Tolley®CPD

October 2021

Disclaimer

Tolley CPD takes every care when preparing this material. However, no responsibility can be accepted for any losses arising to any person acting or refraining from acting as a result of the material contained in these notes.

CONTENTS

Personal tax

IR35 decision overturned but still waiting (Lecture P1276 – 21.00 minutes)

Summary – Based on the evidence provided, the First Tier Tribunal was not entitled to make the findings that they did in relation to notice periods and working hours. We await the Court of Appeal decision in Professional Games Match Officials Limited on mutuality of obligation before a final decision is made.

George Mantides is a urologist who works through his personal service company, George Mantides Limited. He provided locum services to two hospitals in 2013: the Royal Berkshire Hospital and the Medway Maritime Hospital.

The First Tier Tribunal considered hypothetical contracts with both hospitals concluding that under a contract directly between:

- Medway Maritime Hospital and George Mantides, he would not be regarded as an employee of the hospital;

- Royal Berkshire Hospital and George Mantides, he would be regarded as an employee of the hospital, primarily on the basis of mutuality of obligation.

HMRC sought permission to appeal the Medway Maritime Hospital decision but this was declined as HMRC's submission was late.

On the taxpayers appeal to the Upper Tribunal on the Royal Berkshire Hospital element of the decision, the company argued that there was no proper basis on which the Tribunal could find that the contract would be terminable early on at least one week's notice on either side, or that the hospital would provide 10 half-day sessions a week for George Mantides. His services as a locum at the Royal Berkshire Hospital were supplied through a company called DRC Locums Limited with the First Tier Tribunal recording that "The contractual documentation of the arrangements was… remarkably thin". George Mantides Limited argued that the First Tier Tribunal had erred in law. Consequently, the First Tier Tribunal had reached the wrong decision. The hypothetical contract would not be one of employment.

Decision

The Upper Tribunal found that the First Tier Tribunal had insufficient evidence to reach their conclusion. It was not clear as to the nature of the contractual arrangements between George Mantides, DRC Locums Limited and Royal Berkshire Hospital. The only contractual documents available were two Locum Booking Confirmations that referred to DRC Locums Limited's standard terms and conditions which were not given in evidence. There was no reference in the Locum Booking Confirmations to either a notice period or to any obligation on DRC Locums Limited or Royal Berkshire Hospital to provide George Mantides with work. The Tribunal found that the one week notice period appeared to have been based more on assumptions and what might have been agreed rather than on evidence as to what actually was agreed between the parties. Further, the obligation to make reasonable endeavours to provide George Mantides with work was based on a "mutual understanding" but the Upper Tribunal did not see any evidence to support this finding.

The final question was whether or not these incorrect findings were significant enough to overturn the First Tier Tribunal decision. The parties agreed that this decision should be made at a later hearing, once the outcome of the Professional Game Match Officials Limited [2020] UKUT 147 (TCC) case is made public by the Court of Appeal. As you will see below, the Court of Appeal released their findings in this case on 17 September but have referred the case back to the First Tier Tribunal and so the final decision in the George Mantides Limited v HMRC case will have to wait a while longer.

George Mantides Limited v HMRC [2021] UKUT 0205 (TCC)

Football referee dispute still undecided **(Lecture P1276 – 21.00 minutes)**

Summary – Both the First Tier and Upper Tribunals erred in law when considering whether the mutuality of obligation and control tests resulted in referees being engaged under contracts of employment. The Court of Appeal has referred the case back to the First Tier Tribunal.

Professional Game Match Officials Limited engaged part-time referees under an overarching contract that covered the entire football season as well as individual contracts for each game, whereby referees were only paid if they officiated at a match.

Referees had control of went on during the game, subject to FA regulations. At all other times, Professional Game Match Officials Limited had various rules and regulations that needed to be followed including a strict fitness and training regime, match day procedures and a requirement to sign a code of conduct.

HMRC issued determinations on the basis that referees' payments were employment income, liable to PAYE and NICs.

On appeal, the First Tier and Upper Tribunal found the referees to be self-employed, concluding that under the overarching contract, outside the individual match engagements, there was no mutuality of obligation.

HMRC appealed to the Court of Appeal.

Decision

The Court of Appeal found that, by looking at whether there was mutuality of obligation in the overarching contract between the referees and the companies, both the First Tier and Upper Tribunals had applied the wrong legal tests. Instead, they should have applied the mutuality of obligation and control tests to each individual match engagement under which the referees officiated and were paid.

The Court found that both Tribunals erred in law when finding that the ability of each side to pull out before a game negated mutuality of obligation. It was immaterial that the contract could be terminated before it was performed.

The Court of Appeal also decided that the First Tier Tribunal had not applied the correct tests when considering control. For example, the Court of Appeal found that the First Tier Tribunal's decision in finding that the coaching system for referees was irrelevant to control was not correct.

Further, the Court identified a number of areas, rejected by the First Tier, suggesting that control was present including that the company had the power to promote or demote referees, the referees were expected to abide by a fitness and training protocol and the referees were required to sign and comply with the Code of Conduct. There were many ‘control’ features, particularly within the terms of the overarching contract.

The Court of Appeal has referred the case back to the First Tier Tribunal, who will now have to revisit the evidence and decide whether there was mutuality of obligation and control.

HMRC v Professional Game Match Officials Limited [2021] EWCA Civ 1370

Grant of options not employment related **(Lecture P1276 – 21.00 minutes)**

Summary – Share options granted by an employer were not granted by reason of employment, nor were the deeming provisions triggered.

In 2006, Vermilion Holdings Ltd granted Marcus Noble share options as part of an equity fund raising exercise. These were in effect payment for advisory services instead of a fee. In 2007, the company was in financial difficulty so the 2006 option agreements were novated and new, less valuable, options issued to Mr Noble, who was appointed its chairman.

The issue was whether the 2007 options were employment-related securities within s.471 ITEPA 2003, as contended by HMRC.

The First Tier Tribunal had found that the options granted to the company's director was not employment-related securities. It was granted as a replacement for the first options and not by reason of employment.

The Upper Tribunal overturned the decision stating that the second options were granted on condition that Marcus Noble became a director, the first options having been cancelled.

Vermilion Holdings Ltd appealed.

Decision

Lord Malcolm, in the Court of Session, said the statutory provisions should be applied in 'a purposive fashion and adopting a realistic view of the facts'. The company did not grant the options to Marcus Noble because he was a director — it was not a 'fringe benefit' of his employment. Taking a realistic view of the facts, when he received the options, he did not acquire something he did not have already. Indeed, it resulted in the 'diminution of his entitlement'. It followed that s.471(1) ITEPA 2003 did not apply.

On the deeming provision in s 471(3), Lord Malcolm said this should not be categorised as a separate and distinct route to taxation which was available even if it had been established that s 471(1) did not apply. It was subordinate to s 471(1) and its application should be limited if and when it was invoked in respect of securities which were known to be unrelated to employment or where that had been established by a tribunal.

Lord Doherty agreed that there was no real link between the employment and the right or opportunity to acquire the replacement options and that 'it would be anomalous, absurd and unjust' if that right or opportunity were treated as having been made available by the employer. Therefore the facts of the case did not trigger the deeming provision in s 471(3).

The company's appeal was allowed although Lord Carloway disagreed stating:

> "Mr Noble became an employee of the appellants on 16 March 2007. On 2 July 2007 the appellants granted him a right to acquire an option. That option was thereby one which was made available by Mr Noble's employers. It was thereby deemed to be available by reason of his employment with the appellants. That is exactly what a deeming provision is designed to achieve. There is no injustice, absurdity or anomaly in this."

Further, he added that this was "simply affording the wording of the deeming provision its plain and ordinary meaning in the statutory context. On this basis the appeal ought to be refused."

Vermilion Holdings Ltd v HMRC [2021] CSIH 45

Adapted from the case summary in Taxation (9 September 2021)

Undeclared rental income and dividends **(Lecture P1276 – 21.00 minutes)**

Summary – In all but two years, the taxpayer failed to provide sufficient, consistent evidence to convince the Tribunal that bank credits were not undeclared rental and dividend income.

HMRC issued Mohammed Shariff with income tax assessments for all tax years from 2001/02 to 2016/17. The assessments raised related to rental and dividend income and were calculated based largely on credits taken from his bank statements.

Mohammed Shariff accepted that he had failed to notify his liability to income tax in those years but challenged the quantum of the tax payable. He appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal found Mohammed Shariff's evidence to be inconsistent and frequently vague. S.12B TMA requires a taxpayer to maintain all such records as may be required for the purpose of enabling them to deliver a correct and complete return for the year or period of assessment. Mohammed Shariff failed to comply with this requirement. There was little reason given as to why he had been unable to provide much of the information sought by HMRC and why answers provided by him were frequently inconsistent or incomplete. For example, he claimed that credits on is bank statements included amounts received by him when collecting rent as the agent for other landlords. However, he could not identify corresponding payments out to the landlord in relation to those properties. Further, he was not able to produce any reconciliation statements showing how much was paid or owed to the landlords for whom he acted as agent.

Instead of assessing Mohammed Shariff's income on the basis of the receipts, HMRC had relied upon Mohammed Shariff's expenses as a basis to imply corresponding income. The First Tier Tribunal were satisfied that HMRC's approach was "fair". Mr Shariff had not provided evidence to show that his expenses were funded from savings or from other sources such as gifts or loans. On that basis, it was reasonable to infer that the expenditure must have been funded from income. The Tribunal noted that other approaches could have validly been taken, for example starting with the evidence of receipts/credits and estimating a reasonable deduction for allowable expenses, but in fact that may well have produced a higher figure.

Mohammed Shariff's appeal was dismissed in all but two tax years.

1. In 2001/02, HMRC assessed him as having had income of £37,500 equal to half the deposit paid for his house which he bought jointly with his wife, on the basis that the money had not been shown to have come from savings or another non-income source. However, the evidence provided was held to be consistent and credible. Prior to the purchase, he had been working as a computer consultant for some years. At this time he and his wife had been living with his parents and were therefore in a good position to save money, which he then to pay the house deposit.

2. In 2015/16, HMRC had included £24,444 of income. This was on the basis that Mohammed Shariff and his brother each held 50% of the shares in MS2 Solutions Ltd and his brother had declared a dividend of that amount on his tax return. Although no dividend waiver documentation was produced, it was clear from the company's accounts that the total dividend paid was £27,000. The difference was taken by HMRC to reflect the 1/10th credit applied by his brother in his tax return. The First Tier found that, in light of the evidence provided at the hearing, the dividend paid by MS2 Solutions Ltd in the tax year 2015/16 was paid only to his brother.

Mohammed Shariff v HMRC (TC08202)

Lack of awareness is not the test

In February 2018, HMRC sent a high income child benefit charge nudge letter to the taxpayer. He realised he was liable to the charge and contacted HMRC to provide information. It issued assessments for 2012/13 to 2016/17 which the taxpayer paid. HMRC also imposed a penalty calculated at 20% of the tax due — the range is between 10% and 30%.

The taxpayer appealed against the penalty. He said he had reasonable excuse. He had been employed throughout and any underpayments of tax were collected through his PAYE code. No one at HMRC mentioned the high income child benefit charge might apply to him.

Further his partner had been receiving child benefit since 1998 but no communications with the Child Benefit Agency had warned them about the charge.

On whether he had received the generic SA252 letter sent by HMRC to taxpayers who might be affected by the charge, the taxpayer said, had he received it he would have taken note because he was 'acutely aware of the need to take tax seriously'.

He added that the time — five years — between the introduction of the charge and the nudge letter was unreasonable. Finally, HMRC's information about Self Assessment and the requirement to notify was inconsistent and confusing.

Decision

The First Tier Tribunal said the taxpayer had not established a reasonable excuse. He may not have been aware of the charge but awareness was not the test, it is whether the reasonable taxpayer, observant of his obligations should have been aware. The tribunal levelled 'absolutely no criticism' at the taxpayer and stated:

> 'however extensive the campaign of promotion embarked upon by HMRC in 2012 the failure to actively involve the Child Benefit Agency in notifying recipients of child benefit that a spouse or partner may become liable to a tax charge almost beggars belief'.

