Tolley®CPD

October 2023

Disclaimer

CONTENTS

Personal tax

Directors' payments and RTI returns (Lecture P1396 – 21.04 minutes)

Summary –Payments made to a director should have been reported for RTI purposes as he was an officeholder and employee.

John McDonald was the single shareholder/ director of Purple Sunset Limited.

In the years before 2018/19 he reported employment income received from the company in his Self Assessment return but the company neither paid national insurance contributions nor filed Real Time Information returns.

In December 2018, HMRC carried out a compliance visit and issued NIC assessments totalling £37,785.44 for the four years through to 2017/18, and penalties totalling £3,300 for failing to file RTI returns for 2015/16, 2016/17 and 2017/18.

Purple Sunset Limited accepted the NIC assessments but appealed the RTI penalties arguing that John McDonald did not have an employment with the company. As a director receiving money in that capacity, there was no requirement to file RTI returns.

It was common ground that the payments were not dividend income.

HMRC argued that:

- the PAYE Regulations 2003 require RTI returns be made for all employees;
- the term "employee" in those regulations is defined by reference to the same word in s.5 ITEPA 2003;
- that section provides that the term "employee" includes office holders; and
- directors are officer holders.

Decision

The First Tier Tribunal found that:

- as a director, John McDonald was an office holder;
- under s.5 ITEPA 2003, the term 'employee' includes office holder;
- the PAYE Regulations impose an RTI obligation for all employees.

As a result, the company was required to complete RTI returns for John McDonald.

The Tribunal found that the company did not have a reasonable excuse for failing to file RTI returns as ignorance of the law did not provide a reasonable excuse.

Purple Sunset Ltd v HMRC (TC08880)

Class 1 NICs on car allowances

Last month we considered the Upper Tribunal's decision relating to the national insurance treatment of car allowances where the Tribunal found that the allowances were made to ensure that the employee had a suitable vehicle available for business use. It did not matter that the amount depended on the seniority of the employee rather not business mileage.

We now know that HMRC it will not appeal this decision.

Laing O'Rourke Services Ltd v HMRC; Willmott Dixon Holdings Ltd v HMRC

Statutory residence test **(Lecture P1396 – 21.04 minutes)**

Summary – A taxpayer who exceeded the permitted UK days for the statutory residence test by 5 days was UK resident. Caring for her ill twin and her twin's minor children did not represent exceptional circumstances.

On 4 April 2015, the taxpayer moved from the UK to Ireland and in 2015/16:

- her husband transferred shares to her and she received roughly £8 million dividend income;

- she completed her 2015/16 tax return on the basis that she was non-UK resident, meaning that the dividend income was not taxable.

Following an enquiry, HMRC believed that she had exceeded the permissible 45 days, making her UK resident. Consequently, HMRC issued an amendment to her return to collect additional tax of £3.1 million.

The taxpayer appealed to the First Tier Tribunal.

It was common ground that:

- she had been in the UK for 50 nights in the relevant year; five days more than the 45 days allowed under the statutory residence test;

- she would be UK resident for the relevant year unless the extra five days satisfied Sch 45, para 22(4) FA 2013 which provides that a day is ignored for the purposes of the statutory residence test day count in relation to a person if:

    - they would not be present in the UK at the end of that day but for exceptional circumstances beyond their control that prevents them from leaving the UK, and

    - they intend to leave the UK as soon as those circumstances permit.

The taxpayer argued that she satisfied the 'exceptional circumstances' rule as she was in the UK because her twin sister, who suffered from alcoholism and depression, had threatened to commit suicide and she was prevented from leaving the UK until the sister was "in a place of safety" and her minor children were being looked after.

The First Tier Tribunal rejected the 'place of safety' argument as the taxpayer's evidence as to the risk of her sister committing suicide lacked credibility. However, the Tribunal allowed the appeal stating that:

> "the combination of the need for the Taxpayer to care for her twin sister and, particularly, for her minor children at a time of crisis caused by the twin sister's alcoholism does constitute exceptional circumstances"

The First Tier Tribunal accepted that she was the only person able to assist her twin sister at the time and was under a moral obligation to do so.

HMRC appealed to the Upper Tribunal.

Decision

The Upper Tribunal disagreed with the First Tier Tribunal, finding that exceptional circumstances for being prevented from leaving the UK could be met by a moral or conscientious inhibition on the taxpayer. Moral obligations are not exceptional but merely part of normal family life.

Further, the First Tier Tribunal had failed to apply each element of the statutory residence test to each of the five extra days that the taxpayer remained in the UK. It was necessary to find the facts for each condition and each day, which the Tribunal had not done.

The Upper Tribunal found that alcoholism was not an exceptional circumstance and so neither was caring for someone suffering from it. Her position was no different to other families dealing with the distress caused by alcoholism.

It considered that the circumstances which the taxpayer found when she visited her sister were not exceptional.

HMRC's appeal was allowed.

HMRC v A Taxpayer [2023] UKUT 00182 (TCC)

Note: The Upper Tribunal set out an approach which could be taken in future cases which is outlined below.

Consider separately each of the days for which the taxpayer is claiming to have met the exceptional circumstance requirements then for each of those days establish the facts which the taxpayer asserts relate to each of the five elements of the statutory test, the burden being on the taxpayer, namely that:

1. The circumstances were exceptional.

2. The circumstances were beyond the taxpayer's control.

3. The taxpayer would not have been present in the UK at the end of that day but for those circumstances.

4. The circumstances prevented the taxpayer from leaving the UK.

5. The taxpayer intended to leave the UK as soon as those circumstances permitted.

Establish the facts which the taxpayer asserts show that the circumstances changed so as to allow the taxpayer to leave the UK after the end of the relevant day or days; this will shed light on whether the taxpayer was previously prevented from leaving by the exceptional circumstances.

Consider which facts are objectively proven, either by documents or credible oral evidence, or by both.

In the light of those proven facts, decide whether each of the statutory requirements has been satisfied.

No exemption from HICBC (Lecture P1396 – 21.04 minutes)

Summary –The taxpayer was liable the High Income Child Benefit Charge for the relevant years. However, the taxpayer had a reasonable excuse, meaning that the penalties were cancelled and two year's assessments were out of time.

In 2000, Ms A and her then partner had a son and she claimed Child Benefit in respect of her son. Her understanding, which was correct at the time, was that all parents were entitled to Child Benefit when they had a child, and its receipt had no tax consequences.

On separation from her partner, Ms A retained custody of their son, her partner was required to pay child support and she continued to claim Child Benefit

Ms A began a relationship with Stephen Lee, and in 2006 they had a daughter. Her Child Benefit claim was increased to reflect her second child and the money continued to be paid into her bank account. From the evidence it was clear that the couple lived together at the same address but kept their financial affairs separate. Neither knew how much the other earned, and Stephen Lee did not know Ms A was receiving Child Benefit.

Stephen Lee completed Self Assessment returns for 2012/13 to 2015/16 showing that he was not a higher rate taxpayer so could not be liable for the HICBC introduced in 2013. Since the couple were not high earners, HMRC did not send them information about the new high income child benefit charge at that time.

HMRC removed the requirement for him to submit Self Assessment tax returns for 2016/17 on the grounds that he was employed and all his income was dealt with under PAYE.

However, in 2016/17 his earnings exceeded £50,000, the HICBC threshold, and it remained over that threshold for subsequent years.

In 2019, HMRC sent Stephen Lee a nudge letter about the HICBC. Ms A cancelled her claim and as HMRC did not explain that she should check the position for previous years, the couple thought the matter had been dealt with.

Later, in May 2022, Stephen Lee was assessed to the HICBC for 2016/17 through to 2019/20 as well as penalties for his failure to notify his liability to the charge.

Stephen Lee appealed and requested HMRC reverse the assessments under ESC A19 which begins:

> "Arrears of income tax or capital gains tax may be given up if they result from HMRC's failure to make proper and timely use of information…"

HMRC rejected the claim stating that it did not apply.

Decision

The First Tier Tribunal found that Stephen Lee had a reasonable excuse for failing to notify his liability as:

- he would never have been received the 2013 publicity about the HICBC when it was introduced as it was not relevant to the couple at the time;
- the 2019 nudge letter did not explain that simply cancelling the claim going forward was not enough; the couple needed to consider whether the charge applied in earlier years.
- a reasonable person who was informed by his partner that they had spoken to HMRC and the matter had been dealt with, would have taken no further action.

Consequently, the First Tier Tribunal cancelled the penalties.

Having found that Stephen Lee had a reasonable excuse, HMRC were restricted to going back four years instead of six as Stephen Lee had not acted carelessly. The assessments for 2016/17 and 2017/18 were out of time.

The assessments for the two later years were upheld as:

- his adjusted net income exceeded £50,000;
- he was the partner of someone who had claimed to Child Benefit;
- he was the higher earner of the two.

The First Tier Tribunal found that that there were no exemptions where the parent is not the biological parent or where child support is paid by another for that child.

Finally, the First Tier Tribunal found that HMRC were wrong to say that ESC A19 did not apply. HMRC were using both Ms A and Stephen Lee's income and child benefit information on file to identify them as relevant parties to receive the nudge latter sent.

However, the Tribunal had no jurisdiction to take this matter further. Stephen Lee should make a formal complaint to HMRC and the information to do so was provided to him.

Stephen Lee v HMRC (TC08872)

Abolition of the lifetime allowance **(Lecture P1397 – 20.28 minutes)**

F(No2)A 2023, which received Royal Assent on 11 July 2023, made a number of important modifications to the tax rules for pensions.

In recent years, the lifetime allowance has been frozen at £1,073,100. This represents the maximum amount of tax-relievable pension savings which an individual can accrue over his working life. Where a member's total capitalised pension wealth exceeds this figure, he was subject to a special lifetime allowance charge, the rate of which depended on how he withdrew the excess capital. By virtue of S18 F(No2)A 2023, the lifetime allowance charge has been abolished for 2023/24 onwards.

Pension scheme members have always been able to receive a tax-free lump sum when they become entitled to their pension scheme benefits. This is known as a pension commencement lump sum (PCLS). The maximum amount which individuals could claim as a PCLS was 25% of their available lifetime allowance at the time when the sum was taken. With the lifetime allowance standing at £1,073,100, this set a PCLS upper monetary cap of £268,275 (25% x £1,073,100), unless the member held a higher level of protection. This limit on tax-free lump sums continues to apply following the abolition of the lifetime allowance.

Other significant pension changes in F(No2)A 2023, all of which took effect on 6 April 2023, were:

- an increase from £40,000 to £60,000 in the annual allowance, i.e., the maximum amount of tax-deductible pension savings which an individual can make in any one tax year (S20 F(No2)A 2023);

- a rise from £4,000 to £10,000 in the money purchase annual allowance for those individuals who have already flexibly accessed their pension savings (S21 F(No2)A 2023); and

- an uplift from £240,000 to £260,000 for the 'adjusted income' threshold after which the annual allowance starts to be tapered for high-income individuals (with the minimum tapered annual allowance of £4,000 being pushed up to £10,000) (S22 F(No2)A 2023).

