes of providing capitalisation for a business and VAT that produces its own income stream, distinct from any income stream derived from downstream economic activity?

The CJEU gave a relatively brief answer to the question. The judgment notes that it is possible for VAT incurred in relation to a non-business activity to be linked to the activities of a business as a whole (as in Kretztechnik); however, the key paragraph states:

"In the present case, it is apparent from the documents before the Court that, first, costs relating to the management of donations and endowments invested in the fund concerned are not incorporated into the price of a particular output transaction. Second, as it is apparent from the documents before the Court that (i) the University of Cambridge is a not-for-profit educational establishment and (ii) the costs at issue are incurred in order to generate resources that are used to finance all of that university's output transactions, thus allowing the price of the goods and services provided by the latter to be reduced, those costs cannot be considered to be components of those prices and, consequently, do not form part of that university's overheads. In any event, as there is no direct and immediate link in the present case either between those costs and a particular output transaction or between those costs and the activities of the University of Cambridge as a whole, the VAT relating to those costs is not deductible."

The answer to the question is very specific to the facts of the case (relating to management of investment funds and use of the money to subsidise operations), but it seems likely that HMRC will see this as a significant victory in showing that a link between costs and taxable outputs has to be more specific than some people have argued since Sveda and Iberdrola.

CJEU (Case C-316/18): HMRC v Chancellor, Master and Scholars of the University of Cambridge

One building or two?

TC06506 was concerned with a repayment return for 01/16 submitted by Glasgow School of Arts (GSA) claiming £405,301, and a Form 652 submitted at the same time applying for £65,778 in respect of costs of a building project. HMRC rejected both claims and replaced them with an assessment for £96,525.

GSA had carried out construction works at its Garnethill campus. There was a difference of opinion as to whether there were two buildings involved, the Reid Building and the Assembly Building; to start with, GSA had referred only to the Reid Building, but later it argued that there were two buildings, while HMRC's position was the opposite of this.

The Tribunal explained that the decision would use "the Assembly Building" to refer to an area of the site occupied by the Students' Union, and "the Reid Building" as an area occupied by GSA itself. However, the whole site had frequently been referred to by both parties as "the Reid Building".

The judge considered the history of the refurbishment project, which involved substantial amounts of demolition and reconstruction. The Assembly Building is an older sandstone structure which shares a party wall with the Reid Building, a modern steel-and-glass construction opposite the historic Mackintosh Building which has recently been destroyed by a second fire in a short period. They were functionally separate, with minimal shared facilities (sprinkler and air handling systems and heating), and access from one building to the other only used for maintenance purposes. The buildings are classified separately for rates, with the Assembly Building classified as a business and the Reid Building as a charity.

The Assembly Building was leased to the Students' Union. The judge noted that the agreement is in reality a Service Level Agreement rather than a lease; the rental is £5,000pa plus VAT. This was at an effective rate of 45p per square foot at a time when the market rate for a city centre bar or restaurant was £7.62 and office space was £12 to £15.

The construction company had originally tendered for the whole refurbishment and reconstruction project as a single contract, and had rendered combined invoices. GSA asked for separate invoices to identify the VAT element of the Assembly Building refurbishment, when it had decided that it ought to be possible to reclaim it. The VAT on the costs had initially been treated as residual, and had recovered it according to an agreed combined PESM (business/non-business and partial exemption) that had operated since August 2009.

GSA's tax agent wrote to HMRC in December 2013 in an attempt to agree a new "capital item special method" based on the floor area of the whole Reid Building site. This suggested that 16.28% of the combined building was used for wholly taxable purposes. On 14 August 2014 the agent submitted an option to tax covering the whole building. In October 2014, the agent submitted a capital goods scheme adjustment working which produced an overall taxable percentage of 29.98%; the taxable areas included the Assembly Building (rented to the Students' Union), a refectory (operated by a company as agents for GSA) and a retail shop (operated by a commercial subsidiary).

HMRC refused the claims on the basis that the outputs of £102,500 did not fairly represent the economic use of the building costs and did not justify the recovery of £2.1m of input tax.