However, given that a 'long line of tribunal judges' had already considered the same arguments on reasonable excuse and rejected them, unless this tribunal considered those judgments to be wrong or that the facts in this appeal to be materially different, it should follow the conclusions reached.

The taxpayer had not presented any other excuse or special circumstances, so no penalty reduction was due.

The appeal was dismissed.

Matthew Francis v HMRC (TC08209)

Adapted from case summary in Taxation (19 August 2021)

Capital tax

No PPR available (Lecture P1276 – 21.00 minutes)

Summary – Gains arising on the sale of building plots sold from the grounds of a Grade 1 listed mansion house did not qualify for Principal Private Residence relief. The plots had been appropriated to trading stock so crystalising chargeable gains.

Heather Whyte bought the Bunny Hall Estate in 2001 which included Bunny Hall, a Grade I listed mansion house that was unoccupied and extremely dilapidated. The purchase was partially funded by her husband who was a property developer. Heather Whyte's family moved into a renovated flat within Bunny Hall.

The Bunny Hall Estate included 17 acres of grounds that were completely overgrown and had not been touched for decades. They included walled and terraced areas of formal gardens, informal grassed and wooded areas, lawns, and fenced grass paddocks.

The couple knew that to be able to renovate the Hall, significant funds would be needed. Before buying the Estate, plans were already in place to sell off part of the land for housing. English Heritage approved the sale of a number of plots and between 2003 and 2006, Heather Whyte sold five plots to her husband and a sixth to a 'known' third party. At the time of sale, all of the plots had utilities in place and groundwork for the properties to be built had already commenced.

Heather Whyte reported gains on her tax returns in the relevant years and claimed Principal Private Residence relief (PPR) against these gains, claiming that the plots of land were part of her garden or grounds.

HMRC rejected the PPR claims arguing that the plot sales were either:

- trading transactions liable to income tax; or
- capital transactions liable to CGT but without PPR.

She argued that this was not a trade, as it was a one-off transaction and the plots of land had been in her sole name prior to sale for over two years.

Decision

The First Tier Tribunal found that Bunny Hall was originally acquired by Heather Whyte as a capital asset.

Having considered the Badges of Trade, the Tribunal concluded that Heather Whyte had been trading. She had worked with her husband developing properties and had bought this property with the intention of selling development plots on at a profit. The land had been divided into six plots for sale which had been cleared, utilities had been installed and an access road constructed. All of these actions made the plots easier to sell.

The Tribunal concluded that in 2003, when plans for the six plots were submitted to the Council, they were appropriated to trading stock. Gains liable to CGT arose on the plots at this time but PPR relief was denied as the partially developed land was not part of the garden or grounds of Bunny Hall.

The profit generated after this time was liable to income tax.

Heather Whyte v HMRC (TC08215)

Interpreting a will

Summary – With specific legacies exceeding the nil rate band at death, the rest of the estate was left to a number of charities.

Audrey Arkell died on 17 August 2017 leaving an estate valued for probate at £3,127,174.

Clause 4 of her will stated "I leave the Nil Rate Sum to my Trustees on trust for my said friend John Wayland Beasant", with other clauses leaving specific items 'free of inheritance tax' as follows:

- To John Beasant, her main residence and shares worth nearly £460,000;
- To six other individuals, cash gifts totalling £45,000.

The remainder of her estate, after costs and tax, was to be split between 21 charities.

The claimant in this case was one of the 21 charities, acting on behalf of all of the legatee charities.

The issue to be decided was the interpretation of Clause 4, the gift to John Beasant:

- The Royal Commonwealth Society for the Blind claimed that no sum was due to John Beasant, as the total value of the specific gifts exceeded the nil rate band of £325,000.
- John Beasant claimed that the other legacies did not have to be taken into account in interpreting Clause 4, meaning that in addition to the house and shares, he was also entitled to a tax-free amount of £325,000.

In reaching their decision, the Hight Court needed to consider the relevance, if any, of Clause 4.1. It read:

> "In this clause 'the Nil-Rate Sum' means the largest sum of cash which could be given on the trusts of this clause without any inheritance tax becoming due in respect of the transfer of the value of my estate which I am deemed to make immediately before my death."

Decision

The High Court referred back to the language of the will and stated that, if the deceased had intended to gift the nil rate band to John Beasant, the will could simply have stated that there should be a gift equal to the nil rate band and expressed that to be free of IHT, as was the case with the other gifts contained within the will. The definition in Clause 4.1 would not have been necessary.

However, the Court stated that Clause 4.1showed a clear understanding of how IHT worked, referring to "without any inheritance tax becoming due" and "in respect of the transfer of the value of my estate which I am deemed to make immediately before my death". The Court found that Clause 4 clearly contemplated that the 'Nil-Rate Sum' should be calculated by reference to the operation of IHT across the whole of the deceased's estate and the order of the gifts in the will does not matter. The sum is limited to the amount left of the nil rate band, if any, before tax would become payable.

The High Court agreed with the charities that John Beasant was entitled to nothing under Clause 4 and so the residue left to the charities was not reduced by a gift of £325,000 to John Beasant.

Royal Commonwealth Society for the Blind v John Wayland Beasant and Benjamin How Davies (as PR of the Estate of Audrey Arkell deceased) [2021] EWHC 2315

Non-resident trust tax credits

Summary – The Court confirmed that ESC B18 allows beneficiaries a tax credit for tax suffered on payments from a non-UK resident trust if that income arose to the trustees within the six years before the year of assessment of the payment.

Hugh Murphy and Winifred Linnett were beneficiaries of a Guernsey-resident retirement trust. Prior to any distributions being made, their adviser asked HMRC to confirm that ESC B18 applied to allow UK tax credits on distributions out of UK source income from the trust, with no limitation for payments out of income received by the trustees more than six years before the year of assessment of the payment.

HMRC did not agree, stating that credit under ESC B18 was limited to payments out of income received not more than six years before the year of assessment of the payment.

The adviser asked HMRC to reconsider, but before HMRC replied, the distributions totalling £9,652,320 went ahead. The income, on which they paid tax, was treated as the claimants' income for 2018/19. The beneficiaries then claimed around £4 million tax credit of UK income tax paid by the trustees on UK source income arising for all years.

HMRC allowed the claims for the years from 2012/13 but rejected those for the years before that.

The beneficiaries appealed.

The parties agreed that the main question concerned the construction of ESC B18. This was, in essence, whether as HMRC contended, the amount of credit was limited to income which arose to the trustees not earlier than six years before the end of the year of assessment in which the payment was made or as the claimants argued, there was no such limit.

Decision

The High Court agreed with HMRC, stating that the overall intention of ESC B18 was that the six year time limit applied. The Court acknowledged that there was some ambiguity in the wording but it seemed to the judge that the concession in its entirety intended the six-year time limit to apply. Further, the authorities were clear that, because an extra-statutory concession relieved taxpayers of a liability imposed by the law, any ambiguity should be resolved in favour of HMRC.

The appeal was dismissed.

Hugh Murphy and Winifred Linnett v HMRC [2021] EWHC 1914 (Admin)

Adapted from Taxation (12 August 2021)

A trust CGT trap – Crowe v Appleby (Lecture P1279 – 11.18 minutes)

Background

When the beneficiary of a trust becomes absolutely entitled to a trust asset, the trustees are generally treated as having disposed of the asset and reacquired it at market value for capital gains tax (CGT) purposes.

The trustees then hold the asset as bare trustees for the beneficiary, until the asset is appointed to that beneficiary (TCGA 1992, s 71(1)).

IHT and CGT charges

For inheritance tax (IHT) purposes, most lifetime trusts created these days are ‘relevant property’ (e.g., discretionary) trusts. When a beneficiary becomes absolutely entitled to relevant property, there is normally an immediate IHT (‘exit’) charge on the trustees (IHTA 1984, s 65).

To prevent simultaneous CGT and IHT charges arising on the same event, a CGT holdover relief claim is generally available (under TCGA 1992, s 260), subject to certain exceptions and alternative conditions. One of those conditions is that there is an immediately chargeable lifetime transfer for IHT purposes (section 260(2)(a)). This will normally be the case where a beneficiary becomes absolutely entitled to a discretionary trust asset.

For example, the trustees might appoint a buy-to-let property to a discretionary trust beneficiary. However, what is the CGT position if the trust holds a single asset such as a plot of land for several beneficiaries in undivided shares?

Crowe v Appleby

In Crowe v Appleby Ch D 1975, 51 TC 457, a parent died in 1938, leaving in his will the residue of his estate to trustees on trust in certain shares for the benefit of his five children. The share of each child was held on protective trusts for their benefit for life. One child ('G') died in August 1952. His 5/30ths share of residue devolved on his son. Another child ('C'), who was the life tenant of a further 5/30ths of residue, died in May 1968. Her share devolved on her two children as tenants-in-common in equal shares. The testator's other three children were alive and were life tenants of 9/30ths, 6/30ths and 5/30ths of residue respectively. The trust residue consisted of freehold property. The trustees sold the freehold property in 1969.

The Inland Revenue (as they were then) raised CGT assessments for the tax years 1968/69 and 1969/70. On appeal, there were potentially two issues for the Commissioners and ultimately the Courts to consider: (1) firstly, whether for CGT purposes on the death in 1968 of beneficiary C with a 5/30ths share of the testator's residuary estate, the trustees were deemed to have disposed of the whole of the assets or only a 5/30ths share of their sale proceeds; and (2) secondly, the amount of the chargeable gain for CGT purposes arising on the sale in 1969 of the freehold property.

In the High Court, the leading judgment was given by Goff J. Held: it was not possible to segregate a share in the notional proceeds of sale of unsold land; the son of beneficiary G and the children of beneficiary C were unable to direct the trustees how to deal with their respective shares, because they couldn't call for immediate payment of their respective shares, or interfere with the exercise of the trustees' discretion to postpone sale, and so they weren't absolutely entitled as against the trustees.

Holdover restriction?

The principle established by the judgment of Goff J in Crowe v Appleby gives rise to a potential CGT 'trap'.

Example: Industrial unit

A will trust holds an industrial unit in London for three children (Alison, Brian and Claire) to take in equal shares absolutely at age 25. Alison reached age 25 in May 2017; Brian was 25 in June 2019; and Claire was 25 in July 2021. The property is standing at a gain for CGT purposes.

The three beneficiaries reached age 25 in different tax years. However, it is only when Claire reaches 25 in the tax year 2021/22 that the beneficiaries can direct the trustees to transfer the property to them, and a CGT charge then arises under TCGA 1992, s 71.

Unfortunately, holdover relief under TCGA 1992, s 260 can only be claimed in respect of the gain attributable to Claire's interest, so the trustees are liable to CGT on the balance. This is because there is only a simultaneous IHT and CGT charge when the youngest beneficiary (Claire) reached age 25 in July 2021. The other two beneficiaries, Alison and Brian, became absolutely entitled for IHT purposes at age 25, in May 2017 and in June 2019 respectively. As there is no simultaneous IHT and CGT charge in respect of them, the condition for claiming CGT holdover relief is not met on their share of the gain.

Crowe v Appleby involved a legacy of freehold property in trust. However, in some cases an individual's will might leave the trust an undivided share in land, as opposed to (say) an entire plot of land. In such cases, according to HMRC's guidance the principle from Crowe v Appleby is not considered to apply, because that share is readily divisible (see HMRC's Capital Gains manual at CG37543).

Other assets

The Crowe v Appleby principle may apply to assets other than land if those assets are indivisible. For example, the trustees may hold a valuable antique, or an expensive item of jewelry. However, if the trustees sell the asset for cash before a beneficiary becomes absolutely entitled to an interest, the Crowe v Appleby principle will cease to apply, and the problem regarding holdover relief under TCGA 1992, s 260 disappears, as the cash is not a chargeable asset for CGT purposes.