Some immediate planning thoughts

If an individual was close to breaching the lifetime allowance prior to 6 April 2023, he might have chosen to opt out of his company pension scheme. Now that the lifetime allowance charge has been abolished, he can rejoin his workplace scheme and receive the benefit of employer contributions. This, along with the increase in the annual allowance, could give him greater funding for his retirement.

Example 1

Edward is aged 58. He is employed at a senior level in his company and receives an annual salary of £210,000 (plus bonuses). He has a pension pot worth £990,000 but has no form of lifetime allowance protection in place.

In March 2021, Edward opted out of his company pension scheme, given that he was getting close to exceeding the lifetime allowance and was therefore facing a lifetime allowance charge. He plans to retire in early 2024.

In view of the removal of the lifetime allowance charge and the increase in the maximum annual allowance, Edward can rejoin his employer's scheme and so, using the carry-forward of his unused annual allowance relief, he can have a total pension contribution of up to £60,000 + £40,000 + £40,000 = £140,000 for 2023/24.

It is now estimated that Edward's pension fund may be worth in the order of £1,200.000 when he retires.

In order to pay off his mortgage, Edward will fully crystallise his pension and then move it into drawdown. His lifetime allowance tax charge is zero, but, if he had completed the same steps in 2022, the excess tax charge could have been as high as £70,000.

When it existed, the lifetime allowance charge was payable by pension scheme administrators out of the individual's pension fund. However, where the pension arrangement was a money purchase scheme, it was only paid when the excess over the £1,073,100 limit was drawn upon. This naturally led many people to keep such excesses in their pension pots so that they did not incur the hefty tax charge. Now that this charge has been abolished, an individual can access the entirety of his pension fund without having to worry about paying a lifetime allowance charge. Accessing this money without being penalised could mean that an individual is able to stop working and retire at an earlier date.

Example 2

Maria is aged 57 and has a money purchase pension scheme valued at £1,600,000. She planned to retire at the age of 60 due to her pension fund being worth more than the lifetime allowance limit.

Prior to 2023/24, Maria's excess of £1,600,000 – £1,073,100 = £526,900, if taken as a lump sum, would have been taxed at 55% when she accessed it. This would have reduced the value of her pension fund by 55% x £526,900 = £289,795, i.e., to £1,310,205.

In 2023/24 without the lifetime charge arising, Maria will keep the full value of her £1,600,000 pot. The additional funds mean that she can retire immediately, enjoying a higher level of pension income than she had previously anticipated.

Draft FB 2024 legislation

On 18 July 2023, HMRC published draft legislation which is due to form part of FB 2024 and which will take effect from 6 April 2024. The purpose of these proposals is to tidy up the remaining tax rules for the abolition of the lifetime allowance. It also clarifies that those members who already qualify for one of the special levels of protection will retain their rights to higher benefits and it should be noted that it is possible for taxpayers to make an application for fixed or individual protection 2016 up until 5 April 2025.

A key part of the changes is that, although the lifetime allowance is going, it is being replaced by a new regime. All tax-free lump sums, including tax-free lump sum death benefits, are instead to be tested against a lifetime limit which will be set at £1,073,100. Any lump sums paid above this level will be taxed at the individual's marginal rate of income tax. Within this overall limit, there is to be a tax-free limit for PCLSs and other lump sums. This limit will be known as the 'lump sum allowance' and will be £268,275 (i.e., 25% x £1,073,100) or any higher protected amount.

One of the uncertainties in this regard is that the Labour Party have confirmed that they will reverse these changes if they win the next general election. However, amendments cannot be made to pension legislation retrospectively. This emphasises the importance, especially for those nearing retirement age, in taking action sooner rather than later.

Contributed by Robert Jamieson

Employer round-up (Lecture B1398 – 20.45 minutes)

Autumn Statement 2023

it has been announced that the Chancellor, Jeremy Hunt, will make this announcement on 22 November 2023

Employers April 2023 Bulletin

This bulletin has a section on "Avoiding duplicate employments". The recommendations when a new employee starts are:

- Avoid the need for any updates to employee's name, date of birth or gender;
- Always provide consistent data e.g., William Brown remains that and does not change to Bill or W Brown;
- Only include start date and starer declaration on first FPS;
- Do not report changes to start date to HMRC.

Similarly, do not change the employee's payroll ID. The employee with more than one job with the employer can have two IDs. Where an employee leaves and is re-employed use a new payroll ID. Also start their year to date payment information again as £0.00

For leavers once the FPS has been submitted do not submit another even if the leavers details have changed. You should submit another FPS to report a correction to pay and deductions or a payment made after leaving. The leave date should be included and remain the same.

February 2023 Employer Bulletin

In this bulletin HMRC reminded employers how to deal with salary advances ahead of normal pay day. Under current rules these advance payments are treated as payments on account of earnings. This means employers must submit additional RTI reports, FPS, to record the advanced payment of salary. HMRC appreciate the extra burden this gives employers, and HMRC.

HMRC will amend secondary legislation so that salary advances can be reported on or before the employee's contractual pay day. This means that each payment of salary need only be reported on an RTI report once. Employers who are currently reporting salary advances on or before pay day may continue to do so until legislation is in place. There will be further information in future additions of the Employer Bulletin.

Advice on tax relief on pension contributions

There are two methods for employer to use to give tax relief on employees' pension contributions:

1. Net pay arrrangement
2. Relief at source

HMRC has found that employers are making errors, possibly due to those names being misunderstood.

Net pay arrangement

Under this method the employer deducts the pension contribution from the employee's gross pay BEFORE deducting PAYE.

As a result, the employee receives full tax relief through the payroll with nothing further to claim under Self Assessment. If the pension contribution is £100 and gross pay is £1,200 the PAYE calculation is based on £1,200 less £100 - £1,100. The employee's gross pay remains £1,200 on the payslip and the £100 pension contribution is then deducted from net pay. NB: NIC is calculated on the £1,200 gross pay.

Relief at source

Under this method the employer deducts an amount from net pay, after having deducted tax and NIC based on gross pay, which is equal to the pension contribution less basic tax relief only. In this case if the gross pay was £1,200 and the pension contribution is £100 an amount of £80 is deducted from net pay. PAYE and NIC are calculated on gross pay of £1,200. The pension provider claims the tax relief, £20 in this case, from HMRC. Where the employee is a higher rate taxpayer, they would have to claim any additional tax relief via Self Assessment.

An employee cannot decide which method they want used. The "relief at source" has been the default for new registered pension schemes since April 20000. However, an employer can elect at the start of a new pension scheme to operate "net pay" as long as the scheme meets certain conditions.

Closing PAYE scheme

When a business stops trading and no longer has any employees it must close the PAYE scheme. This can be done by:

- Selecting the "final submission because scheme ceased" field;
- Completing the "date scheme ceased" filed on the final FPS, full payment submission or EPS, employer payment summary. The date entered MUST be the date scheme ceased and not a date in the future.

HMRC will then check the information and the scheme should be closed automatically. Any estimated monthly charges raised for a pay period after cessation date will be cancelled.

In addition, the employer must:

- Send in forms P11D, expenses and benefits;
- Enter leaving date on each employee's record;
- Give employee P45 on their last day.

Where the PAYE scheme includes "payments to subcontractors" the employer should contact the CIS to notify date they stopped using subcontractors. To cease a "contractor

only" scheme the employer must contact the CIS helpline to notify date they stopped using contractors.

NMW Report - June 2023

In June 2023 the government published the names of 202 employers who were found to have failed to pay some of their workers the national minimum wage. The HMRC investigations took place between 2017 and 2019. The workers, 63,000 of them, were underpaid by nearly £5 million. As a result, those employers faced penalties of almost £7 million. The employers ranged from well-known high street names, WH Smith, Lloyds Pharmacy, Argos, right down to small local businesses.

W. H. Smith, Swindon	owed £1,017,693 to 17607 workers
Lloyds Pharmacy, Coventry	owed £903,207 to 7916 workers
Marks & Spencer, London	owed £578,390 to 5363 workers

The results showed that:

- 39% of employers made deductions pay from workers' wages. Most deductions will reduce a worker's pay for minimum wage purposes. This can include deductions for meals, uniform, equipment as well as many other things;

- 39% of employers failed to pay workers correctly for their working time. For example, time spent waiting at or near the workplace, travelling or training is all working time for minimum wage purposes;

- 21% of employers paid the incorrect apprentice rate. To qualify for the apprentice rate, a worker must be employed under a statutory apprenticeship agreement or a contract of apprenticeship. The minimum wage apprentice rate will apply if the apprentice is under the age of 19 or they are aged 19 or over and in the first year of their apprenticeship.

To support employers, HMRC provide a lot of information and guidance:

- "A checklist for employers" - Common issues which lead to workers being underpaid;

- "calculating the minimum wage" – guidance on calculations;

- "Common issues that can bring workers below the minimum wage".

National Living Wage

£10.42	where aged 23 and over (was 25 and over)

National Minimum Wage

£10.18	for workers aged 21 to 22 (was 24)
£7.49	for a young worker aged 18 to 20 inclusive
£5.28	for workers aged 16 to 17, and > compulsory school age but < 18

£5.28 for apprentices who are either under 19 or over 19 or in the1st year of apprenticeship

Potential for Errors with NMW and NLW

- Failing to implement annual increases brought in from 1 April each year;
- Missing an employee's birthday at 18, 21 or 25 years;
- Paying the apprentice rate but employee not an apprentice under an apprenticeship contract undergoing structured training or continuing to pay apprentice rate for too long;
- Making deductions from pay for items or expenses connected to job - uniforms, tools, safety clothing;
- Making deductions from pay deemed to be for employer's own use or benefit – Christmas savings club;
- Charging more than stated offset rate for accommodation;
- Including top ups that do not count for NMW or NLW – e.g., shift allowances, customer tips or bonuses;
- Treating workers as volunteers, interns or self employed incorrectly;
- Not paying all time worked – travel, sleeping, opening or shutting up shop or training.

Update on advisory fuel rate from 1 September 2023

Where employee is provided with a company car and pays for fuel personally they can claim for business travel undertaken in that car. HMRC publish advisory fuel rates, each quarter, to be used by employers when they either:

- Reimburse employees for business travel in their company car
- Need employees to repay the cost of fuel used for private travel in company car

Where the correct advisory rate is used based on engine size and fuel type there is no taxable profit and no Class IA NIC due. But if an employer pays over and above these rates and is unable to prove that fuel costs are actually higher no "fuel benefit" results where the mileage payments are made only for business travel. Instead the excess will be treated as a taxable earnings for PAYE tax and Class 1 NIC to be processed through the payroll. There is no entry on the P11D form.

Employers can use lower rates if their vehicles are fuel efficient or, with HMRC approval, higher rates if they can justify the figure, e.g. an employee using a 4X4 to cover rough terrain. Where employers reimburse employees at a lower rate the employee is not entitled to use these rates to claim a deduction under self assessment.

