Tolley®CPD

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Personal tax

Payments In Lieu Of Notice (Lecture P1091 – 12.01 minutes)

Introduction

Finance (No. 2) Act 2017 and Finance Act 2018 have made a number of changes to the termination payments regime such as:

- The abolition of foreign service relief for UK residents from 6 April 2018;
- The imposition of Class 1A NICs for employers on ex-gratia payments over £30,000 (this measure is deferred for 12 months and becomes effective from 6 April 2019);
- A new system for taxing payments in lieu of notice (PILONs).

These notes will cover the changes in the tax treatment of PILONs.

Payments During the Notice Period

Most employees have a notice period. This is the amount of notice an employee must give their employer before leaving their job. It is also the amount of notice an employer needs to give an employee before the termination of their contract.

The legal minimum period of notice that an employer is required to give an employee is generally one week for each complete year worked, up to a maximum of 12 weeks. However, notice periods are normally specified in the employment contract and can exceed the statutory notice period. As a general rule, the more indispensable the employee, the longer the notice period.

If an employment is terminated (other than for reasons of gross misconduct), the employee normally has a legal right to work and is entitled to receive wages for the duration of the notice period.

When notice of the termination of employment is given, the employer has a number of choices:

- It can honour the notice period by allowing the employee to work for the notice period and terminate the contract at the end of that period. In this case the employee will receive wages, all of which would be taxable.
- It can honour the notice period by paying wages but not require the employee to work (the so-called "garden leave"). Employers may do this to protect their client base (for example if the employee is leaving to work for a competitor) or if the employer feels that the employee's continued presence is likely to be disruptive or unhelpful. Amounts paid during a period of garden leave are fully taxable.
- It can terminate the employment within the notice period. This will typically be accompanied by a termination payment which at least in part represents pay which

the employee would have been entitled to had the notice period been honoured. Such payments are called PILONs.

The latter has been something of a moving target since the case of EMI v Coldicott in 1999 when HMRC successfully argued that a PILON should be treated as earnings from the employment as the contract reserved the right for the company to make a PILON. Non-contractual PILONs on the other hand were not earnings and instead fell within the rules for termination payments thereby qualifying for the generous reliefs that those provisions bring. This never sat comfortably in Whitehall and things have now changed. The only real surprise is that it has taken the Government the best part of two decades to get around to it.

The tax treatment of PILONs until 5 April 2018

This is still relevant for those with clients who received a PILON in 2017/18 and need to know how this should be disclosed.

Until 5 April 2018, PILONs were either:

- Taxed in full if the employment contract gave the employer the right to make a PILON (which some contracts did to preserve the integrity of other elements of the contract such as non-disclosure agreements or restrictive covenant clauses); or

- Treated in the same way as an ex-gratia termination payment if the contract did not give the employer the right to make a PILON. In this case the making of the PILON was a breach of the contract and the subsequent compensation payment was treated as damages, thereby triggering eligibility for the £30,000 exemption. Non-contractual PILONs of less than £30,000 therefore escaped tax.

In cases within a), PAYE and NIC should have been applied to the full payment. I use the word “should” deliberately here as history is littered with cases where payments should have been put through payroll and haven’t. If PAYE has not been applied correctly, thought should be given to treating the payment as having been made net of PAYE leaving HMRC to seek the tax from the employer.

In cases within b), PAYE should have been applied to the excess over £30,000. There is no NIC liability.

The tax treatment of PILONs since 6 April 2018

Since 6 April 2018, whenever a termination payment (other than a statutory redundancy payment) is made before the expiration of the contractual notice period, the payment needs to be divided into:

- Post-Employment Notice Pay (PENP); and

- Amounts which are not PENP.

PENP is taxable and subject to Class 1 NICs (employer and employee).

The amount of the payment that is not PENP is taxed under the rules for termination payments.

These new rules only apply to payments received on or after 6 April 2018 in circumstances where the employment ended on or after 6 April 2018. PILONs made after 6 April 2018 in respect of an employment that ended before 6 April 2018 will be taxed under the old rules.