If the trust has a controlling shareholding in a family or other owner-managed company, there is an argument that there is no disposal for CGT purposes on each occasion of absolute entitlement by the beneficiaries. This is on the basis that a pro-rata distribution of shares to beneficiaries would mean the value of the shares received by the first beneficiary is greater than the values received by the other beneficiaries, because the value of a majority holding would be greater than the value of the minority holdings per share (see CG37560).

However, in other cases where a trust holds a number of shares in a company, it should be possible to prevent the principle in Crowe v Appleby applying if the trustees have a power of appropriation over the shares, and actually exercise that power in favour of a beneficiary (or beneficiaries).

Note: The position in Scotland and Northern Ireland can differ in some respects, particularly where the trust asset is land (e.g., see CG37543).

Contributed by Mark McLaughlin

House purchase through a company

Summary – With the power to call for conveyance, a couple were liable to SDLT on a property bought through a company but transferred to them through a distribution in specie.

In 2007 Michael and Bridget Brown acquired a house under an arrangement whereby a house was sold by a third party to an unlimited company and immediately transferred to the couple by way of a distribution in specie. The couple argued that this arrangement gave them no liability to SDLT on the acquisition of the house but HMRC disagreed.

The company was incorporated as an unlimited company on 2 July 2007, with the Browns each subscribing for 47,751 £1 shares at par, paying £95,502 in total.

On 9 July 2007, the company contracted to buy a house for £955,000, paying a deposit of £95,000.

The day before, the company had issued to each of Michael and Bridget 432,250 shares at par, bringing the total nominal value of shares in issue to £960,002.

The subscription to the company was made by the couple giving promissory notes payable on the day of completion of the house purchase.

On 15 August 2007, the company:

- resolved to reduce its share capital from £960,002 to £2 by way of a distribution in specie of the house, conditional on and simultaneous with the completion of its original house purchase contract;

- used the balance of the money deriving from the share subscriptions to complete the transfer of the house to it and a transfer was executed in its favour.

- transferred the house from the company to the Browns and the company's share capital was reduced.

Michael and Bridget Brown made no SDLT return on the basis that no chargeable consideration had been given for the transfer of the house to them.

On 8 August 2011, HMRC issued a notice of determination to the Browns in respect of the acquisition of the house, setting an SDLT liability of 4% of £955,000.

The Browns appealed.

Decision

The First Tier Tribunal noted that:

> "the shares subscribed for on 8 August were subscribed for in return for promissory notes for £432,250 from each of Mr and Mrs Brown. These promissory notes were expressed to be payable on 15 August 2007, the day of completion of the company's purchase."

The Tribunal went on to say that these monies were paid from their mortgager to the company's conveyancer, who paid the monies on to the vendor of the house.

The First Tier Tribunal concluded that this arrangement fell within s.45 FA 2003 which covers the situation where:

> "land was contracted to be sold by A to B, but there was an assignment, sub-sale or other transaction as a result of which C became entitled to call for a conveyance."

Under this section, SDLT should be charged only by reference to C's acquisition under a notional ("secondary") contract.

The First Tier Tribunal found that this arrangement fell with s.45 with the Browns effectively providing the funds through the company to buy the house, which they acquired through a distribution in specie.

The Tribunal stated that:

> "The scheme provided the overall bargain or arrangement which made what they paid "consideration" and their obvious intention meant that what they paid was "for" the transfer of house."

The Tribunal found that the consideration liable to SDLT was the total value of the couple's payment of £960,002 and not the £955,000 referred to in HMRC's determination. The completion statement showed that the difference was due to the conveyancing costs that were incurred.

The appeal was dismissed.

Michael and Bridget Brown v HMRC (TC08158)

Business issues, CGT and OTS (Lectures P1277/ P1278 – 31.17/ 22.01 minutes)

In May 2021, the OTS published their second report on CGT. One of the chapters of this OTS review deals with various troublesome business issues in their examination of three pertinent areas:

1. deferred sale proceeds;
2. different types of debt; and
3. a timing matter in relation to business asset disposal relief.

Deferred sale proceeds

Deferred sale proceeds most commonly arise on the disposal of an unincorporated business, unlisted shares or land. The way in which the payment of the proceeds is structured affects how much CGT is payable and when. For example, a company may be sold for an upfront cash sum, with further proceeds becoming due over the next few years. The further proceeds may be a combination of cash and other assets such as shares or loan notes in the acquiring company. Alternatively, land or shares in a company may be sold for an uncertain price, the level of which depends on subsequent events.

When discussing these arrangements, the OTS remark:

> 'In the context of the challenging economic conditions stemming from the COVID-19 pandemic, it is possible that the use of deferred proceeds on a sale of a company could become more common in future.'

Where the sale proceeds relating to the disposal of, say, a private company are paid over a period of several years but the value of the proceeds is fixed, they are usually referred to as 'ascertainable'. In these circumstances, CGT is due on the full amount of the sale proceeds, regardless of when payment is made (S48 TCGA 1992).

Illustration 1

Jan sells her company, which has a negligible base cost, for £2,500,000. This sum will be paid in cash, with £1,500,000 being due immediately and the remaining £1,000,000 being paid in two equal instalments on – respectively – the first and second anniversaries of the transaction.

Jan is taxed on her gain of £2,500,000 at the time of the sale. There is no allowance for the delay in handing over the two instalments totalling £1,000,000 and all of Jan's tax is payable on the normal due date.

If she ultimately receives a lower amount (because, for example, the buyer defaulted), she can make a claim for an adjustment to the original CGT calculation so as to obtain a tax repayment (see Para CG14933 of the Capital Gains Manual for the practical details). The time limit for this claim is four years from the end of the tax year in which it became clear that the full amount would not be paid. Thus Jan's ultimate tax liability will be based on what she actually receives.

Sometimes the sale proceeds will include a payment determined by an agreed formula based on a future event (which cannot therefore be known at the time of the sale). Such a transaction is typically described as an 'earn-out' and the proceeds are referred to as 'unascertainable'.

In this situation, CGT is payable on:

(i) the upfront cash proceeds; and

(ii) the present value of the estimated proceeds which will be received in the future.

This is because CGT is due on sale proceeds whether they are received in the form of money or money's worth. As a result, depending on how the sale is structured, the vendor may be paying tax on an element of proceeds which he has not yet received. The figure put on the estimated proceeds is the value of the right to receive those future amounts. This follows from the decision of the House of Lords in *Marren v Ingles (1980)*. The OTS summarise the position with these words:

> 'A professional valuation is normally required to determine (the estimated) figure. When the right is later exchanged for cash, this disposal is a taxable event in its own right – it is not related to the original share disposal. The base cost is the original valuation of the right and the proceeds (are) the amount of cash received. There will be multiple such taxable events if the proceeds are received over a number of tax years.'

Illustration 2

Priscilla sells her company for an immediate cash sum of £2,000,000 plus 10% of the company's net profit for the next 12 months. The earn-out element will be paid in two years' time.

If the present value of the future proceeds is estimated to be £450,000, Priscilla's initial liability will be based on proceeds of £2,000,000 + £450,000 = £2,450,000, taxable in the year of disposal.

However, there will be a second CGT event when Priscilla receives the earn-out proceeds in a later tax year. If she is paid £575,000, she has made a further gain of £575,000 – £450,000 = £125,000, taxable in the year of receipt. On the other hand, if she only receives £150,000, she has made a capital loss. Thus:

£

Earn-out proceeds	150,000
Less: Base cost of earn-out right	450,000
CAPITAL LOSS	£(300,000)

As an alternative to carrying this loss forward, Priscilla can make an election under S279A TCGA 1992 to carry it back against the gain on the original disposal which will result in a repayment of some of her CGT.

As has already been noted, non-cash proceeds are taxed in the same way as cash. However, if the proceeds are deferred and are payable in the form of specified assets such as shares or loan notes in the buyer's company, the vendor can normally postpone the taxation of the deferred element until the disposal of the new shares or the redemption of the loan notes (S138A TCGA 1992). In this case, there is no need to go through with the exercise of valuing the right to the future proceeds. Although this provision sounds helpful, it has not usually been tax-efficient to pursue such a structure in recent years.

Illustration 3

Jonathan formed a trading company (Jonathan Enterprises Ltd) in March 2003, subscribing for the company's entire share capital of 100 ordinary shares of £1 each at par. On 1 July 2021, he sold his shares to a plc.

The sale contract provided for:

(i) an initial cash consideration of £360,000 to be paid on completion; and

(ii) a deferred earn-out consideration based on the company's profits for the 12 months ended 30 June 2022 which was to be satisfied in the form of loan notes from the plc (the maximum earn-out payment was set at £640,000).

Jonathan continued to act as managing director of Jonathan Enterprises Ltd during the earn-out period (for which he was appropriately remunerated by the plc).

Jonathan's earn-out right was valued at £540,000 on 1 July 2021.

On the assumptions that the actual earn-out consideration turns out to be £600,000 for the 12 months ended 30 June 2022, that the loan notes were received by Jonathan from the plc on 1 December 2022 and that the loan notes were redeemed on 1 June 2023, Jonathan's CGT computations would proceed as follows in line with S138A TCGA 1992:

2021/22

	£
Sale proceeds	360,000
Less: Cost $\frac{360,000}{360,000 + 540,000} \times 100$	(40)
	359,960
Less: Annual CGT exemption	(12,300)
	£347,660

CGT @ 10%	£34,766

2023/24

	£
Earn-out proceeds	
	600,000
Less: Cost (100 – 40)	(60)
	599,940
Less: Annual CGT exemption	(12,300)
	£587,640
CGT @ 20%	£117,528

Jonathan's aggregate CGT liability for this transaction amounts to £34,766 + £117,528 = £152,294. Note that Jonathan is not entitled to claim business asset disposal relief on the encashment of his loan notes on 1 June 2023. It is generally accepted that a loan note should have a life of at least six months – as here – in order to be effective (see Para CG52570 of the Capital Gains Manual).

If, however, Jonathan's earn-out deal had been structured in cash so that the payment of £600,000 was made on, say, 1 June 2023, the tax position changes significantly. The calculation below now derives from the ruling in *Marren v Ingles (1980)*:

2021/22

	£
Sale proceeds (360,000 + 540,000)	900,000
Less: Cost	(100)
	899,900
Less: Annual CGT exemption	(12,300)
	£887,600
CGT @ 10%	£88,760

2023/24

	£
Earn-out proceeds	600,000
Less: Cost	(540,000
	60,000
Less: Annual CGT exemption	(12,300)
	£47,700
CGT @ 20%	£9,540

Business asset disposal relief is again not available on the disposal of the earn-out right. However, Jonathan's aggregate CGT liability is now £88,760 + £9,540 = £98,300, a saving of £53,994. Even though Jonathan has paid more tax initially, the overall saving will certainly be worth having. Hence the comment about S138A TCGA 1992 being less useful for tax planning than it used to be.

The OTS have not commented on this discrepancy and content themselves with a number of general observations which may be summarised as follows:

(i) Understanding the tax rules in this area is ‘beyond even the most sophisticated non-professional taxpayers’ and the whole process is certainly not intuitive.

(ii) The regime can result in tax being charged upfront on cash which has not yet been received.

(iii) The valuation of future proceeds, which is a required part of the exercise, can be challenging.

(iv) The differences in tax treatment can create an ‘uneconomic distortion’ in the sense that they push taxpayers away from arrangements which make the most commercial sense.

(v) The reliefs apply inconsistently – for example, business asset disposal relief, as Illustration 10 demonstrates, is often not available where it would have been if the company had been sold for a known amount of cash. However, it is possible to sidestep this problem – see below.

The recommendation of the OTS for improving the system is that CGT should be charged on a receipts basis. In other words, tax would only be payable when the sale proceeds are actually available or received (and are therefore quantifiable). The OTS say that this would have several benefits:

(i) tax would be paid out of the cash which the taxpayer has received without the need to make a claim or election if a lesser amount is paid than was anticipated;

(ii) there would be no need to value the right to future proceeds which can be complex and expensive; and

(iii) it would not be necessary to structure a disposal using, say, loan notes in order to defer the payment of CGT on sums which have not yet been received.