Such a calculation should be based on the actual costs incurred.

From 1 September 2023

	Petrol	LPG	Diesel
Engine Size:			
1,400cc or less	13p	10p	
1,401 to 2,000	16p	12p	
Over 2,000	25p	19p	
1,600cc or less			12p
1,601 to 2,000			14p
Over 2,000			19p

From 1 June 2023 – 31 August 2023

1,400cc or less	13p	10p	
1,401 to 2,000	15p	12p	
Over 2,000	23p	18p	
1,600cc or less			12p
1,601 to 2,000			14p
Over 2,000			18p

Hybrid cars are treated as either petrol or diesel for advisory fuel rates.

Electric cars

From 1 September 2023 the advisory rate for a fully electric car is 10p per mile, previously 9p from 1 March 2023.

Reminder of payment due for PAYE Settlement Agreement (PSA)

A PSA is available to all employers, regardless of size. It is a flexible arrangement under which an employer can settle with one payment the income tax and NIC liability on three types of expenses and benefits in kind – minor, irregular or where it is impracticable to operate PAYE. They are not intended to be an alternative to operating PAYE in the usual way and cannot be applied to the cash payment of wages and salaries. Neither can a PSA cover major benefits such as cars and fuel provided to an individual employee, round sum allowances, loans, mileage payments or shares.

When a PSA has been agreed with HMRC:

- no entries are required on form P11D for the items covered by PSA
- no entry is required in the payroll where item dealt with by the PSA

Instead, the employer has to pay HMRC the tax due on the PSA benefits plus employer's Class 1B NIC on the grossed up value of the benefits in the PSA.

The completed PSA calculation must be filed with HMRC by 31 July following the end of the tax year. HMRC will agree and confirm the tax and NIC liability between 6th July and 19th October and payment is due no later than 19th October, or 22nd if paid electronically.

When calculating the tax due on the benefits under a PSA employers have to ascertain the value of the expense or benefit provided including VAT, the number of employees receiving the expense or benefit and the marginal rates of tax to be used. Where some employees are basic rate taxpayers and others pay 40% or 45% the benefit must be grossed up separately for each group of employees. Scottish tax rates should be used for Scottish taxpayers.

Class 1B employer's NIC - for 2022/23 tax year ONLY this is payable, at 14.53% (reverting to 13.8% from 6/4/23) on the value of the items including VAT, which would have given rise to a Class 1 payroll NIC or Class 1A NIC liability. The value is based on the gross cost – so actual cost grossed up for tax.

Example

An employer provides its 75 employees with a benefit value of £200 each, 10 employees pay tax at 20%, 45 at 40% and 20 at 45%.

The tax and Class 1B NIC payable under a PSA would be calculated as:

Value of benefits to employees:

Those paying 20% = 10 x £200	£2,000 (A)
Those paying 40% = 45 x £200	£9,000 (B)
Those paying 45% = 20 x £200	£4,000 (C)
Total of benefit provided	£15,000 (D)

Gross up and calculate the tax:

Tax on (A) £2,000 @ 20%	£500.00
Tax on (B) £9,000 @ 40%	£6,000.00
Tax on (C) £4,000 @ 45%	£3,272.73
Total tax payable	£9,772.73 (E)

Class 1B NIC payable	(14.53% of £24,772.73(D + E))	£3,599.48
Total due to HMRC	(9,772.73 + 3,599.73)	**£13,372.21**

Contributed by Alexandra Durrant

Capital taxes

CGT law knowledge lacking (Lecture P1396 – 21.04 minutes)

Summary –Payments made to redeem a mortgage and under a personal guarantee were not deductible for CGT and no Entrepreneurs' Relief was available.

In January 2017, John and Janet Beesley submitted their Self Assessment tax returns for 2015/16 but these did not include any information relating to CGT disposals.

Based on Valuation Office information, HMRC believed that the couple had sold a property in October 2015 and issued an Information Notice requiring the full information to be lodged by 22 July 2018.

The couple's agent replied promptly stating that the property had been "sold for the sole purpose of repaying a personal guarantee" and that he was chasing up the documents needed with solicitors.

On 10 August 2018, HMRC requested a CGT computation for the disposal and allowed an additional 30 days to provide the information from the solicitors.

On 3 October 2018, the agent sent HMRC a CGT computation showing a sale price of £395,037 and deductions of:

- a "Redeem Mortgage" figure of £186,345;
- a "Personal Guarantee" of £152,016;
- legal fees and agent's commission.

For each taxpayer, the net gain was stated to be £17,779.50, with CGT payable calculated at 10% as entrepreneurs' relief was claimed.

HMRC disallowed the deductions for both the mortgage redemption and the personal guarantee.

Although HMRC suggested that relief for loans to traders might be available for the guarantee, this was not supported by suitable evidence.

HMRC produced an amended CGT computation showing two gains of £134,945, assessments were raised and penalties charged.

After much correspondence between the parties lasting approximately one year, the Beesleys appealed.

Decision

The First Tier Tribunal stated that it was clear that 'the agent has never understood the basic principles of capital gains tax'. S.38 TCGA 1992 is clear and provides that the only deductions from proceeds of a sale are the purchase price together with incidental costs of purchase, the incidental costs of sale and the amount of any expenditure wholly and exclusively

incurred on enhancing the property. Consequently, HMRC was correct to disallow the mortgage redemption fee.

With no evidence supplied to support a claim that personal guarantee payment was a qualifying loan for relief for loans to traders, this deduction was also disallowed.

The Tribunal agreed that the agent had offered 'absolutely no evidence' to support a claim for entrepreneurs' relief.

Having confirmed that HMRC's computations and assessments were correct, the Tribunal moved on to consider the penalties. The Tribunal found that the taxpayers' behaviour was careless and there was no reasonable excuse as they:

- had never cooperated with HMRC;
- should have been aware of the gain and questioned the need to report it for tax purposes.

The appeal was dismissed.

John and Janet Beesley v HMRC (TC08871)

Share exchange scheme (Lecture P1396 – 21.04 minutes)

Summary – The main purpose of the share arrangement was to realise the value in the family business; it did not form part of a scheme or arrangement of which the main purpose, or one of the main purposes, was the avoidance of a liability to CGT. As a result, the share for share rules contained within s.135 TCGA 1992 applied.

Mr and Mrs Wilkinson owned about 58% of the ordinary shares in P Ltd.

A few days prior to the shares for share deal detailed below, Mr and Mrs Wilkinson transferred a significant number of ordinary shares in P Ltd to their daughters. The daughters were also appointed non-executive (and unpaid) directors of a company that was a 100% subsidiary of P Ltd.

A deal was then carried out under which P Ltd was be acquired by the BCA group through an acquisition vehicle, TF1 Ltd, for a consideration of £130million (the transaction).

On completion of the transaction:

- the shareholders (other than the daughters) received cash and loan notes;
- the daughters received a different class of loan notes and B ordinary shares in TF1 Ltd but no cash consideration.

These arrangements were designed so that s.135 TCGA 1992 applied so the daughters would:

- not suffer an immediate CGT charge on the gain arising from the sale of their shares in P Ltd;

- be eligible for entrepreneurs' relief when they redeemed their loan notes and sold their B shares a year later.

This had the effect of reducing the CGT rate payable by the daughters from 20% to 10%.

HMRC raised discovery assessments denying relief under s.135 TCGA on the basis that the exchange formed part of a scheme or arrangements of which the main purpose, or one of the main purposes, was the avoidance of a CGT liability by the Wilkinson family (s.137 TCGA 1992)

The couple appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal considered two questions:

1. Was the exchange part of a scheme or arrangement?

   It held that the only scheme or arrangement of which the exchange was a part was the deal to sell P Ltd to TF1 Ltd for a total consideration of £130million. It rejected HMRC's view that the exchange also formed part of another scheme or arrangement, namely the Wilkinsons' CGT planning. This was because, on a realistic view:

   (i) the CGT planning was not a self-standing scheme or arrangement in its own right, and

   (ii) even if the CGT planning could be said to be a self-standing arrangement, the exchange did not form part of it as the exchange was a much larger endeavour, involving more parties, than the CGT planning.

2. Was the avoidance of a liability to CGT a main purpose, or one of the main purposes of the transaction?

   The First Tier Tribunal found that enabling the Wilkinsons' CGT planning was a purpose of the transaction but not a 'main purpose'. It was a purpose because the deal contained several features that would not otherwise have been present, such as granting the daughters B shares and directorships. It was not the main purpose, or one of the main purposes, of the transaction because the 'pre-eminent' main purpose was that of selling the company. The minority bloc of shareholders, who held 42% of P Ltd's shares, had no stake in the Wilkinsons' CGT planning. Even for the Wilkinsons, as the majority shareholders, viewed in isolation, the value of the CGT planning (circa £3m) was only 4% of their proceeds.

Olivia Wilkinson and others v HMRC (TC08887)

Adapted from the case summary in Tax Journal (8 September)

Disapplication election on takeover (Lecture P1398 – 18.33 minutes)

An agreement for a corporate takeover may include the right to receive future consideration which is unascertainable at the time of the contract, often because it depends on the acquired company's performance over the next year or so.

Such a right was held by the House of Lords in Marren v Ingles (1980) to be a separate asset under what is now S22(1) TCGA 1992. It is typically referred to as an 'earn-out right'. However, where the earn-out right is a right to receive shares or debentures in the acquiring company, this right is treated as a security so that the paper-for-paper exchange legislation in S135 TCGA 1992 can apply. The subsequent issue by the acquiring company of, say, loan notes in these circumstances is regarded as a conversion of securities so that no tax charge arises. A charge will only occur when the relevant securities are disposed of, i.e., when the loan notes are cashed in. These rules are set out in S138A TCGA 1992.

This treatment is mandatory, subject only to the taxpayer's option to disapply it by making an election under S138A(2A) TCGA 1992.

Example 1

Robin sold his 100% interest in Linda Logistics Ltd (an unquoted trading company) to a plc for £480,000 on 1 July 2022. He had acquired these shares following his mother's death in November 2007 when they were worth £60,000. Robin is a higher rate taxpayer and has been the company's managing director since before his mother's death.

Under the terms of the transaction, Robin received his initial payment in cash, but he was also entitled to further consideration depending on Linda Logistics Ltd's profit performance over the year to 30 June 2023. This further consideration was to be satisfied by an issue of loan notes in the plc. Robin's right to receive this future consideration was professionally valued at £420,000 on 1 July 2022.

On 1 December 2023, Robin received loan notes worth £640,000 which he encashed six months later on 1 June 2024.

Because the terms of the deal satisfy the requirements of S138A TCGA 1992, Robin's CGT position is calculated as follows:

2022/23

			£
Sale proceeds			480,000
Less: Cost			
	$\frac{480,000}{480,000 + 420,000}$	x 60,000	32,000
			448,000
Less: Annual exemption			12,300
			£435,700
CGT @ 10%			£43,570

2024/25

	£

Earn-out proceeds	640,000
Less: Cost (60,000 – 32,000)	28,000
	612,000
Less: Annual exemption	3,000
	£609,000
CGT @ 20%	£121,800

Robin's aggregate CGT liability for this transaction amounts to £165,370 (43,570 + 121,800). The gain on the earn-out proceeds does not attract business asset disposal relief.