Calculating PENP

PENP is calculated using the following formula:

$$\frac{BP \times D}{P} - T$$

where:

> BP = the employee's basic pay for the pay period immediately before the date on which notice is given. Basic pay excludes taxable benefits and "extra-ordinary" payments such as bonuses, commissions, overtime payments and share-option gains. If the employee participates in a salary sacrifice arrangement (for example by giving up salary for employer pension contributions), pre-salary sacrifice pay must be used.
>
> D = the number of days in the "post-employment notice period" being the period from midnight on the last day of employment through to the 'earliest lawful termination date' (this being the date when the minimum notice period would have expired if given in full).
>
> P = the number of days in the pay period immediately preceding the period in which the termination payment was made; and
>
> T = amounts included as PENP that are already taxable as earnings (excluding holiday pay and termination bonuses). Deducting amounts already classed as earnings prevents a double charge. Amounts deducted would typically be payments such as contractual PILONs.

The intention of the formula is to produce a number that is equal to the basic salary the employee would have earned had they remained in employment for the whole of their notice period.

In essence, the slice of the termination payment that correlates with a PILON will now be taxable, irrespective of whether there is a PILON clause in the employment contract.

Example 1

Julian worked for Alpha Ltd. His basic salary was £52,000 per annum, paid weekly. Julian's employment contract specified a 4-week notice period. The contract did not contain a PILON clause.

Alpha Ltd gave notice of termination to Julian on Monday 13 August 2018. It was agreed that he would work for 5-days to clear his work on hand. He left the employment on Friday 17 August 2018 receiving a termination payment of £5,000.

Alpha Ltd is required to work out the amount of PENP within the termination payment.

If we apply the formula to Julian's payment:

BP = £1,000

D = 18 August 2018 – 9 September 2018 (23 days)

P = 7 days

T = Nil (i.e., none of the termination payment is otherwise taxed as earnings).

The post-employment notice pay (PENP) is:

$$\frac{1{,}000 \times 23}{7} \quad - \text{ Nil} \quad = £3{,}286$$

This amount will be treated as earnings and is fully taxable. This should be put through payroll with PAYE and Class 1 NIC applied.

The remaining payment of £(5,000 – 3,286) = £1,714 will be treated as an ex-gratia termination payment and will qualify for the £30,000 exemption. None of this will therefore be taxable or NICable.

This new regime reflects HMRC’s historical opinion that all PILONs should be taxable on the grounds that, had the employee worked and earned his wages as usual until the end of his notice period, that pay would be fully taxable. PENP is the way of ensuring this now happens.

Monthly basis calculations

HMRC Guidance at EIM13886 confirms that a monthly basis can be used where:

- The pay period is exactly a calendar month;
- The notice period is expressed in calendar months; and
- The unexpired period of notice is a period of whole calendar months.

‘P’ in the formula is then taken to be 1 (and thereby ignored) and ‘D’ is calculated in months rather than days.

Example 2

Julia worked for Beta Ltd. Her basic salary is £72,000 per annum, paid monthly. Julia’s employment contract specified a three-month notice period. Julia resigned on 1 September 2018 and was immediately dismissed without notice. A termination payment of £60,000 was paid to Julia on 8 September 2018.

If we apply PENP the formula to Julia’s payment (working in whole months):

BP = £6,000

D = 3 months

T = Nil

The post-employment notice pay (PENP) is:

6,000 x 3	- Nil	= £18,000

The remaining payment of £(60,000 – 18,000) = £42,000 is treated as an ex-gratia termination payment. After deducting the £30,000 exemption, £12,000 of this will be taxable.

PAYE should be applied to the £12,000 but it is not currently subject to NICs. [such payments will be liable to Class 1A NICs from 6 April 2019.]

As this falls within the termination payments rules, the £12,000 will be treated as the “top-slice” of income and should be taxed after savings income and dividends. [This will make a difference in cases where taxable non-savings income does not exceed the basic rate threshold.]

What you will notice here is that the taxable amount of £30,000 (being PENP of £18,000 plus non-PENP of £12,000) is the same as would have been the case under the old rules. Julia received a non-contractual PILON of £60,000 that, under the pre-2018 regime, would have qualified for the £30,000 exemption leaving £30,000 taxable.