Mention was made above that, with appropriate tax planning advice, it is possible to structure these sorts of transaction so that full business asset disposal relief is available. This is achieved by having what is sometimes referred to as a ‘negative earn-out’. That is to say, the price is set at the maximum possible figure (£360,000 + £640,000 = £1,000,000 in the example involving Jonathan above).

Only the basic amount of £360,000 is paid upfront, with remainder to be handed over in deferred cash at the earn-out date. However, this deferred cash amount is reduced if the earn-out targets are not fully met.

Provided that the deal is structured this way round, one obtains a similar economic effect between the parties to an earn-out, but the tax calculation is initially based on the full £1,000,000 sale price.

If less than this is received, then, under S48 TCGA 1992, it is possible to reopen the computation and adjust the sale proceeds figure to the actual receipt.

The main advantage of this arrangement is that the vendor qualifies for business asset disposal relief on the full amount received (subject, of course, to the cumulative lifetime limit). This is because he has moved into the realm of *deferred* consideration rather than *unascertainable* consideration. In the Jonathan example, the taxpayer saves an additional £3,600.

Different types of debt

Debts can be classified as either:

(i) a simple debt; or

(ii) a debt on a security.

A simple debt falls outside the CGT regime as long as it remains in the hands of the original lender. The rationale for this rule is that, when individuals make a loan, i.e. a simple debt, they will generally be repaid the same amount or – perhaps – a lesser sum. However, it would be unusual for them to be repaid more. By making simple debts an exempt asset, there is no allowable loss if the funds repaid are less than the original amount lent, but it should be noted that second-hand simple debts are within the charge to CGT.

If a debt is not a simple debt, it is usually known as a debt on a security and falls within the scope of CGT. When considering the type of debt, the OTS say:

> 'Whether the debt is classified as a simple debt or a debt on a security is not always obvious.
>
> A debt on a security is a debt with added characteristics which generally enable it to be realised at a profit or a loss. These characteristics are based on case law and include, for example, that the debt:
>
> (i) is marketable;
>
> (ii) is held as an investment;
>
> (iii) is capable of being realised at a profit; and
>
> (iv) is at a commercial rate of interest (see *WT Ramsay Ltd v CIR (1981)*).
>
> Not all of these characteristics need to be present and whether the debt is marketable is considered to be the main one. Just because a debt is documented in writing does not mean it is a debt on a security.'

'Corporate bond' is a generic term for debts or securities issued by a company in order to raise finance. There are different tax treatments depending on whether the corporate bond is what is termed:

(i) a qualifying corporate bond (QCB); or

(ii) a non-qualifying corporate bond (non-QCB).

A QCB is defined in S117 TCGA 1992. It can generally be described as a debt:

(i) which is on normal commercial terms (see S162 CTA 2010);

(ii) which is denominated in sterling; and

(iii) where there is no provision for conversion into, or redemption in, another currency.

Any corporate bond which is not a QCB is a non-QCB. QCBs are exempt from CGT, whereas non-QCBs are taxable.

The sale arrangements for a company can include corporate bonds. Given that they form part of the proceeds, this will have the effect of deferring the CGT on that part of the proceeds until such time as they are redeemed and the cash received. Where the bonds issued are QCBs, S116(10) TCGA 1992 applies and the gain which would have arisen on a market value sale of the shares at the date of the paper-for-paper exchange is held over until the redemption of the QCBs. Effectively, the vendor's tax position is frozen at the date of the exchange, with the payment of CGT being postponed on an interest-free basis.

A disadvantage with QCBs is that no loss relief is available if the acquiring company is unable to redeem them (because, for example, it has become insolvent). Despite this, when the QCB is 'redeemed' (albeit for no value), the original held over gain is still taxed in full. It is therefore always advisable for vendors to insist on bank guarantees for QCBs in order to protect their position. However, in the absence of a bank guarantee, HMRC have confirmed that a worthless QCB can always be gifted to a charity in order to avoid a charge on the held over gain (see Para CG66624 of the Capital Gains Manual).

It is possible to ensure that bonds are not QCBs by a variety of devices which generally have no other purpose than to ensure that the bond is a non-QCB. One of the more common is to insert a foreign currency component into the bond's terms and conditions. Another is to give the bond holder the right to subscribe for additional shares or securities in the acquiring company or to convert his bonds into shares in the acquiring company.

The vendor then holds non-QCBs. The exchange of shares for non-QCBs is treated for tax purposes in exactly the same way as a share-for-share exchange (S135 TCGA 1992). By virtue of S127 TCGA 1992, there is no disposal of the original shares and the new holding is treated as the same asset as the original one. This means that, if the worst comes to the worst, automatic loss relief is available in that any gain or loss on the ultimate redemption of the bond is computed by reference to the amount actually repaid.

Where an individual has made a loan to a trader which is a simple debt, any loss would not normally be allowable. However, there is a specific relief in S253 TCGA 1992 which can allow the lender to claim a capital loss on the debt, provided that:

(i) the money lent was used wholly for the purposes of the trade; and

(ii) all or part of the money loaned has become irrecoverable.

Thus, if a loan of £250,000 to a trading business goes bad, S253 TCGA 1992 provides the taxpayer with relief in the form of a capital loss which he can offset against his current or subsequent capital gains.

The OTS have made a number of suggestions for improving the tax position of debts:

(i) They recommend that it should be possible for the choice about the tax status of a corporate bond to be made by the inclusion of a 'permanent irrevocable upfront provision in the legal documentation for the bond'. This would avoid the need for the insertion of complex clauses which serve no other purpose and which make it difficult for the parties involved to know which type of corporate bond they hold.

(ii) In the absence of such provision, the OTS recommend a default position whereby the bond is automatically a QCB and therefore exempt from CGT. This outcome, they argue, 'is more intuitive for taxpayers and reflects that there are wider uses of corporate bonds beyond company sales'.

(iii) HMRC should consider improving their guidance on when relief under S253 TCGA 1992 will not be permitted on the basis that it was unreasonable for the lender to believe that a debt was recoverable at the time when the loan was made. This guidance 'should include relevant case studies of situations which are definitely within the rules to bring further clarity for taxpayers'.

A timing matter in relation to business asset disposal relief

The CGT legislation specifies that, where at the time when a business ceases there is a disposal of one or more business assets, business asset disposal relief can be claimed as long as this disposal takes place within a three-year period following the date of the cessation (S169I(2)(b) TCGA 1992).

The OTS observe that this requirement to sell at or shortly after the cessation of the business 'may not reflect some common retirement scenarios'. They go on:

> 'For example, a farming business could be sold but the farmer may continue to harvest existing crops after the sale or a retail business may need to continue for some time after the retail premises are sold. However, a strict interpretation of the legislation could lead to the relief being forfeited if trading continues after exchange of contracts for the sale of a business.
>
> The specific awkwardness of the timing of . . . disposals in relation to entrepreneurs' relief (now business asset disposal relief) used to be covered by a formal HMRC concession. However, this has been withdrawn.'

The last point is referring to ESC D31 which was deleted more than 15 years ago. It stated that, for CGT purposes, HMRC 'are prepared to accept the date of completion as the date of disposal where, pending completion, business activities continue beyond the date of unconditional contract'. Despite the reassurance given by HMRC in published correspondence with the ICAEW, the OTS have been told that, in order to mitigate the risk of losing relief, businesses are seeking other practical ways of circumventing the legislative position such as the use of cross options between vendor and prospective purchaser.

The OTS conclude that HMRC should provide more detailed examples in the Capital Gains Manual and elsewhere about how they interpret the legislation in situations where the date of cessation is unclear in order to help and reassure farming and other businesses whose proprietors are looking to retire over a period of time.

Contributed by Robert Jamieson

Administration

Failing to provide adequate information

Summary – The application for closure notices to be issued was dismissed as the appellants had yet to provide the information requested and needed by HMRC.

Julian Standen established an online forum through which musicians and music professionals could communicate. He made money by advertising products and services on the platform.

He was dyslexic and totally reliant on his advisers. Based on their advice, in 2011 he incorporated his business, transferring its assets to Gearslutz.Com Limited, a newly formed company. There was no written agreement for the transfer of the business and Julian Standen had no detailed recollection of the transfer of the business or subsequent events.

In September 2014, a new firm of advisers advised that the intangible assets of the Gearslutz.com business had a value of £750,000 at the date of incorporation and that this value could be amortised at a rate of £150,000 per annum from 2011. The accounts filed at Companies House and sent to HMRC, for the period ended 29 April 2014 included intangible assets acquired for £750,000 at an unspecified date and the 2013 figures had been restated.

HMRC opened enquiries into Julian Standen's 2014/15 return as well as the company's returns for a number of years. HMRC requested various pieces of information including details of the intellectual property (IP) made available to the company under the agreement.

Julian Standen's advisers stated that they were not concerned about the enquiry. It later transpired that his advisers had been the subject of a dawn raid because HMRC perceived them to be promoting a tax scheme potentially involving evasion of tax, concerning amortisation of intangible assets.

Julian Standen appointed InTAX to handle the enquiry who, after some time, applied to the First Tier Tribunal for closure notices to be issued.

Decision

The First Tier Tribunal acknowledged that HMRC's enquiries had not been conducted efficiently as there had been delays due to lack of resource. However, the Tribunal concluded that much of the blame lay with Julian Standen's advisers, who failed to forward notices of enquiry to the company and Julian Standen and also failed to answer the questions asked.

The Tribunal stated that the burden was on the taxpayer to describe and explain the terms of the agreement and how it was amended after the appointment of the new advisers in 2014, and provide supporting evidence to show:

- the terms on which the intangible assets were transferred, including the nature of the consideration, how, when and to whom it was paid, any covenants assumed to be in place to justify the valuation, and the tax consequences for Mr Standen;
- how the amendment to the 2011 agreement could have retrospective effect;

- how the valuation of the intellectual property rights was arrived at.

The First Tier Tribunal found that HMRC should be allowed to continue their enquiries, to enable a conclusion to be reached based on information yet to be provided by the taxpayers.

The application for closure notices to be issued was dismissed

Gearslutz.Com Limited & Julian Standen v HMRC (TC08119)

Chinese food - Suppression of takings (Lecture B1276 – 24.05 minutes)

This month we have two cases involving Chinese restaurants/takeaways, both with a similar outcome.

Kong's Restaurant Ltd v HMRC (TC08169)

HMRC made two unannounced visits to Mr Kong's restaurant and take away business. The first was on a Friday evening which was Chinese New Year and the second roughly six months later at the end of June.

HMRC's case depended on the assumption that as the takings on these two Fridays exceeded the average reported Friday takings during the first six months of 2017, that amounted to clear evidence of suppression of takings on the other 24 Fridays, as well as the previous two and a half years.

Kong's Restaurant Ltd appealed stating that the assessments were not valid best judgment assessments as Mr Kong, the owner and director of the business, had not been given the opportunity to justify why HMRC's assessments were inappropriate. It was unreasonable to extrapolate from the two Fridays (Chinese New Year's Eve and a midsummer pay day) that the restaurant had been undeclaring its takings on a consistent basis.

The First Tier Tribunal found HMRC's assumptions to be unreasonable. HMRC had assumed the worst and sought subsequently to justify their approach with limited investigation to support their decision. The Tribunal stated that the arbitrariness of their assumption could be illustrated by simply selecting two other Fridays, for example one week before each of the two Fridays actually chosen. Both these figures were well below the overall average calculated for the period by HMRC.

The First Tier Tribunal concluded that the company did show that HMRC had not exercised best judgment.

Brough East Yorkshire Limited v HMRC (TC08213)

In this case, HMRC made a single inspection visit to the Chinese takeaway on a Friday afternoon. As far as HMRC could see, there was no till, with cash takings being placed under the counter. Having followed up their visit by checking credit card and banking data, HMRC established that Friday's Gross Daily Takings of £1,656.91 were some £600 more that the average for Fridays and so concluded that there was a suppression of cash sales. HMRC raised a best judgement VAT assessment that covered a six-year period, together with a £25,000 penalty and a Personal Liability Notice on the owners.