However, if Robin's earn-out deal with the plc had been structured in cash so that the final payment was made on 1 June 2024, the tax calculation changes significantly. It now derives from the ruling in Marren v Ingles (1980):

2022/23

	£
Sale proceeds (480,000 + 420,000)	900,000
Less: Cost	60,000
	840,000
Less: Annual exemption	12,300
	£827,700
CGT @ 10%	£82,770

2024/25

	£
Earn-out proceeds	640,000
Less: Cost	420,000
	220,000
Less: Annual exemption	3,000
	£217,000
CGT @ 20%	£43,400

Robin's aggregate CGT liability is now only £82,770 + £43,400 = £126,170, a saving of £39,200.

This would have been Robin's preferred structure, but, because the deal was framed under S138A TCGA 1992, that provision takes precedence.

However, if Robin makes an irrevocable election under S138A(2A) TCGA 1992 by the first anniversary of 31 January following the tax year in which the sale transaction took place (i.e. by 31 January 2025), S138A TCGA 1992 treatment does not apply and the calculation proceeds on the basis of the decision in Marren v Ingles (1980). This is clearly what Robin should do.

Contributed by Robert Jamieson

Diversification of farmland (Lecture B1397 – 12.48 minutes)

With challenges like reducing subsidies and rising costs, farmers in many parts of the UK are increasingly looking at other potential sources of revenue beyond the traditional income from their farm.

Environmental and ecological diversification of agricultural land is one option, but it should be borne in mind that a move away from mainstream farming may well be at the cost of the landowner's IHT reliefs.

Farmland usually qualifies for 100% agricultural relief, saving a 40% IHT charge on, e.g., death. This enables the business to be passed onto younger members of the family and to continue operating without part of it having to be sold or to be burdened with debt to pay a tax bill.

Depending on the type of diversification being considered, there are knock-on impacts which need to be considered. For example, if the farmer diversifies into renewables, the land may no longer attract agricultural relief, unless this becomes an integral part of the agricultural business such as providing power for the principal farming activities. Of course, the farmland may still qualify for business relief, but it would not do so where the land is leased to someone else so that they can build wind turbines.

A joint venture could be the appropriate solution in these circumstances.

With woodlands, agricultural relief is only available if they are an integral part of the farm such as shelter belts, game coverts or coppices grown for fencing materials on the farm. The relief is lost if the farmer goes into commercial forestry and grows timber to sell, given that this counts as a non-agricultural activity. On the other hand, business relief may apply.

As far as the farmhouse is concerned, agricultural relief is available, but only if that property is at the centre of the farming business and is appropriate in size and nature to the relevant operations. Moving the running of the business to an office in an outbuilding might make sense from a practical perspective but be warned that relief on the farmhouse will be lost.

Where the farmhouse remains the hub of the farming business, there is still a risk of losing agricultural relief on the property if the farmer has diversified his business to the extent that most of the activities carried out are essentially non-agricultural. In such situations, farmers are generally advised that separate business vehicles will be the right option: one for the farm and the house and one for the other business activities. This is subject to the proviso that the farmhouse is not then out of proportion to the agricultural operations. As one well-known commentator has pointed out:

'By recognising the risks, the entitlement to relief can . . . be managed by the landowner so that the relief is fully preserved and not lost altogether on the whole business – or at worst (the projects are structured) so that the main business continues to qualify, even if the environmental projects cannot.'

Of course, if contractors or other personnel are brought in to help with the running of the farm, agricultural relief may be lost on the farmhouse unless the owner is still the farmer

and decision-maker. It will be important to be able to provide evidence of this. Even if relief is not available on the farmhouse, the owner would still expect his land to qualify.

If a farmer does miss out on agricultural relief as a result of diversifying away from farming into other activities, business relief – as has already been mentioned – can be helpful.

However, relief for relevant business property is not available where the business is wholly or mainly an investment in land. This means that, if the diversification tips the balance from mainly farming to mainly letting (such as holiday or residential lets or letting land out to others), business relief will not be available and the farmer will not benefit from any IHT reliefs.

Diversification can cause farmers to lose relief for their original activities, but there are ways to mitigate this. One approach is that the diversified elements of the business (which attract no IHT reliefs) can be structured separately in order to protect the core relieved activities.

All the elements of a farming business need to be examined before diversification happens. Commercial opportunities should be uppermost in the farmer's mind, but IHT is always going to be an important factor. Careful planning and structuring can go a long way to protecting the availability of key IHT reliefs.

Contributed by Robert Jamieson

Inheritance Tax Planning pitfalls **(Lecture P1399 – 18.26 minutes)**

Although inheritance tax (IHT) is only responsible for about £7bn of Government revenues out of nearly £800bn, there is a disproportionate amount of attention on planning in this area. The questions that need to be asked from the beginning are whether significant IHT planning is appropriate for the client.

On too many occasions, planning is entered into that is not appropriate and is not in the long-term interests of the client.

The arguments for IHT planning centre around the very large IHT liability at 40% which is a high figure by comparison with similar inheritance taxes across the world. However too often the planning goes wrong—sometimes disastrously.

A crucial element about IHT is that one only knows whether the planning is effective when the person has died. Normally IHT is levied on the death of an individual and therefore it is the laws at the time of the death that are relevant. As most people don't know when they are going to die, this is acutely relevant. I once had a client who was in the process of being talked into an IHT scheme by a promoter. He then asked me whether one could guarantee that it worked, and I said that no one could guarantee whether an IHT scheme would work as one cannot guarantee what the law will be when you pass on. The client did not do the scheme.

IHT planning is quite often a long-term exercise, and one needs to take account of the fact that governments not only change but so can legislation. For example, home loan schemes were popular a couple of decades ago; so much so that the government introduced the pre-owned assets tax regime which created an income tax charge on the benefit in kind value of the asset. What looked like a very neat way of side stepping the gift with reservation of benefit rules became a bureaucratic nightmare and costly in tax too, unless you opted back

into the gift with reservation regime. The old saying of 'if it looks to good to be true it probably is' was certainly valid on this occasion. A recently decided case The Executors of Mrs Leslie Vivienne Elborne and others (TC08863), shows the perils of pre-owned asset tax planning.

The problem with giving assets away is not only that you no longer have use of them but also the potential capital gains tax charge on the disposal of the asset which increasingly comes into play as the annual exemption was reduced to £6,000 for 2023/24 and £3,000 for 2024/25.

For most taxpayers, their largest asset is their property that they live in and that is less susceptible to IHT planning as they need somewhere to live and there are specific rules, such as the gift with reservation of benefit and pre-owned asset tax that prevents these assets falling out of the estate for IHT purposes.

Probably the worst form of IHT planning is almost anything to do with one's private residence. It is natural to think whether one can avoid IHT when passing over or bequeathing the private residence. However, a lifetime gift appears not to be a particularly wise choice. The restrictions on the subsequent use of the property by the donor should not be underestimated and are invasive of one's privacy, to put it mildly. Lease carving is also unlikely to be effective, particularly if the taxpayer wishes to retain a significant interest in the property. The decisions in Lady Ingram's Executors V CIR and Viscount Hood (executor of Diana, Lady Hood deceased) v HMRC CA (2018) reenforce the point.

I came across a question posed in a forum for a Sunday newspaper where a father was writing that his daughter was pestering him to gift the property to her and she would 'sort out' the rental requirement for it to be out of his estate. He would need to pay market rent to her in order to avoid the gift with reservation clause. Quite apart from the seeming unfairness of someone who is paying rent on what was their own property and the dangers in giving assets to a relative who is pestering you, the rent would represent taxable income to the daughter and so all that is being achieved is paying income tax in stages instead of IHT.

The other challenge is that people often underestimate the amount that they will need for a comfortable existence after retirement, particularly as they cannot know how much healthcare support they will need in their later years.

The curious element about IHT is that the richer one is, the more opportunities one has to avoid IHT. Take the simple example of giving money away and surviving 7 years. That is only a realistic possibility if one does not need that money.

Similarly, gifts into trusts are irrevocable and the individual needs to be assured they can live a lifestyle that they wish without the funds that disappear from the estate.

The recent case quoted in the Tolleys July update is worth repeating. Mr and Mrs Bhaur were partners in a property partnership that owned 35 properties. Looking to substantially reduce any inheritance tax payable, the couple entered into a scheme under which the business was transferred to an employee benefit trust, which excluded Mr and Mrs Bhaur but benefited younger family members, including their son.

After it became apparent that the scheme was ineffective, the couple applied to the High Court for the last of these transactions to be set aside on the grounds of mistake. The High

Court dismissed the claim, holding that there had not been a mistake (i.e., relating to a past or present matter) but instead a misprediction (relating to a possible future event); the couple had miscalculated the consequences to them if the scheme went wrong. The Court of Appeal upheld the verdict of the High Court.

You also need to consider the challenges of the family. HMRC seems to take the view that the whole family will cooperate to deprive them of their “rightful taxes”. In practice family dynamics are generally quite different and therefore again IHT planning becomes more difficult and hazardous. What happens if family relationships break down? What happens when individuals emigrate? How does one ensure that the funds go to descendants who actually need them given that they will have different income and capital assets and requirements? What happens if a trustee disappears or becomes difficult?

Let's not forget Sir Charles Clore who spent years being miserable in Monaco but still died domiciled in the UK. This still does not seem to deter taxpayers or their executors trying to prove a near deathbed change in their domicile as in the case Ameet Shah (as Executor of the Estate of Anantra Maneklal Shah Deceased v HMRC (TC08842), The taxpayer rarely succeeds.

In conclusion, I take a very cautious view on IHT planning. If one is going to give assets away, one should rule out ever having a benefit from them in the future. This would normally exclude any gift of the main residence. If any planning is proposed, then holding assets which retain IHT advantages such as farmland, woodlands or a portfolio of AIM shares would appear to be the most sensible strategy as one does not lose permanent control of them. Again, this is advice which only the wealthy can follow; but that is probably why IHT falls disproportionately on middle income households.

Contributed by Jeremy Mindell

Septic tank part of the garden **(Lecture P1396 – 21.04 minutes)**

Summary – A septic tank on part of the grounds serving a number of adjacent properties was part of living in the country and formed part of the garden and grounds of the property.

In September 2015, Andrew and Della Bloom bought a property for £4,400,000 comprising two registered titles:

- A house, cottage, swimming pool, garage, stables and equestrian facilities;
- 5,6 acres of land with a sewage treatment plant serving the property and ten neighbouring flats as well as a tennis court built by the taxpayers was at least partly on the land.

The only visible parts of the plant were manhole covers, and two small structures containing the electrical controls and for storage. The tennis court had been built close to the manhole covers.