The PENP rules ensure that:

- Where the non-contractual PILON is less than £30,000, some part of it – ie, the bit correlating with a PILON – is taxable (this wouldn’t previously have been the case);
- The PENP element is earnings and is subject to Class 1 NICs. Under the old rules, none of the taxable amount of £30,000 would have been subject to NICs.

Example 3

Julio works for Gamma Ltd. His annual salary is £120,000 paid monthly on the final working day of each month. He participates in an occupational pension salary sacrifice arrangement under which he sacrifices £1,000 per month in lieu of additional company pension contributions. His gross monthly pay is therefore £9,000.

His employment contract provides for a three-month notice period. Alternatively Gamma Ltd can terminate the contract by making a payment in lieu of notice equal to three months' basic salary.

On 1 September 2018 Julio is informed by Gamma Ltd that he is being made redundant and he must leave his job immediately without being required to work his notice period. He receives the following payment:

	£
Payment in lieu of notice (3 months' salary @ £9,000)	27,000
Statutory redundancy pay	10,000
Employer pension contributions (3 months @ £1,000)	3,000
Non-statutory redundancy payment	25,000
Total	65,000

First we divide the payment into PENP and non-PENP.

PENP can be calculated on a monthly basis (the conditions are satisfied).

BP = £10,000 (being the pre-salary sacrifice monthly pay for August 2018)

D = 3 months

T = £27,000 (being the contractual PILON)

The post-employment notice pay (PENP) is:

10,000 x 3 - 27,000 = £3,000

The taxable amounts are therefore as follows:

		Taxable
	£	£
PENP		3,000
Non-PENP:		
Contractual PILON		27,000
Employer pension contributions	Exempt	
Statutory redundancy	10,000	
Non-statutory redundancy £(25,000 – 3,000)	22,000	
Total	32,000	
Less: Exemption	(30,000)	
		2,000
Taxable income		32,000

Note:

Again we can see that the taxable amount is the same as would have been the case under the pre-April 2018 rules as the contractual PILON would have been taxable in full, the employer pension contribution was exempt and £5,000 of the redundancy payments (being the excess over £30,000) would be taxable. The difference now is that £3,000 of the redundancy payment is re-classified as PENP. This does however increase the overall liability as PENP is liable to Class 1 NIC whereas redundancy pay is not.

Other issues

Employers may wish to consider including a PILON clause within their standard contracts of employment as this allows them to terminate the employment contract without breach and without having to allow the employee to work out their notice period. Before April 2018 PILON clauses were omitted in order that a subsequent PILON would qualify for the £30,000 exemption. This has now gone.

It will also be interesting to see whether the new PENP rules will lead to employees trying to negotiate more generous termination packages in order to compensate them for the extra PAYE which will have to be withheld.

Contributed by Steve Sanders

Security for PAYE

Summary – HMRC took into account all relevant information and did not take into account any irrelevant information and did not reach a conclusion which no reasonable officer of HMRC, if properly directed could have reached. The appeal was dismissed

These were three appeals in which all the material facts are identical which were heard as a single consolidated appeal. The appeals are against three separate notices of requirement to give security for PAYE and NIC liabilities in accordance with Part 4A of the Income Tax (Pay As You Earn) Regulations 2003 and Part 3B of Schedule 4 to the Social Security (Contributions) Regulations 2001. Three separate notices were given to the three appellants and three notices, relating to the three appellants, were given to the director and 100% shareholder, Mr Sheikh Abid Gulzar, of all three appellants in his personal capacity.

Albany took over a business formerly trading as Sheikh Abid Gulzar t/a Albany Lions Hotel. Boship took over a business formerly trading as Sheikh Abid Gulzar t/a Boship Lions Hotel and Mansion took over a business formerly carried on by Lions Hotels Ltd, of which Mr Gulzar was also the sole director and shareholder. At the time the decision to issue the notices of requirement to give security was taken Sheikh Abid Gulzar t/a Albany Lions Hotel owed £47,626.49 PAYE and NIC as well as having a VAT liability of £16,582.74, Sheikh Abid Gulzar t/a Boship Lions Hotel owed £79,825.08 PAYE and NIC and Lions Hotels Ltd had become insolvent on 13 January 2017 with a PAYE and NIC debt of £260,013.05.