The company appealed the VAT assessment arguing that there was no reliable evidence of suppression of cash takings and that HMRC's approach was flawed.

The Tribunal found that the owners recorded sales from the order slips taken at the point of sale, passing her figures to their accountants. There was no evidence during HMRC's visit of any irregularities in the way that orders were processed or paid for. Despite being shown that prices had increased, HMRC failed to take these into account, despite both recorded cash and credit card sales increasing after HMRC's visit.

with HMRC disregarding the owners' explanations for the inconsistencies in the figures and one night's Invigilation being unrepresentative of the previous VAT periods concerned, the Tribunal allowed the appeal.

HMRC statutory review (Lecture P1280 – 12.51 minutes)

The statutory review process was introduced in 2009 and can be used where there is an appealable HMRC decision. This session considers the process to follow, and various practical issues.

What is the process?

The relevant legislation is at Tax Management Act 1970, ss 49A -49I, and HMRC's guidance can be found in the Appeals Reviews and Tribunals Guidance Manual (ARTG4000 et seq). Where there is a decision that can be subject to a statutory review, the taxpayer can request a review, or HMRC may offer one. A review must be requested within 30 days of HMRC's decision or assessment. HMRC should notify the taxpayer when a decision can be subject to a statutory review.

For indirect taxes, the decision letter will include an offer of a review. Taxpayers have 30 days from the date of the decision to accept the offer. Where there is new information, it may be possible to defer the start of the review, to see whether agreement can be reached.

The process is not suitable for dealing with issues about the handling of an enquiry, and advisers will need to consider other remedies (including HMRC's complaints' procedure).

Written representations can be submitted to the reviewing officer, giving an opportunity to submit information or documents to HMRC that have not previously been provided.

The review

The review may also be referred to as an "internal review", or an "independent review". That is one of the downsides of the review – it is undertaken by a HMRC officer. The reviews are undertaken by an officer who has not been involved in the case, but the fact remains that you have one HMRC officer reviewing the decision of another HMRC officer.

The statutory time limit for the review is 45 days, although this can be extended by agreement. Advisers should note that if the taxpayer does not agree to an extension of the 45-day statutory time limit, the original decision will be upheld. In practice, it is prudent to agree to an extension to benefit from the process.

If the decision of the reviewing officer is not accepted, in whole or in part, the taxpayer has 30 days to appeal to the tribunal. Advisers should note that the dispute is concluded in line with the outcome of the review (subject to the tribunal accepting a late appeal).

Outcome of the review

Potential outcomes of the review are that the original officer's decision is upheld, in whole or in part, or it can be overturned. Another outcome is that HMRC may not complete the review within the statutory time period. If the review is not completed, the reviewing officer will write to the taxpayer advising that the review is treated as having reached a conclusion and that an appeal may be made to the tribunal (or they can seek an extension, as noted above). The practical issue here is that if the reviewing officer is not able to complete the review within the statutory 45 days, the taxpayer has to agree to an extension for finalisation of the review, or the original decision stands.

Although the review is carried out by HMRC, it can still be worthwhile requesting one. The process can help to identify HMRC's arguments, or gain clarity on their position, which can be useful if the matter is subsequently heard at the tribunal (or Alternative Dispute Resolution). The review may also help to avoid the time and costs associated with a tribunal hearing, or to refine the issues to be discussed through the Alternative Dispute Resolution process (see below).

Financial (and other) considerations

There isn't a fee for seeking a statutory review. In practice, it is often sensible to submit representations to the reviewing officer, including new information or documents to support the client's position. The professional fees for making such representations are, generally, lower than they would be for going to the tribunal, or for going through the Alternative Dispute Resolution process. Advisers are strongly advised to ensure that suitable representations are made, and new information or documentation is submitted, as appropriate.

HMRC have commissioned a review of the process, and taxpayers' awareness of it. The results are due to be published imminently (at the time of drafting this text), and changes to the process can be expected in the future. HMRC are keen to encourage greater use of the statutory review process by taxpayers, partly because their costs are considerably lower than for taking a case to the tribunal. Advisers need to consider whether it is in their client's interest to use the process where agreement cannot be reached with the HMRC caseworker.

Is it a worthwhile process?

As noted above, the statutory review can help to avoid the costs of litigation, and the time delay likely to be encountered before a hearing can be arranged at the tax tribunal. Irrespective of whether the original decision is upheld or cancelled, the review can help to clarify the understanding of HMRC's position. That can be useful for any subsequent hearing at the tax tribunal or Alternative Dispute Resolution. Advisers should consider requesting a statutory review before appealing a HMRC decision direct to the tribunal.

Contributed by Phil Berwick, Director at Berwick Tax

Deadlines

1 October 2021

- VAT on food, accommodation and attraction entry fees to increase from 5% to 12.5%

- Corporation tax for periods to 31 December 2020 for SMEs not paying instalments

5 October 2021

- Notify 2020/21 income tax or CGT if a return or notice to file has not been received

7 October 2021

- Online VAT return and payment for 31 August 2021 quarter

14 October 2021

- Submit form CT61 and pay tax for quarter to 30 September 2021

- Monthly EC sales list (paper return) —businesses selling goods in Northern Ireland

19 October 2021

- PAYE/CIS liabilities for month to 5 October 2021 if by cheque

- File monthly CIS return

- PAYE settlement agreement liabilities if paying by cheque

- PAYE liability for quarter to 5 October 2021 if average monthly liability < £1,500

21 October 2021

- File online monthly EC sales list — businesses selling goods in Northern Ireland

- Submit supplementary intrastat declarations for September 2021
  - arrivals only for a GB business
  - arrivals and despatch for a business in Northern Ireland

22 October 2021

- Online PAYE/CIS liabilities for month to 5 October (online)

- PAYE for quarter to 5 October 2021 if average monthly liability < £1,500 (online)

- Online PAYE settlement agreement liabilities

31 October 2021

- Submit 2020/21 paper Self Assessment tax returns

News

Health and Social Care Levy (Lecture B1276 – 24.05 minutes)

Introduction

Going against their manifesto pledge, and in an attempt to address the funding gap facing the NHS and our social care system, the Prime Minister has announced that national insurance contributions (NICs) and dividend tax rates will increase by 1.25 percentage points across the UK from April 2022.

Building Back Better: Our Plan for Health and Social Care

In September, the government published "Building Back Better: Our Plan for Health and Social Care". Here the government:

- explains its plans to clear the current electives backlog, put the NHS on a sustainable footing, and focus on the prevention of chronic conditions;

- pledges to cap adult social care costs at £86,000 over an individual's life. Anyone with assets worth less than £20,000 will not need to pay towards their care, and those with up to £100,000 will be eligible for means-tested support. Further, an integrated care system aims to link the range of health and social care services that patients might receive.

Funding the plans

From 1 April 2022:

- the government will introduce a new 1.25% Health and Social Care Levy on Employee Primary and Employer Secondary Class 1, 1A and 1B as well as Class 4 NICs payable by the self -employed;

- The Class 1 rise will include deemed employees;

- Class 2 and Class 3 NICs will be unaffected.

From 6 April 2023:

- the Levy will be separately identified and collected independently of NICs;

- Class 1 and 4 NICs will return to their lower rate;

- the new Levy will also apply to those individuals working above the State Pension age.

Current secondary class 1 NIC reliefs and allowances will apply to the levy, including:

- the £4,000 employment allowance;
- reliefs for employers of apprentices;
- newly employed veterans; and
- new employees in freeports.

Increase in dividend tax rates
The government has also announced that, after the dividend allowance of £2,000, from 1 April 2022 there will be a 1.25% increase in dividend tax rates so that rates will become:

- 8.75% for basic rate taxpayers;
- 33.75% for higher rate taxpayers; and
- 39.35% for additional rate taxpayers.

Under s455 CTA 2010 the rate of tax that applies to overdrawn directors' loan accounts is directly linked to the dividend higher rate. This will mean that from April 2022 this rate will increase from 32.5% to 33.75%.

Dividends received from ISAs will remain tax-free.

Funds raised

The government estimates these measures raise around £12bn per annum and have stated that these funds will be ringfenced to pay for health and social care.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1015736/Build_Back_Better-_Our_Plan_for_Health_and_Social_Care.pdf

Autumn Budget 2021

The Autumn 2021 budget will take place on 27 October 2021, with the Office for Budget Responsibility preparing an economic and fiscal forecast which will be presented at the same time.

The Spending Review 2021 (SR21) was launched on 7 September 2021 and on 27 October 2021 the government will set the UK government departments' resource and capital budgets for 2022/23 to 2024/25 and the devolved administrations' block grants for the same period.

OTS report on changing the tax year end

On 15th September, the OTS published 'The UK tax year-end date: exploring the potential for change' that reports on the benefits, costs and wider implications of a change to the UK tax year end date.

Summary of findings

The OTS findings were summarised as follows:

> "There are clear benefits in adopting a tax year which is either aligned with the calendar year or with a calendar month-end, especially given the increasing automation, internet-enabled commerce and digitisation of financial information and accounting systems generally.
>
> The costs of change are significant, both in terms of the financial cost and the opportunity cost. Whether moving to 31 March or 31 December, the work involved would consume government and private sector resources and make it much harder to implement other changes at the same time. A move to 31 December could also require changing the UK's financial year.
>
> The review did not aim to make a specific recommendation about whether such a change should be made. Instead, the report presents information and analysis about the issues involved to inform evaluation of any potential change, and its timing.
>
> A tax year aligned to the calendar year would be the natural, simplest and easiest approach for everyone to understand. It would align with the approach in many other countries and support improvements in the use of international data to help taxpayers in fulfilling their obligations. It would also help individuals who move internationally (and, where relevant, their employers), or who have overseas income.
>
> Moving to 31 March would also be much more understandable, align with the UK's financial year, and assist taxpayers who prepare business accounts or report income from investments.
>
> The systems impacts of such a change, for government and the private sector, could be comparable with those for a change to 31 December, but the overall scale of what would be involved in a change to 31 March would be lower.
>
> The OTS considers that any change would be best carried out after major projects such as the Single Customer Account have been completed. It would in any case not be feasible to change the tax year end date before the scheduled 5 April 2023 start date of Making Tax Digital for Income Tax.
>
> While the OTS does not consider such a change should take place in the immediate future, the OTS recommends that in the short-term the government and HMRC pursue ways to formalise arrangements to allow (or even require) taxpayers to use a 31 March cut off to stand in for 5 April in respect of the calculation of profits from self-employment and from property income, ahead of the implementation of Making Tax Digital for Income Tax."

https://www.gov.uk/government/publications/exploring-a-change-to-the-uk-tax-year-end-date

Business Taxation

Deductibility of amounts paid to father (Lecture B1276 – 24.05 minutes)

Summary – The was insufficient evidence to support the deduction of payments of £30,000 paid to the taxpayer's father in arriving at his taxable self-employed income.

David Cation had worked in construction since 1983 and qualified as a chartered surveyor in 1990. He worked as an employee as a pre-sales director a sales role for companies until 2016 including Charles Henshaw & Sons Ltd, dealing with multi-million pound contracts in major city- centre projects.

In March 2012, he formed Glassal Limited, a specialist supplier and installer of bespoke glazing systems. David Cation was an equal shareholder with a former colleague, and in the initial years he continued to work full-time with Henshaw. David Cation provided his services to Glassal Limited in his personal capacity, trading as 'DC Consult', with DC Consult raising invoices to Glassal for payment of his service.

In 2014/15, DC Consult rendered invoices to Glassal generating total turnover to £70,000. Included in his deductible expenses was an amount of £30,000 that was said to have been paid to his father in return for his services acting as a mentor and advisor to his son, helping him to become self-employed, following up on quotations and chasing potential customers. The work covered a three-year period from August 2011 to March 2014. There was no formal agreement; the £30,000 was simply agreed as a fair value for the work undertaken over the period.

The £30,000 was settled over a number of years, with two payments of £10,000 being paid in January and February 2017, shortly after HMRC opened their enquiry into the return.