Andrew and Della Bloom initially paid SDLT on the basis that the whole property was residential, but later claimed overpayment relief arguing that, due to the presence of the sewage treatment plant, it was in fact mixed-use.

HMRC disallowed the claim and the couple appealed.

Decision

The First Tier Tribunal found in HMRC's favour finding that the majority of the tennis court was sited on the land and stated:

> "Given the 5.6 acres available in which this tennis court could have been erected it did not seem credible that it had been placed so near to a septic tank if it "constantly" emitted a repugnant smell."

Further, the Tribunal found that:

- the septic tank was a mandatory requirement due to the lack of mains sewerage, not uncommon in the country;

- a well-managed and serviced septic tank should not 'constantly' emit smells and noted that this one was serviced four times a year.

- the agreement with the neighbours provided for the split of maintenance costs of the septic tank on a fair basis with no profits made. It represented a restrictive covenant and not a commercial agreement.

The appeal was dismissed.

Andrew Jonathan and Della Ann Bloom v HMRC (TC08866)

Marital home not main residence (Lecture P1396 – 21.04 minutes)

Summary – Despite his separated wife and children continuing to live in the marital home, Additional Dwelling Supplement (ADS) was not refundable when he transferred that home to his wife, having bought a new home as it was more than 18 months between leaving the home and buying his new one.

In 2008, Alexander Duran bought a home in Edinburgh jointly with his now ex-wife.

On separation in 2015, he moved out permanently from the property and moved into temporary accommodation until in August 2019, he bought a new property and paid the ADS of £12,348 that fell due. He transferred his interest in the jointly owned property to his ex-wife and later submitted a claim for the repayment of the ADS previously paid.

Revenue Scotland denied the repayment as he had moved out of the marital home more than 18 months before buying the new property.

Alexander Duran appealed, arguing that although personal circumstances prevented him from living in the marital home, with no other permanent accommodation, it remained his main residence until purchase of the second in 2019.

Decision

The First Tier Tribunal for Scotland was sympathetic to his position but decided in Revenue Scotland's favour.

The Tribunal stated that it could only enforce powers given to it expressly by statute. This provided that to be eligible for a refund, the taxpayer must:

- within the period of 18 months beginning with the day after the effective date of the transaction (new property purchase), the buyer disposes of the ownership of a dwelling (the marital home); and

- the property disposed of was the buyer's only or main residence that he had occupied at some point during that 18-month period as his only or main residence.

Alexander Duran did not live in the marital home at any time in the 18-month period ending with the effective date of the transaction to buy his second property. The Tribunal stated that it was "difficult to envisage a scenario in which a property could be viewed as a main residence if, as a matter of fact, no time had been spent there in the relevant period".

The appeal was dismissed.

Mr Alexander Joseph Duran v Revenue Scotland [2023] FTSTC 2

Administration

Two -part test for carelessness

Summary – Although the implementation of an employee benefit trust scheme was careless, this did not result in a loss of tax, meaning that HMRC's PAYE determinations were issued out of time and the company was not liable for penalties.

Magic Carpets (Commercial) Limited provided carpets and flooring services based in Salisbury. Mr and Mrs Holt were the company's directors.

The company had entered into a tax avoidance scheme whereby contributions were made to an employee benefit trust and loans were made to the company's directors.

HMRC issued determinations for unpaid PAYE income tax for 2009/10 and 2010/11 as well as a related penalty assessment. HMRC had issued its determinations for additional PAYE outside of the normal four-year window but within the six-year timeframe allowed where a loss of tax is brought about carelessly.

The company accepted that the scheme did not give rise to the intended tax savings but appealed, with the issues to decide being whether:

- the determinations were made in time because the company and/or a person acting on its behalf carelessly brought about the inaccuracies in its P35 returns for the tax years 2009/10 and 2010/11;

- the company was liable to the penalty on the grounds that there was an inaccuracy in its PAYE return which was brought about carelessly.

The company accepted that if the Tribunal found that determinations were made in time and upheld the penalty, the amount of the determinations and penalty were not disputed.

Decision

The First Tier Tribunal found that the test for carelessness was a two-stage test (*Bayliss v HMRC)*:

1. the company must fail to take reasonable care, by reference to a prudent and reasonable person in the taxpayer's position; and

2. there must be a causal link between failing to take reasonable case and the loss of tax or inaccuracy in a tax return.

The First Tier Tribunal found that the company had been careless as it:

- made no attempt to understand the steps in the scheme beyond a vague understanding that it involved an EBT;

- did not understand the documents that the company was entering into or that the documents were properly executed.

A prudent and reasonable person would have sought further information about the scheme from their own, or another adviser.

However, on the second stage, HMRC had not shown a causal link between the company's carelessness and the P35 tax loss. Even if the company had sought independent advice, at the time an adviser would have been likely conclude that the scheme achieved its aims.

Magic Carpets (Commercial) Limited v HMRC (TC08892)

Always check returns

Summary - An employee had not taken reasonable care when he failed to check the expenses claimed by his agent when submitting his tax returns.

Sunil Joseph worked as a social worker for some 13 years, initially providing out-of-hour assistance to people with autism or similar needs and from 2013/14, with Alcohol Services for a single employer, Croydon Social Services. As an employee, income tax and NIC was deducted under PAYE at source.

Through his trade union he learned about his 'entitlement' to expense claims. He approached an agent who claimed to have previously worked for HMRC. Sunil Joseph did not check his credentials.

The agent submitted Self Assessment returns on Sunil Joseph's behalf on the basis that he was self-employed for 2013/14 to 2016/17. Travel and subsistence expenses claimed created losses resulting in nearly £23,000 of tax repayments.

Later, HMRC raised discovery assessments to recover the repayments and charged inaccuracy penalties totalling £3,412.56, on the basis of carelessness with prompted disclosure and allowing the maximum possible penalty reduction.

Sunil Joseph accepted the discovery assessments which were being settled by way of a payment plan but appealed the penalties.

Decision

The First Tier Tribunal found that Sunil Joseph had been careless as he had not taken reasonable care.

He had not checked his adviser's credentials nor what had been submitted in his tax returns. Annual expenses claimed of around £27,500 were for unsupported claims. This was not expert knowledge.

His appeal was dismissed.

Sunil Joseph v HMRC (TC08895)

Concluding an HMRC enquiry (Lecture P1400 – 15.12 minutes)

This article will consider the various ways in which an HMRC enquiry into a taxpayer's tax return (whether under Self Assessment or Corporation Tax Self Assessment) can be brought to a conclusion. The article will also consider associated matters that may need to be dealt with when concluding an enquiry with HMRC.

Closure notice issued by HMRC

At the end of an enquiry into a tax return, HMRC may issue a formal notice, called a 'closure notice'. The notice will either state that no amendments are required to the return that was being enquired into, or it will state the amendments that HMRC believe are required to that return. The closure notice is usually issued after the position regarding the revised profits, etc have been agreed with the agent. HMRC will also issue any assessments, or other formal notices, that are required.

If agreement cannot be reached with the agent, HMRC may issue a closure notice in the figures which the officer considers to be correct, against which the taxpayer has the right of appeal. In those circumstances, the client can seek a statutory review of the decision or seek to resolve the matter through mediation (Alternative Dispute Resolution) or at the tribunal.

Closure notice application by client

The law permits taxpayers to make a closure application to the First-tier tribunal. This might be appropriate when an inspector continues to request information, or documents, beyond the point that the agent considers reasonable, or where all information requested by the inspector has been provided, but they are taking an unreasonable length of time to review it, and to reach a conclusion.

The tribunal is asked for a direction requiring the officer to issue a closure notice. Under the process, the onus is on HMRC to explain to the tribunal why the enquiry should be allowed to continue. However, it is important to be able to demonstrate to the tribunal that your client has co-operated with the HMRC enquiry, providing information that is reasonably required, and responding without unreasonable delay. If the tribunal agree to the application, they will direct that the closure notice is issued within a defined period of time.

It would be prudent to discuss the position with the enquiry officer to establish why they have not been able to close the enquiry, before making an application. The agent should also discuss the position with their client. The issue of a closure notice will not, necessarily, conclude the enquiry. The issue of a closure notice will, however, allow the client to bring an appeal against that notice, to allow the substantive issues to be brought before the tribunal, if necessary. There is a risk that if a closure notice is sought prematurely, and HMRC subsequently establish a significant tax irregularity, your client may be exposed to higher penalties than would otherwise be the case.

Contract settlement

Where a closure notice is not issued, your client may be invited to conclude the enquiry by a contract settlement. This method can be used where there is a tax liability and penalties arising and avoids the issuing of formal assessments and determinations.

The process involves the exchange of formal letters between your client and HMRC, which creates a binding contract. The client submits a letter of offer to HMRC, and HMRC responds with a letter of acceptance, assuming that the terms of the offer are acceptable. The content of the letter of offer is agreed with the inspector, and will cover the amount of the additional liabilities, interest and penalties, as well as other aspects, including the agreed instalment arrangements. The amount of any offer is for the client to decide, but the inspector will indicate an amount that will be acceptable to HMRC in the circumstances of the case.

A standard form is used for the letter of offer, which confirms that the statutory process will not be followed by HMRC, in exchange for your client making a monetary offer to HMRC, to cover the tax, interest and penalties due, which is payable within an agreed period.

An advantage of a contract settlement over the formal assessing route, is that it is possible to agree the repayment terms with the enquiry officer, rather than having to discuss those arrangements with a different part of HMRC.

The contract settlement will provide finality in most cases. HMRC may, however, seek to reopen a settlement where they establish that the taxpayer has provided incorrect information.

Advisers should note that a contract settlement cannot be used for VAT, or VAT penalties. Any such liabilities will be recovered by formal means.

Settlement deed

A Deed is an unusual method of concluding an SA or CTSA enquiry and will only be applicable in a limited number of circumstances, including when there is uncertainty about whether the consideration is adequate to form a binding contract. Further, the drafting of a Deed is a 'reserved legal activity' under the Legal Services Act 2007, meaning that the work must be undertaken by a qualified lawyer who is regulated by an approved regulator.

Accountancy expenses arising out of an enquiry

The costs of dealing with an enquiry can be significant, and a burden for clients, unless they have insurance which covers those costs.

HMRC will not allow the additional accountancy expenses arising out of an SA or CTSA enquiry into the accounts information in a particular year's return where there are discrepancies and additional liabilities for the year of enquiry, or any earlier year, which arise as a result of:

- Careless or deliberate behaviour (for periods beginning on or after 1 April 2008 where the filing date is on or after 1 April 2009), or

- Negligent or fraudulent conduct (for earlier periods).

The additional accountancy expenses will, however, be allowable, in certain, limited, circumstances. HMRC will allow the costs where the enquiry results in no additional to profits, or an adjustment to the profits for the year of enquiry only, and that adjustment does not arise as a result of careless or deliberate behaviour (or negligent or fraudulent conduct, for the historical periods noted above).