The amounts of the security requested were calculated by taking four months average PAYE and NIC payments for the respective businesses.

Decision

The Tribunal examined HMRC's calculations of the amounts of security required and considered that they were in accordance with HMRC's normal practice and were reasonable.

Given the history of the businesses concerned, and the history of Mr Gulzar, the Tribunal were satisfied that the decision which HMRC took that the giving of security was necessary in these cases was not unreasonable.

Boship Lions Farm Hotel Ltd Mansion Lions Hotel Ltd Albany Lions Hotel Ltd v HMRC (TC06613)

Failing to make FPS submissions

Summary – Notices for filing to make PAYE FPS submission when no moey was due were held to be invalid and the penalties were cancelled.

J&L Benson Building Services Ltd appealed against penalties for failing to make PAYE full payment submissions (FPSs) on or before it made payments to employees for two consecutive months. The company appealed, saying it did not know how to file a return when it owed no money — no tax or National Insurance was due on the payments to the employees.

Decision

The First Tier Tribunal was satisfied that the penalty had been incurred because of the late filed FPSs.

However, the judge noted that s55 FA 2009 required the penalty assessment to show the period for which it was assessed. HMRC had provided the tribunal with a specimen notice that referred to a quarter ended on 5 January that he presumed would have shown 5 July for the company. In his view this did not reflect the periods penalised. These were for the months ended 5 June and 5 July.

Did this mean that the notice was invalid? S114(1) TMA 1970 could be used to rectify the position, as long as the recipient could be sure of the correct period but this did not seem likely. On this basis, the judge found the notices invalid and cancelled the penalties.

The judge added that were he wrong on this, he would not have accepted that the company had reasonable excuse because they admitted that they had been in 'this sort of trouble before'.

The taxpayer's appeal was allowed.

J&L Benson Building Services Ltd (TC06546)

Spotlight 44 Disguised remuneration: schemes affected by loan charge

In July 2018, HMRC added spotlight 44, concerning the disguised remuneration loan charge being introduced from April 2019.

HMRC make it clear that the only way to make sure the loan charge will not apply is by:

- settling before the loan charge takes effect;
- repaying all loans in full.

Instalment plans

HMRC will agree instalment plans of up to 5 years for individuals wanting to settle their disguised remuneration schemes before the loan charge arises, without having to give detailed supporting information of means and ability to pay if:

- expected current year income < £50,000 (gross earnings for employees; expected net profit for the self-employed);
- the person is no longer engaged in tax avoidance.

However, to reduce interest, taxpayers should always pay over the shortest period possible.

If income > £50,000, or the individual needs a longer period to pay, HMRC can still work out a suitable arrangement but they will need more information before doing this.

Schemes affected by the loan charge

Most disguised remuneration schemes will be affected by the loan charge in 2019. HMRC is also aware of new arrangements being sold to try to avoid the loan charge on an existing scheme. These schemes do not work. Read more on these schemes in Spotlight 36 and Spotlight 39.

Failing to settle

Individuals who do not settle before 5 April 2019 and fail to pay the loan charge you may face:

- continued enquiries;
- higher tax bills;
- interest;
- possible penalties.

www.gov.uk/guidance/disguised-remuneration-schemes-affected-by-the-loan-charge-spotlight-44

Annual payments (Lecture P1092 – 8.12 minutes)

In *Hargreaves Lansdown Asset Management Ltd v HMRC (2018)*, the First-Tier Tribunal decided that amounts paid by Hargreaves Lansdown (HL), an investment platform service provider, to its investor clients as 'loyalty bonuses' were not annual payments within S683 ITTOIA 2005. As a result, the Tribunal held that there was no requirement for HL to deduct basic rate income tax from such payments under S901 ITA 2007.

As mentioned above, HL operates a platform offering investment products from different fund providers directly to investors. In the past, such platforms were commonly financed by payments from the fund providers that represented rebates on the annual management charges paid by their retail clients. A result of this arrangement was that many platforms were able to market their services at no explicit cost to their clients.

However, in 2014, the Financial Conduct Authority (FCA) concluded that this type of fee structure created risks for investor protection and hindered transparency. The FCA therefore changed their rules by requiring platform service providers to charge clients a direct fee for their work, with the rebates being passed on in full to the investors.