David Cation never confirmed the date of his self-employment commencing and there was a failure to notify liability in respect of the tax year 2013/14. His 2013/14 return was submitted in June 2017, after HMRC had opened their enquiry into 2014/15.

Following the enquiry, HMRC disallowed the £30,000 deduction arguing that it was not 'wholly and exclusively' for the purpose of his trade. There was no claim of expenses for 2013-14, but JGBA had advised that the payments to Peter Cation related to services provided from August 2011 to March 2014. No evidence was provided to suggest that his father provided services that merited the £30,000 payment. The single invoice dated 1 March 2015 gave no detailed account of the services provided. HMRC argued that "If there was a bona fide commercial agreement between the parties, particulars to evidence the services provided at a commercial rate should have been available."

Decision

With no written agreement, David Cation's defence relied heavily on the testimonies of his father and his own. The existence of a handwritten invoice and bank statements showing the flow of funds were insufficient evidence.

The First Tier Tribunal found that the assistance given by his father was occasional, non-technical and he did not expect to be paid. It was ad hoc and there was no regular work arrangement in place to engage his father's services to support the 2 days a week purported to have been worked leading to the £30,000 fees.

His father's experience was as a sales representative in polystyrene containers and fancy party outfits; nothing to do with bespoke glazing systems.

The Tribunal found that the 'mentoring' and 'coaching' by his father, referred to by David Cation as 'consultancy', was an overstatement. His father's business experience was limited while David Cation's own experience was far more relevant. He might have used his father as a 'sounding board' but little more. There was no evidence to support payment of £30,000 for consultancy services supplied.

The Tribunal noted that his father's evidence supported that the lump sum payments totalling £20,000 were unexpected, and he did not know whether they were a 'gift' or a 'salary'. The £20,000 was received by his father in 2017/18 but included in an amended 2015/16 return. The Tribunal concluded that on the balance of probability, the two lump-sum payments of £10,000 were triggered by HMRC's enquiry in January 2017, and explained why there was this mismatch in tax years for the relevant events such that the:

- claim of £30,000 was made in the appellant's 2014/15 return;
- two £10,000 payments were made in 2017/18 tax year;
- two £10,000 receipts were included retrospectively by amending his father's 2015/16 return.

The Tribunal rejected David Cation's explanation that 'accruals' were the reason for the mismatch in timing and that the payments in 2017, nearly two years after the supposed date of the hand- written invoice, was due to good trading results, which allowed him 'to settle his account'.

Having disallowed the £30,000, the First Tier Tribunal went on to consider whether the failure to notify a new income tax liability in 2013/14 was a deliberate act. The Tribunal concluded that David Cation clearly understood his obligation to file a Self Assessment return to declare his self- employed income for 2014-15 when his turnover reached £70,000. There was no good reason for not notifying and returning the £20,000 he had received in 2013/14 as self-employed income. HMRC were justified in charging the resultant penalty as being 'deliberate' as David Cation took no steps in January 2016 (when he was filing his 2014/15 return) to file his late 2013/14 return.

The appeal was dismissed

David Cation v HMRC (TC08253) deductibility of £30,000

Film partnerships were trading

Summary – The First Tier Tribunal had not erred in law and so were correct when they found that the LLP film partnerships were trading with a view to profit.

The Ingenious group established LLPs that provided film and video game schemes to investors, claiming that these generated trading losses for the investors to use against their other income. The three LLPs in this case were the lead appellants, with in excess of £1.6 billion in disputed losses at stake.

HMRC argued that the LLPs were not trading as the LLPs simply acquired rights to income that HMRC stated was an investment.

Having worked through the Badges of Trade, the First Tier Tribunal concluded that there was a trade being operated with a view to profit for two of the LLPs, but that Ingenious Games LLP was not trading.

HMRC appealed to the Upper Tribunal, still arguing that the LLPs were not trading and did not operate with a view to profit. The Upper Tribunal agreed but the LLPs appealed to the Court of Appeal.

Decision

The Court of Appeal confirmed that First Tier Tribunal decisions can only be overturned if there is an error in law. In this case, they found that the First Tier Tribunal had weighed up all of the facts and evidence provided and had not erred in law. Consequently, there was no basis for the Upper Tribunal to overturn the trading with a view to profit decisions.

The appeals of Inside Track Productions LLP and Ingenious Film Partners 2 LLP were allowed but the appeal in respect of Ingenious Games LLP's was dismissed as both the First Tier and Upper Tribunals agreed, it was not trading.

Ingenious Games LLP, Inside Track Productions LLP, Ingenious Film Partners 2 LLP v HMRC [2021] EWCA Civ 1180

NIC on rental profits? **(Lecture B1280 – 11.05 minutes)**

Background

Individual taxpayers who are landlords are not normally liable to National Insurance contributions (NICs) on their rental profits, unlike self-employed individuals carrying on a trade. However, there are certain exceptions to this general rule.

What would be the NICs position of (say) a UK resident landlord who is 40 years old and owns a portfolio of buy-to-let properties located in North-West England?

Class 4 NICs

Self-employed individuals living and working in the UK are generally liable to Class 2 and Class 4 NICs. There are separate rules that establish liability to Class 2 and Class 4 NICs respectively.

Self-employed individuals whose net profits or gains are chargeable to income tax (i.e., under the trading income provisions in ITTOIA 2005, Pt 2, Ch 2) are generally liable to Class 4 NICs (if those profits are not from a trade, profession or vocation carried on wholly outside the UK). This general rule is subject to certain exceptions, such as people under the age of 16 or over state pension age at the beginning of the tax year.

The Class 4 NICs legislation (SSCBA 1992, s 15(1)) refers to profits immediately derived from carrying on a trade, profession or vocation. An individual's rental income (e.g., from a conventional buy-to-let property business) is not trading income, so no Class 4 NICs liability should arise on the landlord's profits.

Furthermore, although furnished holiday accommodation is deemed to be a trade for certain tax purposes, HMRC accepts that although the income is treated in many ways as if it were from a trade, it remains assessable as property income, so Class 4 NICs are not applicable (see HMRC's Property Income manual at PIM4115).

Class 2 NICs

However, for Class 2 NICs purposes, the position of individual landlords is rather less clear. The Class 2 NICs legislation (SSCBA 1992, s 11) states that Class 2 contributions potentially apply if a self-employed earner is a person who is gainfully employed in the UK, other than in employed earners employment.

A 'self-employed earner' is defined as 'a person who is gainfully employed in Great Britain otherwise than in employed earner's employment (whether or not he is also employed in such employment) (SSCBA 1992, s 2(1)(b)). For these purposes, 'employment' includes 'any trade, business, profession, office and vocation…' (s 122(1)).

It should be noted that the Class 2 NICs legislation does not require a self-employed person to be carrying on a trade; it simply requires a self-employed person to be 'gainfully employed' otherwise than in an employment. This effectively brings within the scope of the term 'self-employed earner' anyone carrying on a business activity, and it broadens the ambit of Class 2 NICs compared to Class 4 NICs.

Is there a 'business'?

However, whether the activities of a buy-to-let landlord necessarily amount to a 'business' such that landlords become liable to Class 2 NICs will depend on the particular circumstances. HMRC's guidance in its National Insurance manual (at NIM23800) states:

> '…a person who is liable to Income Tax on the profits arising from the receipt of property rental income will only be a self-employed earner for NICs purposes if the level of activities carried out amounts to running a business.'

HMRC's view is that for a property owner to be a 'self-employed earner' their property management activities must extend beyond those generally associated with being a landlord. Possible pointers towards there being a 'business' for Class 2 NIC purposes include the ownership of multiple properties, actively looking to acquire further properties to let, and the letting of property being the individual landlord's main occupation.

Property agents

Some landlords engage an agent to manage the properties for them. The agent might be a professional managing agent, or even a friend or member of the landlord's family.

HMRC's approach in such circumstances is generally to attribute what the agent does to the landlord. However, the landlord will only be treated as a self-employed earner on this basis if the tasks the agent performs for them are sufficient to constitute a business.

HMRC's guidance at NIM23800 includes four examples of what does and doesn't constitute a business for NICs purposes.

In Rashid v Garcia [2003] SpC 348 (a NICs case), the appellant sought to pay Class 2 NICs in respect of earnings from property letting. The Special Commissioner held that, whilst it wasn't free from doubt, the arrangements didn't amount to a business, but there was an investment which, by its nature, required some activity to maintain it.

Non-NICs case law

It may sometimes be instructive to look at case law involving other taxes when considering what constitutes a 'business' (albeit that such cases might not set legally binding precedents for NICs purposes).

For example, the decision in Ramsay v Revenue and Customs [2013] UKUT 226 (TCC) concerned the meaning of 'business' in the context of rental property activities and capital gains tax incorporation relief. Following Ramsay, HMRC amended its guidance in the Capital Gains manual. It now states (at CG65715):

'Mrs Ramsay was found to have worked on the property for about 20 hours per week which was found to be sufficient to indicate the carrying on a business. You should accept that incorporation relief will be available where an individual spends 20 hours or more a week personally undertaking the sort of activities that are indicative of a business. Other cases should be considered carefully.'

Contributed by Mark McLaughlin

Professional fees deductibility **(Lecture B1276 – 24.05 minutes)**

Summary - Banking and accounting fees were deductible revenue management expenses. It was not necessary to have formal board decisions at the company level in order to determine that investment activities had been undertaken and expenditure incurred in respect of them.

Centrica Overseas Holdings Ltd was an intermediate holding company, with a Dutch sub-group (Oxxio) in the group headed by Centrica plc. Centrica plc decided to sell the Oxxio businesses.

Following difficulties in the Oxxio sub-group, Oxxio sold one subsidiary and the assets of two further subsidiaries, with the remainder of the Oxxio sub-group remaining under Centrica Overseas Holdings Ltd.

Centrica Overseas Holdings Ltd claimed that £2.5m of the £3.8m professional fees incurred were expenses of management deductible from its profits as a company with investment business under s1219 CTA 2009. HMRC refused this claim.

The First Tier Tribunal rejected Centrica Overseas Holdings Ltd's appeal on the basis that the directors had not made specific, recorded decisions in their capacity as Centrica Overseas Holdings Ltd directors.

Decision

The Upper Tribunal concluded that the First Tier Tribunal had been wrong and that, while it might be preferable, it was not necessary, for the board of Centrica Overseas Holdings Ltd to have made formal decisions regarding its investment activity. The group head of tax and general counsel were heavily involved in the process from beginning to end. They were also directors of Centrica Overseas Holdings Ltd. The Upper Tribunal stated that s1219 CTA did not require this level of formality and that it was clear that the directors were 'participating in the strategic decision making in relation to Oxxio'.

The Upper Tribunal upheld the First Tier Tribunal's findings that the banking and due diligence fees incurred in relation to decision making rather than implementation were expenses of management, confirming that it is not appropriate to use a single cut-off date, but rather consider the purpose of the expenditure. Further, the fact that the banking fees were contingent on completing the deal did not automatically render them non-deductible, and the banking and due diligence fees were not capital in nature.

However, with regards to the legal fees, the Upper Tribunal remitted the question of whether the fees were expenses of management to the First Tier Tribunal and overturned the decision that these fees were all capital, finding that, to the extent the First Tier Tribunal finds that some of the fees were expenses of management, they will also be revenue in nature because they informed the decision making in relation to the disposal of the Oxxio business.

The Upper Tribunal broadly allowed Centrica Overseas Holdings Ltd's appeal, allowing deductions for most of the expenditure incurred. Where a parent company is involved in managing an investment business, management expenses may still be deductible provided the company's directors participate in making the decisions.

Centrica Overseas Holdings Ltd v HMRC [2021] UKUT 200 (TCC)

Adapted from the case summary in Tax Journal (10 September 2021)

Loan relationships and the unallowable purpose test

All of the taxpayer companies were members of the Kwik-Fit group.