With a continuing business, normal practice is to allow the accountancy expenses as a deduction in computing the profits of the accounting period in which they were incurred. With a business which has ceased, the additional expenses can be allowed in the final accounts up to cessation.

The above position is confirmed in HMRC's Enquiry Manual (at EM3981).

Other considerations

When dealing with the conclusion of an enquiry, there are other aspects that the agent may need to consider, in addition to the method of closing the enquiry. These include the following:

- Consider using the Alternative Dispute Resolution process, or request a review by a senior officer, where agreement cannot be reached with the inspector, before the issue of a closure notice;

- Payments on account – consider the appropriate allocation of payments on account made to HMRC by the client during the enquiry process;

- Whether any non-financial sanctions (including, for example, the publishing of deliberate defaulters' details) may apply;

- The imposition of suspended penalties, and making sure that your client knows what he needs to do to meet the relevant terms;

- Settlement meeting – HMRC may request a meeting with the client to deal with the settlement formalities. The inspector cannot insist on such a meeting, and my view is that, unless there are exceptional circumstances, your client should not attend;

- Formal certificates – the inspector may request various formal certificates or statements (including a statement of assets and liabilities) as part of the settlement process. Any such requests should be carefully considered, and, where these documents are provided, it is important to remind that the client that the submission of a false statement or certificate can result in a criminal investigation;

- Voluntary restitution – this is where HMRC seek recovery of tax that they do not have a legal ability to assess.

In view of the complexities that can be involved, agents may want to seek a second opinion when concluding a case with HMRC. This may include whether it is appropriate to seek a closure notice from the tribunal, or where a client is considering making voluntary restitution.

Contributed by Phil Berwick

Deadlines

1 October 2023

- Corporation tax for periods to 31 December 2022 (SMEs not paying in instalments

5 October 2023

- Notify HMRC of IT or CGT liabilities for 2022/23 if no tax return or notice received.

7 October 2023

- VAT return and payment for 31 August 2023 quarter (electronic)

14 October 2023

- Form CT61 and tax paid for quarter ended 30 September 2023
- Quarterly corporation tax instalment for large companies depending on year end
- Monthly EC sales list (paper return) – businesses selling goods in Northern Ireland

19 October 2023

- Pay PAYE/CIS liabilities for month ended 5 October 2023 (cheque)
- File monthly CIS return
- PAYE settlement agreement (PSA) tax/class 1B National Insurance (cheque)
- PAYE for quarter to 5 October 2023 if average monthly liability < £1,500 (cheque)

22 October 2023

- PAYE/CIS payments if paid online
- Electronic PAYE for quarter to 5 October 2023 if average monthly liability < £1,500
- Electronic payment of PSA liabilities

31 October 2023

- Submit 2022/23 paper self-assessment tax returns
- Individuals with PAYE income must have requested a return for 2019/20
- accounts to Companies House
  - private companies with a 31 January 2023 year end
  - public limited companies with a 30 April 2023 year end
- corporation tax self-assessment submitted for periods ended 31 October 2022

News

Autumn Statement

The Chancellor of the Exchequer has announced that he will present the Autumn Statement 2023 to Parliament on 22 November 2023.

The Office for Budget Responsibility has been commissioned to prepare an economic and fiscal forecast to be presented to Parliament alongside his Autumn Statement.

https://www.gov.uk/government/news/autumn-statement-2023-date-confirmed

Online tool for tax codes

HMRC has published an online tool for taxpayers to use to help them understand their tax code.

Having input their income and tax code, the tool informs them how much income tax is deducted at source every week, 4 weeks, month, and year, and what the prefix means.

https://www.gov.uk/guidance/check-what-your-tax-code-means

Business Taxation

ULEZ fees (Lecture B1396 – 17.53 minutes)

The charge

The ultra-low emission zone (ULEZ) was expanded to all London boroughs on 29 August 2023. From this date, drivers of vehicles that do not meet the emissions standards must pay a daily charge of £12.50 when driving within this area.

HMRC has confirmed that sole traders and self-employed taxpayers are entitled to claim tax relief on low emission zone charges, including London's ULEZ fee, as long as they have been incurred 'wholly and exclusively for the purposes of the trade'.

Scrappage scheme

London residents with a vehicle that does not meet the ULEZ standards can apply for up to £2,000 for scrapping a car or up to £1,000 for scrapping a motorcycle.

For wheelchair accessible vehicles there is a payment of £10,000 to scrap or £6,000 to retrofit to the ULEZ standards.

The ULEZ van and minibuses scrappage scheme is open to small businesses (under 50 employees), micro businesses (with up to ten employees), sole traders and registered charities. The organisation must operate within the 32 boroughs of London or the City of London. The grant to scrap or retrofit a non-compliant van is £7,000 (£9,000 for a minibus).

Eligible sole traders and businesses and charities can apply to scrap or retrofit up to three vans or minibuses.

Charities – but not sole traders and businesses – that have received a grant through the previous scrappage scheme may reapply to scrap or retrofit up to three vehicles.

Adapted from the article in Taxation, 7 September 2023

Not self-employed (Lecture B1396 – 17.53 minutes)

Summary – Having incorporated, the taxpayer was no longer self-employed, meaning he was not eligible for the SEISS grants claimed.

Noel Spencer was self-employed and worked to produce bespoke signage by computer design for billboards, posters, and screen printing and in October 2019, he incorporated Bare Branding, a Community Interest Company.

On 17 June and 24 August 2020, Noel Spencer applied for support payments through the self-employed income support scheme (SEISS).

Later, in June 2021, HMRC sought to confirm his trading status for eligibility for the grants as his tax returns for 2018/19 and 2019/20 showed he had ceased self-employment on 5 April 2019.

Noel Spencer claimed he did not understand the difference between a sole trader and a community interest company and, unable to afford to check with his accountant, he concluded from his own research that he was eligible for payments under SEISS.

HMRC disagreed and issued:

- assessments to recover the grants paid;
- a 'penalty questionnaire' with a view to imposing non-deliberate penalties but had not yet issued any.

Noel Spencer appealed.

Decision

The Tribunal stated that it did appear that Noel Spencer held a genuine belief that he was "carrying on the same trade under the auspice of Bare Branding".

However, the reality was he was trading through his community interest company. Consequently, with no self -employed trade during the period 2018/19 to 2020/21, the First Tier Tribunal found that he was not eligible for payments under SEISS.

> "we can make no findings of fact as regards the relevant issues for consideration such as 'special circumstances' (para 11 Sch 24 FA 2007) because the penalty assessment has not been raised, and the matter is not part of the present appeal."

The appeal was dismissed.

Noel Spencer v HMRC (TC08881)

Film partnership - not trading

Summary – Loss relief was denied as the Limited Liability Partnership was not trading with a view to profit. Further, members' expenditure for buying into the partnership was capital, so denying them relief on loans taken out to finance their investments.

The Gala Film Partners LLP was set up to enable high-net-worth individuals to invest in the distribution of films produced by Sony. An investment of £10 million by each partner was 75% funded by borrowing.

The LLP's trade involved distribution rights and incurred advertising 'and other trading expenses', making a significant tax loss in the first year. The LLP members obtained tax repayments of £4 million based on loss relief which was more than their cash contributions.

The scheme included an option from year three for Sony to buy the LLP's business. Expected tax advantages only accrued if this option was exercised.

HMRC contended that the expenditure by the partnership was not 'laid out, or expended, wholly and exclusively for the purpose of the trade'. Alternatively, it claimed that the costs were not laid out in 2003/04 and were capital expenses.

Individual partners claimed loss relief against other income on the basis that trading was on a commercial basis. Relief for loan interest to buy into the partnership depended on loan monies being used wholly and exclusively for the purpose of the trade.

Decision

The First Tier Tribunal decided that the partnership was not trading, and, even if it had been, relief for loan interest claimed by the partners would be denied as the monies were not used wholly and exclusively for the purpose of a trade.

As the LLP did not supply goods or services to a counterparty for reward but 'simply put sums of money in a circle', it was not trading. Some payments reflected capital acquisition of an income stream.

The First Tier Tribunal saw no reasonable expectation of the LLP making a profit from any trading activity during any relevant period. 'It is essential to examine how the relevant activity was actually carried on'.

Weighing against the LLP was the high probability of the three-year option being exercised by Sony. From the outset the transactions were intended to be completed around 5 April 2004. Information for investors highlighted considerable expected tax advantages but did not address any expectation of trading profit.

Loss relief against other income of partners was denied as the LLP's activities were not conducted on a commercial basis or with a reasonable expectation of profit.

The Gala Film Partners, LLP v HMRC (TC08891)

Adapted from the case summary in Tax Journal (8 September 2023)

No substantial shareholding exemption (Lecture B1396 – 17.53 minutes)

Summary - The substantial shareholding exemption (SSE) was not available on the disposal of a subsidiary which the taxpayer company had owned for only 11 months.

M Group Holdings Ltd was wholly owned by one shareholder, Peter Jeffreys, and provided services to the NHS.

Peter Jeffreys wished to sell the company's business and undertook the following transactions:

1. The company incorporated a wholly-owned subsidiary, Medinet Clinical Services Ltd, and then transferred its trade and assets to it.

2. M Group Holdings then sold its shares in Medinet Clinical Services Ltd to a third-party purchaser.

M Group Holdings claimed that the gain arising from the sale was exempt under the Substantial Shareholding Exemption (SSE).

As M Group Holdings only owned Medinet Clinical Services Ltd for a period of just under 11 months, it relied on para 15A Schedule 7AC TCGA 1992. This allows for the ownership period to be treated as extended in certain cases where there has been a transfer of trading assets to the investee company (i.e., Medinet Clinical Services Ltd) within the 12 months before the disposal.

The First Tier Tribunal held that the extension did not apply because it applied only to any period in which the assets were held and used for the purposes of a trade by a company that was at the time of such use 'a member of the group'. As there had been no group prior to the incorporation of Medinet Clinical Services Ltd, there could be no extension.

The company appealed to the Upper Tribunal on three grounds:

1. It is possible to have a 'group' consisting of just one company, so that M Group Holdings could be considered to be part of a group before the incorporation of Medinet Clinical Services Ltd;

2. The clear purpose of the legislation was to apply the SSE where the economic ownership of the trade and assets had remained the same throughout the 12-month period and it should not be interpreted as requiring the corporate structure to have a particular form throughout;

3. Additional words should be read into para 15A to clarify that relief should be available by extending the period of ownership for periods in which the assets were used by the investing company. The company argued that it was an obvious mistake to discriminate against a standalone company compared to a company which already had a dormant subsidiary to which it could hive down the trade.

Decision

On the first ground, the Upper Tribunal held that there was 'no merit at all' in this interpretation. The ordinary and natural meaning of 'group' required there to be more than one company in the group and this was consistent with the context and purpose of the relevant legislation.

On the second ground, the Upper Tribunal agreed with the First Tier Tribunal; the ownership period could only be extended for periods during which the assets were in use by a member of the group. The purpose of the legislation was to provide a benefit to groups of companies; the wording was entirely focused on groups and what was happening to assets used by group members when they were members.