HMRC argued that these sums represented a form of commission paid to the investors and were subject to withholding tax as annual payments. This view was set out in HMRC's Revenue & Customs Brief 04/13 which was published on 25 March 2013. HL challenged HMRC's interpretation.

In order to qualify as an annual payment for the purposes of S683 ITTOIA 2005, four requirements have to be met. The payment must:

1. be made under a legal obligation;
2. be capable of recurrence;
3. be income in the hands of the recipient; and
4. represent a 'pure income profit'.

The Tribunal agreed that three of the essential characteristics of an annual payment (ie. (1 to 3 above) were present in this case, but the judge did not accept that the payments represented a pure income profit in the hands of the investors. Instead, he considered that the payments were, in reality, a reduction of the investor's net cost, quite unlike the receipt of an annuity payment or interest in respect of which a recipient need do nothing but receive the money.

Contributed by Robert Jamieson

The Trading & Property Allowances (Lecture B1091 – 9.28 minutes)

Introduction

The 2017/18 tax return season will soon be upon us and numbers will need to be entered in boxes.

Boxes 17-21 of the Self-Assessment return (SA100) asks about "Other UK Income Not Included on Supplementary Pages". This is the "dustbin" section of the return, reserved for bits and bobs of sundry income that are technically taxable but don't have a natural home anywhere else.

Box 21 requires a description of income being disclosed in this section. In most instances this part will be completed for clients with secondary incomes from transactions in goods or services which fall short of a full-blown trade and are therefore not worthy of making their way on to the Self-Employed pages. For example, receipts from occasional trading via online market places such as eBay and Gumtree or from providing a one-off service for consideration would find their way into Box 17 as would supplementary rental income from the letting or sub-letting of property or renting-out a garage or driveway for storage or parking.

I recently paid a resident of Edgbaston, Birmingham, £10 for the privilege of parking my car on his drive for the day while I went to the Test Match around the corner. No doubt he will be telling his accountant that this is Box 17 income. Box 18 allows a claim for any expenses incurred in generating the miscellaneous income. No breakdown of expenses is required.

The excess of income over expenses is taxable. Or it used to be until 2017/18…

The £1,000 Allowance

Dealing with miscellaneous income has been simplified from 2017/18 with the introduction of the £1,000 Allowance.

There are currently two separate allowances being:

1. The Trading Allowance which is a £1,000 allowance available in respect of trading income and other miscellaneous income from the sale of assets or the provision of services; and

2. The Property Allowance which is a £1,000 allowance available in respect of miscellaneous property income.

The allowances work in a very similar way to each other and broadly stand in place of allowable expenses meaning that receipts within the £1,000 allowance are exempt from income tax and don't need to be reported in Box 17.

The allowances are mutually exclusive meaning that a taxpayer with £1,000 of miscellaneous trading income and £1,000 of miscellaneous property income can claim both allowances such that the full £2,000 is exempt from income tax. The allowances are not restricted based on other income and are therefore available to all taxpayers.

There is no automatic annual uprating of the allowances. The £1,000 limit can be uplifted by statutory instrument but we all know the Government's record on such things so it wouldn't be the biggest surprise if the allowances remained at the current level for many years thereby eroding the value of the relief over time.

Before we consider the details of each allowance, bear in mind that these allowances are only brought into play in the first place if the miscellaneous receipts would otherwise be chargeable to income tax. For example, receipts from a one-off sale of bric-a-brac found in the loft or inherited from Aunt Mable's estate will probably be capital in nature with any resulting gains being exempt from CGT under the chattels rules. [These rules were covered in a TSO lecture from February 2018 – notes are available via the Archive if you need a reminder.] Repeated sales via an online market or through the boot of a car might on the other hand be evidence of trading thereby bringing the allowance into consideration.

Also, occasional rental receipts from a spare room in the taxpayer's main residence are likely to be exempt under the rent-a-room scheme so consideration of the property allowance would not then be necessary. [But be aware of the new "shared-occupancy" test for the rent-a-room scheme being introduced in April 2019 which will deny rent-a-room relief for certain lettings. That in turn will bring the property allowance into play.]