In correspondence during 2015, the tax agent explained that GSA now maintained that the Assembly Building was a separate building from the Reid Building; although the option to tax had referred to the Reid Building, the clear intention had been to opt the Assembly Building. VAT had been charged and accounted for on all rental income; the Assembly Building had been used for wholly taxable purposes. The agent stated that there was no internal link between the buildings, in spite of supplying plans which clearly showed that such a link existed. Further investigation and correspondence ensued about the nature and possible use of the access doors, which were now only to be used as an emergency fire exit from the Assembly Building.

HMRC's argument was summarised as follows:

(a) There was a single supply which had not been altered by the issue of the credit notes and invoices outwith the accounting system.

(b) VAT had been charged at the time of the supply and deducted using the PESM and BNB then in place.

(c) The supply was properly attributable to all of the appellant's activities so the VAT on the construction services was residual and it is not possible years later to re-attribute part of that supply to fully taxable.

(d) The cost component on the supply of construction of the Assembly Building relates to all of the appellant's activities not just the lease so the deduction should not be limited to the Assembly Building alone.

(e) The cost component test relates to whether there is a "direct and immediate link" between the input and the output tax.

(f) Whilst it is accepted that a business does not require to be profitable to deduct its input tax, and that deduction is not being denied by HMRC, the attribution solely to the lease does not reflect the economic reality.

(g) One should look objectively at purpose and funding when considering the economic use of costs and the grant of a lease at an almost notional cost was not the sole or even principal purpose of the refurbishment funded by the Scottish Funding Council.

GSA's argument was that the separate identity of the two buildings was a question of fact, which necessarily determined that the VAT was incurred on two separate sets of costs; and the VAT incurred on the Assembly Building was then fully recoverable, because it was used for wholly taxable purposes.

The judge considered precedents on whether buildings can be regarded as separate, in particular Cantrell. The internal access provisions of Sch.8 Group 5 Notes 16 and 17 only relate to the question of whether something is an "annexe", which had no relevance here. There were factors favouring both possible outcomes, but overall the judge was satisfied that the Reid Building was a single structure with a self-contained area within it. It was "one building constructed as such". The changes to restrict the internal access were made as a result of the HMRC enquiry, not as part of the original plans.

It was still necessary to consider whether there was one supply, on which the input tax would be residual, or two, on which one part was wholly used for taxable supplies. The judge was satisfied that the intention at the time had always been for a single project; in effect, the VAT consideration after the event had led to the "artificial dissection of the transaction". The request for replacement invoices and credit notes did not change the nature of the supply. Even if there were two buildings, there was only one building supply.

The judge also accepted HMRC's argument that the letting of the Assembly Building to the Students' Union did not constitute an economic activity. Although a low rent did not preclude such activity, the judge noted that it would take GSA 500 years to recoup its capital outlay, not allowing for the fact that it bore the insurance and some other costs. It provided the lease and the facilities as part of its necessary support of the Students' Union.

In effect, HMRC won on every argument. The appeal was dismissed.

The school appealed to the Upper Tribunal. The judge summarised the FTT's findings, and in particular identified the key points: the FTT had concluded that the edifice was more akin to a semi-detached building with an internal link than separate buildings; however, the key question was whether there was one supply or two, which it had considered using the principles derived from CPP and Levob. The conclusion was supported by the following findings of fact:

- A single price was charged (although this was not decisive);
- The project had a single procurement strategy encompassing both buildings;
- It was a condition of funding that BREEAM rating (concerning sustainability) be achieved, which meant that the buildings had to be constructed together and physically linked;
- Planning applications were for both buildings;
- The economic and commercial reality was that the appellant intended to, and did, develop the site as a whole;
- Separate invoices were not provided until after the VAT issue arose.

The FTT had also concluded that the letting of the Assembly Building to the Students' Union was not an economic activity, on the grounds that the rent would not recoup the costs of the outlay for 500 years. The lease and facilities were provided as part of the school's necessary support of the Union, and not as an economic activity.

The UT's decision is rather briefer than its review of the decision below. It could see no error of law in the FTT's conclusion that the two structures were in essence a single building, but also agreed with the FTT that it was not a particularly significant finding. As regards the question of a single supply, the FTT had applied the correct test, and an appellate Tribunal should be reluctant to overturn a finding of this kind. Although the appellant wanted and obtained two separate premises with different functions, that did not raise an inference that there were separate supplies. The original invoicing arrangement appeared to reflect the economic and commercial reality of the project more accurately than the amended arrangement that was substituted after the VAT issue had been identified.