On the final ground, the Upper Tribunal found that there was no mistake in the drafting which could be corrected in the manner argued by the taxpayer company. The legislation referred only to members of a group because Parliament intended it only to cover transfers within groups.

M Group Holdings Ltd v HMRC [2023] UKUT 213 (TCC)

Adapted from the case summary in Tax Journal (8 September 2023)

UK company with shares stapled to US corporation

Summary – The company was found to be resident in the US for the purposes of the double tax treaty meaning that a tax credit was available for US federal income tax paid on interest income.

GE Financial Investments Ltd (GEFI), a UK-resident member of the GE group, filed company tax returns in which it claimed a credit for US federal income tax paid on interest income to which it was beneficially entitled as a limited partner in a Delaware limited partnership. The credit was against UK corporation tax paid on that income. HMRC refused the claim for about £125million.

The First Tier Tribunal dismissed the appeal, finding that, although GEFI was liable to US federal tax, it was not resident in the US. Further, it was not carrying on a business in the US through a permanent establishment for the purposes of the treaty.

The company appealed to the Upper Tribunal.

The issue was whether a UK resident company with shares 'stapled' to those of a US affiliate company should be treated as resident in the US under Article 4 of the US/UK double tax treaty for the purposes of US federal tax law. In this case, the company's articles of association had been amended to the effect that its shares were stapled to the stock of its US associate, GE Financial Investments Inc. This means that a shareholder wishing to sell their interest in GEFI Ltd had to sell their shareholding in GEFI Inc to the same transferee at the same time.

Decision

The Upper Tribunal noted that the criteria for residence in Article 4 were all commonly accepted ways in which 'full' taxation was imposed, 'nothing more and nothing less'. There was no basis for an additional requirement for the criteria to have the direct form of a legal connection between the company and the US.

An effect of stapling was that, for US federal income tax, GEFI Ltd was treated as a domestic corporation and liable to tax on its worldwide income. Disagreeing with the First Tier Tribunal, the Upper Tribunal concluded that it was therefore resident in the US for the purposes of the double tax treaty.

This was enough to determine the appeal, but the Upper Tribunal upheld the First Tier Tribunal's decision that GEFI was not carrying on a business through a permanent establishment in the US by virtue of being a limited partner in the Delaware limited partnership.

The company's appeal was allowed.

GE Financial Investments v HMRC [2023] UKUT 00146 (TCC)

Adapted from the case summary in Taxation (17 August 2023)

Exit charges on becoming non-UK resident

Summary - A company which became non-UK resident was subject to exit charges, with the tax payable in five annual instalments.

Redevco Properties UK 1 Limited was a member of a fashion chain founded in the Netherlands.

It was incorporated in the UK in November 2004.

In January 2008, Redevco moved its place of effective management to the Netherlands and became non-resident in the UK for tax purposes. As a result, it was:

- deemed to have disposed of its assets and re-acquired them at market value giving rise to a taxable gain of £139million (s.185 TCGA 1992);
- considered to have assigned the assets and liabilities that represented its loan relationships for a sum equal to their fair value and immediately re-acquired them for the same amount, giving rise to profits liable to corporation tax, of £2.7million (Para 10A Sch.9 FA 1996)

It was not disputed that, at the time of the migration these exit charge provisions when read with s.59D TMA, were incompatible with EU law. This was because the UK legislation did not offer the choice to defer payment of the relevant tax. It was also accepted that Redevco was entitled to rely on EU law.

A dispute arose as to the remedy. Referring to the Trustees of the Panayi Accumulation and Maintenance Trusts Nos 1-4 (TC7406), HMRC said it was possible to construe the UK legislation to provide for payment of the tax over a five-year period.

Redevco disagreed, saying this approach moved into the area of law-making which was not HMRC's place, so the exit charge provisions should be disapplied.

Decision

The First Tier Tribunal decided to follow Panayi case.

The company had not established that the migration would not have happened had the advice received from counsel been different.

Indeed, the advice stated that the most likely response would be 'to have a “trailing” exit charge which would tax a company, which had ceased to be resident, on disposals of UK assets within a period of three to five years, at most six years after migration'.

The judge said that, given the taxpayer had disposed of its properties within such a period, it seemed not to have any 'reasonable legitimate expectation' that it would not have to pay the tax.

The judge considered a conforming construction of the UK legislation to be 'appropriate' in this case. S.59D TMA should therefore be read as follows:

> 'Corporation tax for an accounting period is due and payable on the day following the expiry of nine months from the end of that period or, in cases where the

taxpayer's right of freedom of establishment would otherwise be infringed, in five equal annual instalments following the end of that period.'

The company's appeal was dismissed.

Redevco Properties UK 1 Limited (TC08876)

Adapted from the case summary in Taxation (17 August 2023)

Applying the unallowable purpose rules

Summary - The unallowable purpose rules applied meaning that the loan relationship debits in respect of the interest paid were disallowed.

JTI Acquisitions Company (2011) Ltd was a UK company, which was part of a multi-national group with headquarters were in the US.

It was set up to be a holding company into which it received funds, including $500million in loan notes. It sought tax relief on the loan interest on the basis that HMRC had entered into an advance thin capitalisation agreement confirming that the interest was allowable.

HMRC later said that the company was a party to a loan relationship whose main or one of its main purposes was to secure a tax advantage by surrendering debits by way of group relief. As a result, the unallowable purpose rules in s.441 CTA 2009 applied and relief was denied.

The First Tier Tribunal agreed with HMRC and dismissed the appeal.

The company appealed to the Upper Tribunal.

The main issue was the correct statutory approach when considering the purpose for which the taxpayer was a party to the loan.

- The company argued that the purpose of the loan should be ascertained solely from the perspective of the borrowing entity. When, as was the case here, a company borrowed at arm's length to make a commercial acquisition, no unallowable purpose arose. Further, the existence of the taxpayer and the loan relationship were to be 'givens' when considering the purpose for which the company was party to a loan relationship. In essence, the tribunal should consider contrast between the questions 'what was the purpose of entering into that loan relationship by the taxpayer?' and 'why was the taxpayer a party to the loan relationship as opposed to someone else?';

- HMRC argued that the company was inserted into the acquisition structure for the purpose of obtaining a UK tax deduction for the loan relationship debits.

Decision

The Upper Tribunal said the purpose of s 441 and s 442 was to prevent tax avoidance by the use of loan relationships. It would 'defeat parliament's intention' if the narrow interpretation advocated by the taxpayer were to be adopted. There was no reason why 'such a restrictive meaning should be given to what are, after all, ordinary English words'. Indeed, the wording

of the provisions 'readily' accommodated the question why that 'company in particular (as opposed to someone else) was a party to the loan relationship'. If it had been intended to limit the scope of what could be considered in assessing the relevant purpose, those limits would have been 'specifically articulated'.

The Upper Tribunal considered that HMRC's less restrictive statutory interpretation, which took into account all the facts and circumstances, was the one which better reflected parliament's intentions.

The tribunal then turned to the First Tier Tribunal's decision on attribution. It found the First Tier Tribunal had made errors in relation to interpreting the provision on related transactions and on attribution but considered neither of these to be material.

The appeal was dismissed.

JTI Acquisitions Company (2011) Ltd v HMRC [2023] UKUT 00194 (TCC)

Adapted from the case summary in Taxation (24 August 2023)

Corporation tax implications for charities **(Lecture B1399 – 12.15 minutes)**

Primary purpose trading

There is no corporation tax on trading which is part of the charity's primary purposes. For example, an independent school charging tuition fees to students, or a care home charging residents for accommodation and care.

There is also no corporation tax chargeable on profit from activities which help the charity's primary purpose. For example, a college selling books to students, a museum running a café for visitors.

Other trading activity

Trading profit that does not fall within the primary purpose rules above will be taxable unless it falls below the 'small trading' exemption limit.

This would cover situations such as a university renting out student accommodation to the public during the summer holiday, or a charity that has a separate shop selling items to raise funds for the charitable work.

If the activity is carried out mainly by workers who are beneficiaries of the charity, it is exempt if the profits are used for the charity's primary purpose, for example students helping to run a farm at an agricultural college or disabled staff of a café run by a charity that helps people with disabilities.

Profits from lotteries or fundraising events are exempt if all of it is used for the primary purpose and the event qualifies for exemption from VAT.

Small trading tax exemption

Any trading profits which are not exempted by the primary purpose rule are exempt if the revenue from them is below the exemption limit.

If the charity's gross income is less than £32,000 p.a., non-primary purpose trading profits are exempt if the revenue from that activity is no more than £8,000.

If the gross income is above £32,000 but no more than £320,000, non-primary purpose trading profits are exempt if the revenue from that activity is no more than 25% of the gross income.

If the gross income is above £320,000, non-primary purpose trading profits are exempt if the revenue from that activity is no more than £80,000.

What if the non-primary purpose trading is not exempt?

If there is the possibility of corporation tax becoming chargeable on the charity, it would be worth considering setting up a trading subsidiary.

A charity might do this for other reasons irrespective of any exposure to corporation tax, for example to protect the charity from any trading losses, or to separate all the trading activities from the charitable ones.

The company's profits can then be gifted under corporate gift aid to the parent charity.

If this is done within 9 months of the end of the accounting period of the subsidiary, the amount gift-aided is deductible from its profits from which the gift was made and in principle would reduce the taxable profits to zero.

For legal purposes, a gift aid donation is a 'distribution' or dividend and can only be paid from net realised profits available for the purpose.

If the charity gift aids unrealised profits by mistake or gifts more than the profit available for distribution, HMRC will treat this as unlawful and disallow it.

This can lead to an unexpected corporation tax liability for the subsidiary and it is therefore essential that the charity takes advice before making the gift aid payment.

Loans to charitable companies waived

Ordinarily, if a lender waives a loan to a company, the company is taxable on the write back of its liability to its profit and loss account under the loan relationship rules, unless the credit falls within one of the exceptions within s.322 CTA 2009.

Charitable companies, however, are exempt from tax on their loan relationship credits (s486 CTA 2010) so any waiver of a loan by the lender will not trigger a corporation tax liability for the charity.

Rental income

Rental income and other receipts from an estate, interest or right over land are exempt from corporation tax for a charity as long as the estate, interest or right is vested in any person for charitable purposes, as long as the income is applied for charitable purposes.

This exemption also covers dividends received from investments in real estate investment trusts (which are taxable as property income, generally), as long as the income is applied for charitable purposes.

There is no need to claim this exemption.

Contributed by Malcolm Greenbaum

VAT and indirect taxes

Standard rated cosmetic treatment (Lecture B1396 – 17.53 minutes)

Summary – With insufficient evidence provided, supplies made by a clinic were found to be standard rated cosmetic services rather than exempt medical care.

Eperm Limited carried out a number of skin related treatments including the removal of skin lesions, the treatment of varicose veins and the use of medical devices to treat other skin conditions.

The company argued that its supplies were exempt as these were provided by qualified and trained professionals in a medical centre and so were not subject to VAT.