Following the acquisition of the group by a new owner, a reorganisation of the group's intra-group loans was carried out:

- A number of intra-group receivables were assigned by the taxpayers to an intermediate holding company, Speedy 1, and three new intra-group loans were created;

- The interest rate on the assigned loans and one loan already owed to Speedy 1 was substantially increased;

- The interest rate on intra-group loans that were not involved in the reorganisation was not increased;

Speedy 1 had a carried-forward non-trading loan relationship deficit of £48m and, as a result of the reorganisation, the deficit was utilised within three years rather than around 25 years, which was the estimate previously made by the group's tax manager.

HMRC contended that s441 CTA applied to disallow debits arising to the taxpayers on the basis that they were parties to the loan relationships for an unallowable purpose. For loans assigned to Speedy 1 under the reorganisation and the new loans, HMRC sought to disallow the whole of the interest debits, but in the cases of the loan to which Speedy 1 was already a party, they sought to disallow only the additional interest. HMRC capped the total disallowances at the amount of Speedy 1's carried-forward non-trading deficit.

Decision

The First Tier Tribunal first determined that the debits claimed by the taxpayers were 'tax advantages' for the purposes of the unallowable purpose rule and that the use by Speedy 1 of its non-trading deficit to offset against interest income was a 'relief from tax' and so also a tax advantage.

It was agreed that the taxpayers had originally entered into the pre-existing loans for commercial purposes, but the First Tier Tribunal found that the only reason that they had agreed to incur the additional cost in respect of their loan relationships resulting from the increased interest rate was to secure the tax advantages for themselves and for Speedy 1. They had therefore acquired a new purpose in being party to the loans from the time of the reorganisation. The new purpose was a main (and therefore unallowable) purpose in addition to the existing commercial purpose. The main purpose of the taxpayers in entering into the new loans was to secure the intended tax advantages, and this was an unallowable purpose.

The First Tier Tribunal therefore agreed with HMRC that s.441 applied. However, it considered that, in the case of the loans assigned to Speedy 1, disallowing the whole of the debits did not reflect the extent to which the taxpayers had a commercial purpose as well as an unallowable purpose. It therefore held that only the part of the debits attributable to the increased interest rate should be disallowed and allowed the taxpayers' appeals to that extent.

Kwik-Fit Group Ltd and others v HMRC (TC08226)

Adapted from the case summary in Tax Journal (10 September 2021)

MTD ITSA – Overview of the Regulations (Lecture B1277 – 15.34 minutes)

The digital obligations which relate to MTD for income tax encompass:

- The requirement to keep digital records;

- The requirement to provide ‘periodic’ (quarterly) updates and;

- The requirement to provide an end of period statement.

The broad basis of these obligations was legislated for in 2017 in Finance Act 2017 s60, which inserted Schedule A1 into TMA 1970. The Regulations are made under Sch A1, setting out more detail on the requirements. They will be supplemented by tertiary legislation setting out the precise content and requirements of the elements of the legislation set out below.

Digital record keeping

The requirement for businesses to keep digital records encompasses the use of 'functional compatible software'. This term was also used in the VAT Regulations, and covers one or more software products but also includes spreadsheets, which when used together provide the following functions:

- The creation of a digital record of transactions;
- The retention of that record for the requisite period required by tax law;
- The submission of quarterly updates and end of period statements to HMRC using API architecture;
- The receipt of information from HMRC relevant to compliance with these processes using API architecture.

The precise content of the digital records in terms of the analysis of transactions will be provided by an 'update notice' which is to be issued under the Regulations, but it is safe to assume that it will not be much different to the present analysis on the relevant Self Assessment supplementary pages – that is SA103 for the self-employed and SA105 for property businesses.

Digital records – specific content

Regulation 6 provides the skeleton of what information needs to be captured digitally, and it is similar to the VAT rules in providing only a requirement for brief data items as follows :

For each transaction :

- The amount of the transaction;
- The date of the transaction (according to the basis used for reporting for income tax purposes – cash accounting or full GAAP accounting under ITTOIA 2005);
- The category into which the transaction falls – this is to be specified in an 'Update notice' which is due before the end of 2021.

Timing of digital record keeping

Regulation 5 requires that transactions are entered into the digital records at the earlier of:

- The deadline for submission of the quarterly update; or
- The point at which the quarterly submission is about to be submitted

So, in practice, this allows record keeping to be done at a minimum on a quarterly basis, although many advisers will probably decide that real – time record keeping (or as near to it as possible) will be their preferred solution.

Quarterly updates

The primary legislation sets out the requirement for quarterly updates which stands alone and separate from the requirement to file information under s8 TMA 1970 – so this requirement is imposed whether or not a business has received a s8 notice.

The regulations provide us with a lot more detail about quarterly updates.

Period during which quarterly updates required

The start date for quarterly updates is the digital start date, unless the person is exempt under the income exemption rules.

Quarterly updates must then be filed **for each business** for each quarter shown by the Table below until the quarter including the cessation date for the business. If the person becomes exempt under the income limit rules the last quarterly update will be filed for the final quarter of the tax year before the exemption applied.

Quarter dates

The Regulations (Reg 7) specify the following quarter dates:

Quarterly period	Start date	End date	Filing deadline
1	6 April	5 July	5 August
2	6 July	5 October	5 November
3	6 October	5 January	5 February
4	6 January	5 April	5 May

So every business and every person within MTD will file to the same dates and have the same due dates. This has significant implications for workflow patterns within firms.

Calendar quarter election

Regulation 7(6) allows a person to make an election (on a business by business basis) for the filing intervals to be calendar quarters – that is ending on the last day of the preceding month compared to the months in the table above.

The election must be made by the due date for the first quarter's return in any tax year and will remain in force for the whole tax year and all subsequent years until it is withdrawn. Do note that the election applies on a business by business basis, so you will need to make the election for all businesses where a client has more than one trade or property business. In the first year of the election, the Quarter 1 period starts on 6 April; thereafter it will start on 1 April.

Withdrawing the election will take effect for the current tax year if made before the deadline for the Quarter 1 update, and from the following year if made after that date.

Obviously, firms will wish to consider what is most appropriate for them and their clients, and the basis period reform may also affect these decisions, but the extra five days filing window is useful here.

Content of quarterly updates

The specific detailed content is awaited and will be provided by the issue of an 'update notice'. Reg 8 specifies the content of an update notice which will include (but is not limited to):

- Designatory information (Name, address, trading name are likely);
- Totals of the amounts falling within the specified categories of transaction, derived from the digital records; and
- Details of the properties forming part of the property business.

The regulations allow this to vary for different types of business, and this is likely to be the case in particular for property businesses. (See above regarding the analysis and categories of transactions in the records).

For a quarterly update for the final period of the business, the update must include the date that the business ceased and a statement that because of the cessation this is the final update for that business.

Note that there is no declaration about 'correct and complete' for the quarterly updates, and there will be no compliance effort directed at the content of quarterly updates provided it reflects the transactions and these are recorded in compliance with the digital record keeping requirements.

End of period statements (EOPS)

It is crucial to note that the requirement for the end of period statement applies to each business and is quite distinct from the quarterly updates. The EOPS relates to the **basis period** for the tax year under consideration, which means that if the chosen accounting date is not 31 March or 5 April the EOPS for a tax year will be significantly different from the quarterly updates provided in respect of that year.

The EOPS includes all of the year-end adjustments, capital allowance claims and other reliefs relevant to the business and a declaration that the statement is correct and complete to the best of the taxpayer's knowledge. We, as agents, will therefore follow the same procedure for authorising an EOPS before submission as we now follow for a Self Assessment return. A broad parallel to the EOPS is the SA 103 or SA 105 part of the current Self Assessment return.

The EOPS due date is set by the primary legislation as 31 January after the fiscal year in which the accounting period ends (using the normal basis period rules for a continuing business). So there is no difference in timing between submission of an EOPS and the old requirement to file a Self Assessment return.

Content of the EOPS

An ‘end of period notice’ will be issued by HMRC to specify exactly what the EOPS must include, but it will include at least the following : (Reg 13).

- Designatory Information;
- Details of the relevant period to which the statement refers (that is the dates of the accounting period or basis period if different);
- The totals of the amounts falling within the specified categories of transactions for the relevant period;
- Details of the properties forming part of the property business;
- Information on:
    - Adjustments, allowances, balancing charges or costs
    - Losses or exemptions, and
    - Reliefs and allowances

Once again, the end of period notice may specify different information for different types of business.

There are a few parts of the existing SA103 which may or may not form part of the EOPS – in particular averaging claims by farmers, market gardeners and creative artists, and also loss relief where the loss is set against non-trading income. It is likely that your software will deal with this routinely when the time comes.

Period during which EOPS are required

In principle, a business will submit an EOPS for each basis period from commencement until cessation, but of course the requirements do not commence until 2024. Businesses are not required to submit an EOPS for any period which started before the digital start date for the business, so for example, a business with a 30 September accounting date will not submit an EOPS for the year ended 30 September 2024 as that period commenced before the universal digital start date of 6 April 2024.

The Self Assessment return for 2024/25 will show the profits for the year ended 30 September 2024, and the business will file an EOPS for the year ended 30 September 2025.

Contributed by Rebecca Benneyworth

MTD ITSA – The income exemption **(Lecture B1278 – 12.07 minutes)**

The digital obligations which relate to MTD for income tax encompass:

- The requirement to keep digital records

- The requirement to provide 'periodic' (quarterly) updates and
- The requirement to provide an end of period statement.

The broad basis of these obligations was legislated for in 2017 in Finance Act 2017 s60, which inserted Schedule A1 into TMA 1970. The Regulations are made under Sch A1, setting out more detail on the requirements. They will be supplemented by tertiary legislation setting out the precise content and requirements of the elements of the legislation set out below.

Income limit

The income limit further determines whether the taxpayer is required to comply with this legislation once their digital start date has passed. The Regulations are a little complex on first reading, but that is to prevent taxpayers dipping in and out of MTD as their income fluctuates. In essence a taxpayer's businesses can only drop out of MTD once their income has been below the limit for three consecutive years – see below. The details of the income limit are dealt with by Regs 21 to 23 and are described as the Income exemption.

Gross income

The income exemption refers to the "amount of the person's qualifying income". This is defined as the sum of the amounts of income before any deductions for each business carried on by the person in the tax year, and for which the amounts are included in the Self Assessment (or equivalent) for that year. Given that income from a property is regarded as a 'property business' this means:

- Turnover from all trading activities, and
- Gross rents and other income received from property (including an overseas property business)

Regulation 21(6) requires the amount used to be annualised if the period included on the return (or equivalent) is a period of other than 12 months. This may produce an upward adjustment for short periods, or a downward adjustment for long periods, for example when a trade has a long period of account to cover a change of accounting date.

Structure of the exemption

For the income exemption to apply, Reg 21(3) requires two tests to be met:

1. The digital requirements did not apply to the person in the previous tax year, and
2. The gross income for the tax year for which the filing deadline fell before the start of the tax year in question was less than £10,000. (I will call this the 'relevant year').

So for the first year of MTD, those taxpayers not needing to comply with the rules will identify as follows :

- Not required in previous year – applies to all;
- Gross income for the relevant year below £10,000. The relevant year is the year for which the filing deadline is 31 January 2024 (immediately before the start date for

MTD). This is the filing deadline for 2022/23, so that is the year used for the entry into MTD from the start date of 6 April 2024.

So the base year for income test for the start of MTD will be 2022/23.

For businesses not coming in from the start of MTD and for new businesses, it will be necessary to follow the logic above once the digital start date has been passed for new businesses – until that date the exemption is not relevant.

Persons acquiring the income exemption subsequently

Where a person has been subject to the MTD requirements, they will only become exempt under the income exemption when the last three years have been below the income limit. So for example, a business joining MTD in 2024/25 (the commencement year) would remain in MTD until three complete years have passed during which their income was below the £10,000 limit.

For the first two of those years, it will be the income according to the End of Period statements for the basis period. For the third of those years, it is based on the quarterly filings for that year, as the End of Period statement is unlikely to have been filed for that third year before the person wishes to claim the exemption. Any period in which the period reported is not 12 months should be scaled accordingly.

Electing to disapply the income exemption

A person can elect that the income exemption does not apply to them by notifying HMRC before the start of the tax year in which they would otherwise be exempt. The exemption would then not apply for the next tax year and all subsequent years unless the exemption is withdrawn.