The Trading Allowance

The trading allowance is available in respect of an individual's 'relevant income'. Relevant income means gross income (before expenses) from either:

- A relevant trade; and/or
- Miscellaneous income not otherwise charged to tax (in the Jurassic period we used to call this Schedule D Case VI). This will typically cover receipts from casual services, for example, babysitting, cake-making, dog-walking, ironing, DIY, decorating, gardening or any similar ancillary activity we enter into to help make ends meet.

If the individual's relevant income does not exceed the trading allowance of £1,000, the profit of any relevant trade or any miscellaneous income is treated as nil. Losses are also treated as nil so the application of the trading allowance cannot create an allowable loss.

This is called "full relief" and is the default position. No claim is required for full relief to apply. No tax return disclosures are necessary and Box 17 can be left bare. As the income is treated as nil, it will not result in a clawback of child benefit or personal allowances. It is also disregarded for claiming tax credits (but not necessarily for other income-related benefits, so this should be checked for taxpayers in this position).

An individual can elect for full relief not to be given. The election disapplies the trading allowance so that the profit or loss is calculated under normal business income rules. The election can be made year-on-year and will be of benefit where allowable expenses exceed income in the year and a loss would be created. [Do remember here that sideways relief for losses against other income in the tax year is only available if the taxpayer is carrying on a genuine trade. Losses on non-trading activities will be carried forward against miscellaneous income in future years.]

There is a third option in the form of "partial relief". This applies where relevant income exceeds the trading allowance and permits the deduction of a flat £1,000 of allowable expenses with the excess being subject to tax. No actual expenses can be deducted (this includes capital allowances) and no records need to be kept. This election is beneficial for taxpayers with low expenses.

For example, if a taxpayer makes a one-off sale of goods via eBay, this falls short of a trade and would be treated as miscellaneous income. If the taxpayer has costs of less than £1,000, partial relief would be taken. This is claimed by entering the net amount (being receipts less £1,000) in Box 17 and adding a brief note in Box 21 by way of explanation.

If the receipts are treated as trading receipts (as opposed to miscellaneous income), the "self-employment" pages must be completed. The trading allowance is then claimed in Box 16.1 (or Box 10.1 if the shorter version of the self-employment pages is being used). The expenses boxes would not then be completed.

Elections for full or partial relief must be made no later than the anniversary of the SA filing date (although it is logical for taxpayers to make their claim via the relevant SA return).

Example:

Stephanie is a tax writer employed by a large publishing company. In 2017/18 she undertook some freelance tax consulting work generating fees of £1,800. Expenses incurred in generating this income were £200.

Full relief is not available as Stephanie's relevant income exceeds the trading allowance of £1,000.

Stephanie therefore has two choices:

1. If she disapplies the trading allowance, her profit is calculated under normal business income rules and will be £(1,800 – 200) = £1,600.

2. If she elects for partial relief, a flat deduction of £1,000 is given for expenses reducing the taxable profits to £(1,800 – 1,000) = £800.

Stephanie should therefore elect for partial relief no later than 31 January 2020. The self-employed pages would need to be completed (albeit with only two numerical entries).

Class 4 NIC

The trading allowance will also apply for Class 4 NIC purposes, so the amounts chargeable to income tax and Class 4 NIC are (thankfully) aligned.

The Class 4 charge will be triggered by entries on the self-employed pages, so miscellaneous income that is charged to tax will not be subject to Class 4 NIC.

Income excluded from the trading allowance

There are anti-avoidance rules which prevent the artificial generation of small amounts of income in order to use the trading allowance.

Where the individual's relevant income includes any of the income sources listed below, the trading allowance is not available:

- Income from the individual's or spouse/civil partner's employer (for example, a payment from an employer on a freelance basis for a job which is outside the normal contract of employment);

- Income from a partnership of which the individual (or an associate) is a member; or

- Income from a close company in which the individual (or an associate) is a shareholder.

This means that if, for example, an individual received a payment for a one-off job from a company run by his wife, the trading allowance is not available AT ALL for that tax year, even against other miscellaneous income generated elsewhere. Both sources of income would be fully taxable (with relief for allowable expenses).

Where an individual is disqualified from benefitting from the trading allowance, he will still be able to use the property allowance in the same tax year (assuming none of the property allowance exclusions apply – see below).