For those reasons the appeal failed; for completeness, the UT also considered the question of a separate supply in relation to the Assembly Building. The judges applied the principles of Wakefield College and held that the lease was within art.2 PVD (a supply for consideration) but was not within art.9 (economic activity) because of the nominal rent. The school was therefore not making taxable supplies to the Union, and it was not possible to recover input tax charged on the basis of such supplies being taxable.

Upper Tribunal: Glasgow School of Art v HMRC

Input tax on cars (Lecture B1160 – 10.36 minutes)

Input tax and cars – basic rules

A basic rule of VAT that has been in place since the 1970s is that input tax cannot be claimed on the cost of buying a new car unless it is exclusively used for business purposes and is not intended to be made available for private use (Legislation - Article 7, Value Added Tax (Input Tax) Order 1992). So, in basic terms, there is no problem claiming input tax if the car is a tool of trade e.g. for a driving school, taxi driver or car hire business. And there is no problem with a genuine pool car that is available to all employees and not kept overnight at the home of any specific employee (VAT Notice 700/64, para 3.7). But apart from that, opportunities to claim input tax are few and far between.

Barry Graham (TC7313) - the case

Mr Graham was a sole trader who traded in the computer industry, and with daily fees earned between £3,000 and £5,000, he decided that his business needed to own prestige cars to show he was running a successful venture. He even had a contract in place to pay his children £1,000 per day for any work they did. Input tax of £20,805 was therefore claimed on his March 2017 VAT return, in relation to three cars, an Audi A8, Mini Cooper S and a Porsche Cayenne. HMRC challenged the claim and disallowed input tax on the basis that the vehicles were available for private use.

The taxpayer claimed that the cars were used exclusively for business purposes by he, his wife and children and never made available for private purposes. That had always been the intention since they were purchased. Each family member had a separate car for their private journeys and the keys were kept in a locked safe and only retrieved for business trips. A mileage log proved that 93% of trips were carried out for long business journeys, with the other 7% being for shorter trips, which Mr Graham said he could also analyse if necessary. There was also a contract in place with his daughter which "expressly forbid" private use of the cars.

The appeal was allowed - it seems the main factors in the taxpayer's favour were the fact that each individual owned a separate car which they used for private purposes plus a persuasive argument from Mr Graham that private use was completely blocked for all three cars. He was described as an 'honest witness' in the case report.

Previous case law

Despite this verdict, the odds of a taxpayer winning appeals about input tax and cars are very limited. The last major taxpayer success in the courts was the case of Zone Contractors Ltd (TC5330), where the arguments were helped by the fact that the employees had strict contracts of employment in place that prevented private use of the vehicles and the cars were kept overnight either on site or at the company offices i.e. rather than at the home address of individual employees. It is fair to say that it is harder for an unincorporated business to win the input tax argument than a limited company where everyone is an employee.

There was a famous VAT case back in 2002 when a sole trader Mr Upton ([2002] EWCA Civ 520) managed to persuade the lower courts that his Lamborghini car was used exclusively for business purposes and was not available for private use. However, HMRC eventually triumphed in the Court of Appeal and it has been very difficult ever since for sole traders to convince either HMRC or the courts that a motor car they have bought is not available for private use.

In the Graham case, the judge picked up a on some subtle wording in the legislation (Value Added Tax (Input Tax) Order 1992, Article 7), namely that the test was whether the business 'intended to make it available…….for private use' i.e. a focus on intentions rather than actual outcomes. However, it was still a surprise victory – the taxpayer represented himself at the hearing and was described as an "honest witness" by the court, which was probably the key factor in his win.

As a final comment, the court dismissed the fact that the three cars in the Graham case were only insured for social domestic and pleasure purposes, seeing this as an oversight on the part of Graham's wife, who was ill at the time she dealt with the insurance policies.

Overall, it is still very difficult to justify an input tax claim on the purchase of a new car in most situations – an alternative might be to lease a car instead where 50% input tax can be claimed on the leasing charges, as long as there is some business use of the vehicle in question.

Contributed by Neil Warren