A notice of withdrawing the exemption must specify the date of withdrawal, and the exemption will then apply from the following tax year.

Contributed by Rebecca Benneyworth

MTD ITSA timeline – No extra year (Lecture B1279 – 14.27 minutes)

The digital obligations which relate to MTD for income tax encompass:

- The requirement to keep digital records
- The requirement to provide ‘periodic’ (quarterly) updates and
- The requirement to provide an end of period statement.

The broad basis of these obligations was legislated for in 2017 in Finance Act 2017 s60, which inserted Schedule A1 into TMA 1970. The Regulations are made under Sch A1, setting out more detail on the requirements. They will be supplemented by tertiary legislation setting out the precise content and requirements of the elements of the legislation set out below.

Digital start date

This is an important part of the Regulations as it determines the time when the obligations commence.

- For existing businesses it articulates the commencement of MTD for sole traders and landlords (partnerships are not included in this phase of the implementation).

- For new businesses, it sets the earliest date from which they must comply with the rules, subject to meeting the income threshold.

Businesses trading as at 5 April 2023

The digital start date for these businesses will affect all existing sole traders and landlords with total gross income from both sources of over £10,000. Their digital start date is 6 April 2024. See below for how and when the gross income test is carried out.

New businesses

When new businesses come within the digital requirements depends on when the 'Notice to file information' (previously a 'Notice to make a return') is first issued under s8 TMA 1970. Leaving aside the requirement to notify the income source, and irrespective of whether this is complied with in a timely manner, we already have a distinction as follows (s8(1G) TMA 1970 :

Where the s8 Notice is issued on or before 31 October in the fiscal year following the fiscal year of commencement of trade (Year 1), the current deadline for the (electronic) Self Assessment return is 31 January in that tax year (Year 2).

Where the s8 Notice is issued after 31 October in Year 2 the deadline for the Self Assessment return is three months after the issue of the Notice.

The Regulations take a similar approach to the 'Digital start date' for a new business, as follows:

- Where the s8 Notice has been issued on or before 31 October in Year 2, the digital start date is the following 6 April – that is 6 April in Year 3

- Where the s8 Notice is issued after 31 October in Year 3 there is a delay of a further year, so the digital start date is 6 April in Year 4.

Timing of Quarterly updates

The primary legislation sets out the requirement for quarterly updates which stands alone and separate from the requirement to file information under s8 TMA 1970 – so this requirement is imposed whether or not a business has received a s8 notice.

Period during which quarterly updates required

The start date for quarterly updates is the digital start date, unless the person is exempt under the income exemption rules.

Quarterly updates must then be filed for each business for each quarter shown by the Table below until the quarter including the cessation date for the business. If the person becomes exempt under the income limit rules the last quarterly update will be filed for the final quarter of the tax year before the exemption applied.

Quarter dates

The Regulations (Reg 7) specify the following quarter dates:

Quarterly period	Start date	End date	Filing deadline
1	6 April	5 July	5 August
2	6 July	5 October	5 November
3	6 October	5 January	5 February
4	6 January	5 April	5 May

So every business and every person within MTD will file to the same dates and have the same due dates. This has significant implications for workflow patterns within firms.

Contributed by Rebecca Benneyworth

VAT and indirect taxes

Don't forget to notify an option to tax (Lecture B1276 – 24.05 minutes)

Summary – Although an option to tax the sale of a property was made, it was not notified to HMRC within the required time limit, making it ineffective for VAT.

William Newman was the tenant landlord of a pub. In 2014 the freeholder offered to sell it to him. Having found a buyer, on 22 May 2014 he bought the property and sold it on.

He was invoiced £1.3m plus £234,000 VAT on his purchase and invoiced on to his buyers for £1.8m with VAT of £360,000.

HMRC argued that he did not make an effective election to opt to tax his sale. Had he done so, he would have been able to reclaim the VAT on his purchase, leaving him with a net VAT liability of £126,000. With no option to tax in place, his sale was an exempt supply and his input tax was irrecoverable. As an exempt supply, he could not properly give a VAT invoice to the buyer and the VAT shown on the invoice would be collectable from him under para 5(2) Sch. 11 VATA as a debt to the crown.

Strangely, no VAT return was made on time for the period 07/14 when he bought and sold the pub, although a later nil return was made. William Newman was not advised by his advisors to pay and did not pay HMRC the £126,000 within the prescribed time after the end of the period.

By para 20 Sch. 10 VATA, an option to tax does not have effect unless it is notified to HMRC "within the allowed time", which in non-COVID times is 30 days. William Newman did not notify HMRC by submitting form VAT 1614**A** within the 30-day period.

In October of the following year, HMRC received a form 1614H, requesting permission for a retrospective option, rather than the required form 1614A relating to the notification of an option already made.

On 11 November 2015 HMRC sent a demand under para 5(2) Sch 11 VATA for the VAT charged to his buyer and two weeks later followed up on the incorrect form that had been sent, which resulted in completed and signed form 1614A arriving on 4 December 2015.

William Newman appealed against HMRC's demand for £360,000.

Decision

The First Tier Tribunal concluded that it seemed clear that VAT accounting on both the sale and purchase had been mishandled in 2014 and early 2015 by those advising him.

The issue to decide was whether William Newman had made an effective election before 21 May 2014.

The Tribunal found that he had made an election in time as indicated by the VAT in the sale contract and other documentation. He delegated authority to his advisors to make the election on his behalf and to take such steps as were necessary to make it effective.

Having missed the 30-day notification deadline, the Tribunal concluded that the election could still be "effective" but only if HMRC allowed further time. However, it was clear that HMRC had not done so and the appeal was dismissed.

William Newman v HMRC (TC08147)

Compensation for mis-sold PPI (Lecture B1276 – 24.05 minutes)

Summary - Compensation received on mis-sold Payment Protection Insurance (PPI) was not an VAT exempt insurance transaction.

Claims Advisory Group Limited made claims on behalf of individual customers who had been mis-sold PPI.

Where claims were successful, the customers received compensation amounts that were equal to the PPI premiums they had paid together with interest, with Claims Advisory Group Limited receiving a percentage of the compensation as a fee for its services.

Claims Advisory Group Limited argued that the services it provided were exempt from VAT as insurance transactions or as services performed by an insurance agent related to insurance transactions (Group 2, Schedule. 9 VATA 1994).

HMRC argued that they were standard rated. The First Tier Tribunal agreed with HMRC and found that the supplies did not amount to insurance contracts, nor was the company an insurance agent or intermediary that made supplies related to insurance transactions. The exemption therefore did not apply.

The company appealed to the Upper Tribunal arguing that its services were insurance related as the cancellation of PPI, was required before compensation was paid out.

Decision

The Upper Tribunal examined the contractual arrangements. Claims Advisory Group Limited confirmed in the paperwork sent to potential customers that their services related to claiming compensation, and not to any insurance service. The Tribunal found that the economic purpose and commercial reality of the company's supplies was to claim compensation for mis-sold PPI; this was not an insurance transaction. There was no authority to support the Claims Advisory Group Limited's claim that the cancellation of an insurance contract was such a transaction.

The Upper Tribunal agreed with the First Tier Tribunal that Claims Advisory Group Limited was not acting between the insured and the insurer as an insurance agent, nor performing related services to an insurance transaction. The company was not involved in seeking insurance and had no relationship with the insurer.

Claims Advisory Group Limited's appeal was dismissed.

Claims Advisory Group Limited v HMRC [2021] UKUT 199 (TCC)

Reconstruction of listed building (Lecture B1276 – 24.05 minutes)

Summary – The conversion of a large, listed property into 86 residential units was not a "substantial conversion" of a listed building, making the sale of the units exempt for VAT.

The Royal Star and Garter Home, a large, listed property in Richmond, was built in the early 1920s to provide nursing facilities for servicemen returning from service in the first world war. Changes in medical practice led the charity which owned the building to move its operations elsewhere and the building was then sold to Richmond Hill Developments (Jersey) Ltd

Over some 2.5 years the company converted the building into 86 residential units which it sold. The King's Room was converted into a swimming pool and gymnasium and the Queen's Room was to be converted into a communal sitting room, or for use for large receptions or dining.

The issue in this appeal was whether on sale, the residential units were zero rated or exempt. If zero rated, the company would have been able to recover the input tax on the conversion works. Under Item 1 Group 6 Schedule 8 VATA 1994, the supply of dwellings which are the result of a "substantial conversion" of a listed building are zero rated for VAT.

There was no doubt that major work had been carried out in this case but as the Tribunal stated the issue was whether Note 4 to Group 6 applied, which states:

> "a [listed] building is not to be regarded as substantially reconstructed unless when the reconstruction is completed, the reconstructed building incorporates no more of the original building (that is to say, the building as it was before the reconstruction began) than the <u>external walls</u> together with other external features of architectural or historical interest."

The reconstruction did leave the walls and roof substantially intact but also retained the chapel, a marble staircase, the substantial majority of the reinforced concrete floor slabs and the chimney stacks. HMRC argued that these retentions meant that the property sales were exempt supplies and not zero rated.

The company argued that the concrete floor slabs, vertical steels within the walls and the chimney stack, which were retained in order to maintain the structural integrity of the exterior, should be considered as part of the external walls and features for the purposes of Note 4 and that other retained features were de minimis.

The company also argued that the EU principle of Fiscal Neutrality required that a reconstruction of a listed building in which some part of the original structure was maintained should be treated in the same way as a reconstruction in which nothing other than the external walls was retained.

Decision

The First Tier Tribunal agreed that "external walls" included their foundations and a buttress which are needed for stability, have no other purpose and are closely attached to the wall.

The Tribunal stated that the:

- floor slabs served the purpose of providing floors on which to walk and place objects and extended from one outside wall to the opposite one. They were not part of the walls.

- vertical steels cast into the external walls were part of the walls but supported in part the upper floor slabs and their load, they did not serve only the walls or the roof and so could not be regarded as part of the external walls.

- chimney stack, started at ground level and rose through the building and supported the visible chimneys which rose above the roof. This could not be called part of the external features.

The Tribunal further concluded that, in the context of the building as a whole, the retention of the original marble lined grand entrance and staircase and the passage to the formal garden at the rear were three significant features both before and after the reconstruction and could not be regarded as 'trifling'. The de minimis exemption did not apply.

With evidence lacking, the Tribunal stated that they could not directly conclude that there were similar flats whose sales had been treated differently and so on that basis found that the principle of fiscal neutrality was not infringed. Further, considering theoretical flats and the views of a typical customer, the Tribunal concluded that the grand entrance hall, stairs, the associated entrance corridors and the Queen's Room would have had a significant influence on a purchaser's decision. On that basis they found the Fiscal Neutrality principle was not breached.

The appeal was dismissed.

Richmond Hill Developments (Jersey) Ltd v HMRC (TC08232)

R&C Brief 11 (2021): VAT liability of COVID-19 testing services

This new VAT Brief states that COVID-19 testing can only be exempted where it is carried out and supplied by a relevant health professional within the meaning of items 1, 2, 2A or 3 Group 7, Schedule 9 VATA 1994:

- supplied by a non-registered person, but the services are wholly performed by a relevant health professional—the exemption does not apply where the health professional is a dental technician;

- carried out by a non-registered person acting under the supervision of a relevant health professional—the exemption does not apply where the health professional is a pharmacist, pharmacy technician or dental technician;

- supplied by a hospital or state regulated institution—in this case the exemption also covers the supply of any goods in connection with the supply.

HMRC considers that the objective purposes of COVID-19 testing are diagnosis and the protection of human health. This also applies to tests taken for international air flights. Accordingly, such testing may be exempt medical care subject to meeting the usual requirements.

The supply of COVID-19 testing by a body regulated by the Care Quality Commission (or equivalent in Northern Ireland, Scotland & Wales) for other activities, but not COVID-19 testing, remains standard rated.

https://www.gov.uk/government/publications/revenue-and-customs-brief-11-2021-vat-liability-of-coronavirus-covid-19-testing-services