Having failed to provide the requested three-year breakdown of services provided by 13 August 2010, HMRC compulsorily registered the company on 18 August 2010.

Eperm Limited subsequently submitted nil returns for the periods 02/11 to 08/12.

In May 2013, HMRC made a compliance visit to inspect the company's records. The company maintained its supplies were for the treatment of underlying medical conditions but also improved the clients' wellbeing.

HMRC believed that the company's procedures did not qualify as medical care (Item 1, Group 7, Schedule 9 VATA 1994) as the services did not protect, maintain or restore the health of an individual. Consequently, HMRC issued VAT assessments for the periods from 1 May 2007.

The company appealed.

Decision

The First Tier Tribunal stated that medical care means services provided to diagnose, treat or cure diseases or health disorders or to protect, maintain or restore health. Where treatment was for purely cosmetic reasons it was not classed as medical care.

The Tribunal observed that the company was not registered with the Care Quality Commission that oversees regulated medical care services. Although not definitive, the fact that the Care Quality Commission considered the company were not providing regulated services suggested the clinic was not providing medical care within the context of art 132 of the VAT Directive.

The Tribunal noted that the company's website made reference to 'medico beauty', with the company's intention being to 'bridge the gap between beauty salons and cosmetic surgery'. A significant proportion of the company's procedures were carried out for cosmetic purposes. Procedures to deal with wrinkles, cellulite and tattoos did not constitute medical care.

While the company may have made some exempt supplies of medical care, the company failed to provide evidence to support their claim. Consequently, all of the company's services

had been correctly treated by HMRC as standard-rated supplies, its turnover exceeded the registration threshold, and the appeal was dismissed.

Eperm Limited v HMRC (TC08865)

Holiday cottage built for business purposes (Lecture B1396 – 17.53 minutes)

Summary – Planning permission for the construction of a new cottage required the property to be used as a holiday cottage run on commercial basis, meaning it did not qualify for VAT recovery under the DIY Housebuilders scheme.

Philip Spani built a cottage in Seaford, East Sussex and sought a VAT repayment totalling £13,048.28 under the DIY Housebuilders scheme.

In order to verify the claim, HMRC requested various pieces of information. Philip Spani supplied the requested information including the full Planning Permission documentation and Home and Contents insurance documents. He explained that the Council would not have granted planning permission for the cottage had it not been as a holiday let due to the national park area that it was located in.

In August 2021, HMRC refused the refund claim on the basis that the property was let out on a commercial basis.

Philip Spani appealed to the First Tier Tribunal.

Decision

S.35 VATA 1994 contains a number of conditions to be satisfied before a refund can be made under the DIY Housebuilders scheme, one of which is that the works must not be carried out in the course or furtherance of any business.

Planning permission required the property to "be used for holiday accommodation" and use as a dwelling house was prohibited. Although letting had proved difficult due to COVID, the cottage was advertised on Airbnb and the home and contents insurance stated that tenant's liability insurance was part of the cover.

The First Tier Tribunal found that Philip Spani was not eligible for the refund as the cottage was built in furtherance of a business.

The appeal was dismissed.

Philip Spani v HMRC (TC08916)

Financial hardship (Lecture B1396 – 17.53 minutes)

Summary – With the company having ceased to trade and a bank statement showing no cash was available, the hardship application was allowed.

In November 2019, after an enquiry, HMRC sent the company an assessment for £280,903 for deliberate inaccuracies on VAT returns for the periods September 2013 to September 2019, relating to underpaid output tax.

The company appealed and asked HMRC to postpone payment of the tax while the appeal process was under way. This was on the basis that payment would cause it to suffer hardship (VATA 1994, s 84).

HMRC refused the request, so the company appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal noted that the legislation produced an 'all or nothing' outcome. The fact that some tax could be paid within the financial constraints of a business was irrelevant.

The judge referred to a previous case about hardship (*NT ADA Ltd* (TC7161)) and adopted that Tribunal's decision that he should consider only the taxpayer's 'immediately or readily available resources'.

For example:

- equity in a property would only be an 'available resource' if negotiations with, say, a bank were at an advanced stage to secure a loan;

- the potential sale of business assets was also dismissed, even if the assets were not being used in the business.

The onus was on the appellant to provide clear evidence that there was a case for hardship; a 'value judgment' would then be made on the basis of that evidence. The relevant date to assess the financial position was the date of the hearing.

The commercial reality was that the company had ceased to trade in January 2020 and a bank statement dated 1 July 2019 showed a cash balance of only £167.19. The judge described the company's financial position as 'parlous'. He said: 'It is not, therefore, so much a question of hardship. The company simply has nothing from which it can pay the VAT at stake in its appeal.'

The company's hardship appeal was allowed.

Massala Exotic Ltd v HMRC (TC08862)

Adapted from the case summary in Taxation (10 August 2023)

Direct effect of EU law is not a VAT error

Summary – A decision to rely on the direct effect of EU law which turned out to be unfavourable to a taxpayer was not an 'error' and could not be corrected via the VAT error correction procedure.

The UK VAT legislation excludes wholesale travel supplies from falling under the tour operator's margin scheme (TOMS). However, following a CJEU judgment in *EC Commission v Kingdom of Spain* (Case C-189/11) and *Revenue & Customs Brief 5/2014*, some businesses have relied on the 'direct effect' of EU law to include wholesale supplies within their TOMS calculations. Taxpayers have therefore effectively had a choice of whether or not to use the TOMS for wholesale supplies.

Golf Holidays Worldwide Limited had included wholesale supplies within the TOMS. In so doing it was relying on the direct effect of EU law (albeit it was perhaps not cognisant of this).

It subsequently transpired that excluding wholesale supplies from the TOMS would have resulted in a lower VAT liability.

Consequently, Golf Holidays Worldwide Limited submitted an error correction notice for periods between 2017 and 2021 to reverse the position it had taken and instead rely on the UK legislation.

The claim was rejected by HMRC on the basis that the initial treatment was not an error (within the meaning of SI 1995/2518, reg 35) and therefore could not be corrected.

Decision

The First Tier Tribunal agreed with HMRC.

Golf Holidays Worldwide Limited had not made an error within the meaning of the VAT provisions. Rather, it had used a lawful option of accounting for VAT which it subsequently realised was less advantageous than an alternative lawful action.

This was not a case of HMRC imposing direct effect on the business. Rather, the company had to live with the consequences of its actions, even if those actions did not amount to a considered choice.

The principle of fiscal neutrality could not save the taxpayer either as there had been the same choice of methods open to all taxpayers. The fact that Golf subsequently regretted its decision did not alter this position.

Golf Holidays Worldwide Limited v HMRC (TC08893)

Adapted from the case summary in Tax Journal (8 September 2023)

Conditions for zero rating exports **(Lecture B1400 – 10.41 minutes)**

Where a GB company makes a direct export of goods to an overseas company, provided that certain conditions are met, the supply will be zero rated for VAT.

Where the relevant conditions are not met, the supply is standard rated.

Conditions for zero rating direct exports

The term ‘direct export’ means that it is the GB company that arranges the transportation of the goods.

The zero-rated conditions are within VAT Notice 703 Para 3.3, have force of law and require that the goods are exported from the UK within the specified time limits and that the company both:

- obtains official or commercial evidence of export, as appropriate, within the specified time limits; and
- keeps supplementary evidence of the export transaction.

The time limit referred to is normally three months but can be extended to six months where the goods are moved within Great Britain to be processed into other goods before being exported abroad.

In April 2023, we reported on a case Pavan Trading Limited v HMRC (TC08712), where an HMRC officer believed the evidence had to be provided to HMRC within three months. As the company had failed to so HMRC raised assessments.

The VAT notice states that the evidence must be obtained and kept by the taxpayer. There is no mention of it being sent to HMRC. The First Tier Tribunal were not very sympathetic to the officer's erroneous view!

Commercial evidence

This evidence describes and so proves the physical movement of the goods and can include:

- authenticated sea waybills;
- authenticated air waybills;
- PIM/PIEX International Consignment Notes;
- master air waybills or bills of lading;
- certificates of shipment containing the full details of the consignment and how it left the UK;
- International Consignment Notes/Lettre de Voiture International (CMR) fully completed by the consignor, the haulier and the receiving consignee, or Freight Transport Association own account transport documents fully completed and signed by the receiving customer.

Supplementary evidence

Supplementary evidence is also required and is likely to be held within the accounting system. It includes some or all of the following:

- customer's order;
- sales contract;
- inter-company correspondence;
- copy of export sales invoice;
- advice note;
- consignment note;
- packing list;
- insurance and freight charges documentation;

- evidence of payment or evidence of the receipt of the goods abroad.

This evidence proves that a supply has taken place.

What details must the evidence show?

The evidence you obtain as proof of export, whether official or commercial, or supporting must clearly identify:

- the supplier;
- the consignor (where different from the supplier);
- the customer;
- an accurate and full description of the goods including quantities;
- an accurate and consistent value of the goods;
- the export destination; and
- the mode of transport and route of the export movement.

Vague descriptions of goods, quantities or values are not acceptable.

Clarification

Is it still possible to zero rate the sale if the goods are:

- sold but exported after three months?
- exported within three months but the evidence is obtained outside of the three month window?

VAT Notice 703 provides useful guidance at paras 11.2 and 11.3 and the case of Musashi Autoparts Europe Ltd (2003) provides clarification.

VAT Notice 703 Para 11.2

This states:

> 'If you make an export you can zero rate the supply in your records when the goods are supplied to your customer. You must account for VAT accordingly if the supply would normally be standard-rated in the UK and you do not:
>
> - obtain and hold the required evidence of export;
> - make sure the goods have been exported within the relevant time limit for the supply.
>
> You must amend your VAT records and account for VAT on the taxable proportion of the invoiced amount or consideration you have received. For a VAT rate of 20% the VAT element would be calculated at one-sixth.'

So you can zero rate the export at point of sale but you need to account for output VAT at the three month point if the goods are not exported by the three month point or you do not obtain the evidence by then.

VAT Notice 703 Para 11.3

This states"

> If the goods are either subsequently exported or you later obtain evidence of export you can then zero rate the supply and adjust your VAT account for the period in which you obtained the evidence. This is provided that the goods have not been used in the UK prior to export.

So you zero rate at the point of export but then:

- Standard rate the output if the goods are not exported by the three-month point or no evidence is held at that three month point;

- Make an adjustment to reinstate zero-rating when you do get the evidence that the goods have been exported.

Note that adjustments should be via the VAT return rather than Form 652

Musashi Autoparts Europe Ltd (2003)

In this case, the company exported goods but evidence was obtained outside the three months.

The company made no adjustments to their original zero rating so interest was charged between the three-month point and when they subsequently received evidence, on the adjustment they should have made at the three month point.

The Courts confirmed that the supply was ultimately zero rated as the goods were exported but upheld the interest charge on the failure to make the reversing adjustment.

Created by the seminar recorded by Dean Wootten