Second trades

Where an individual has two (or more) trades, the receipts of all trades are aggregated for determining eligibility for the trading allowance. This means that an individual with an existing sole-trade business is unlikely to benefit from the trading allowance where he has a smaller secondary trade (unless aggregated receipts from the combined trades are less than £1,000 which is highly unlikely).

For example, if Stephanie (in the example above) was a self-employed tax-writer instead of an employee, the freelance tax consulting work would not be eligible for the trading allowance (or more accurately any claims for the trading allowance would probably be disadvantageous compared with deducting actual expenses). As her expenses in relation to this freelance work were less than £1,000, she would end up paying more tax on this income.

The Property Allowance

The property allowance is available in respect of an individual's 'relevant property income'.

'Relevant property income' consists of the individual's 'relievable receipts' from the relevant property business (both UK and overseas). 'Relievable receipts' are all receipts that would be brought into account in computing the individual's property-business profits, excluding rent-a-room receipts and distributions of property income from an authorised investment fund or from a Real Estate Investment Trust (REIT). Profits from furnished holiday lets are also eligible for the property allowance.

Relievable receipts are identified on a cash basis (the legislation deems the individual to have made an election for the simplified cash basis for the purpose of seeing if the £1,000 limit is exceeded. This rule also applies for the trading allowance).

The property allowance can therefore be used by anyone with a property business. However it is primarily aimed at taxpayers with small amounts of rental income with the intention of simplifying the process of calculating and reporting rental profits.

Where relevant property income does not exceed £1,000, the income is exempt from tax and does not have to be declared. As with the trading allowance, this is "full relief" and is the default position.

As with the trading allowance the individual can either:

- Elect not to receive full relief and instead compute the profits or losses of the property business on the normal basis, deducting allowable expenses against property income; or

- Elect for partial relief, with profits then calculated by deducting the £1,000 property allowance from relievable receipts with no expenses considered. If the individual has more than one relevant property business (for example, a UK property business and an overseas property business), he can allocate the property allowance between the businesses as he chooses but no loss can be created in any one business. This may be a consideration if there are brought forward losses from one of the property businesses as one would wish to maximise profits to match the available loss.

Elections must be made within one year of the normal SA filing deadline (being 31 January 2020 for 2017/18).

Where relevant property income exceeds £1,000, the property pages must be completed. There is a box (Box 20.1) for the property allowance where partial relief is claimed.

An individual is excluded from using the property allowance if:

- He is carrying on a property business in partnership; or
- He is claiming a tax reduction for disallowed loan interest payments (as this will necessitate a claim for part of the interest expense which will negate the property allowance); or

The property income includes payments from an employer, from a partnership in which that individual is a partner or from a close company in which the individual is a shareholder (or an associate of a shareholder). Persuading one's employer to pay a rent of £20 a week to park their company car on your driveway is not therefore a planning option.

The property allowance is available where a property (or properties) is/are owned jointly in an arrangement that is not run as a partnership. In this case an individual's share of the relievable receipts are eligible for the property allowance. It is therefore conceivable that a husband and wife who jointly own a property that is let out could use their property allowance in different ways.

Conclusion

In this electronic age it is becoming easier and easier to supplement our income via online platforms and digital marketplaces. Most of the time this can be done at the press at the button with the only 'costs' being invested in the process is time.

The Trading and Property Allowances not only make the disclosure of the resulting profits relatively painless, they can also reduce the tax liability on the receipts. These allowances should not therefore be overlooked.

Contributed by Steve Sanders

Proposed Changes To "Rent-A Room" Relief (Lecture B1092 – 8.55 minutes)

The rent-a-room scheme has now been with us for over a quarter of a century (apologies if, like me, this makes you wonder where that time went).

The original intention of the scheme was to increase the quantity and variety of low-cost rented housing and make it easier for people to move around the country for work. As a by-product, it also made it much easier for landlords to calculate the profits arising from the letting of a room in their own home.

Before 1992, profits had to be calculated by apportioning expenses between the "family" bit of the house and the part of the house let to the lodger, a process which involved scientifically plucking a number out of the air then multiplying it by two and rounding down a bit in case HMRC queried it.

Since April 1992, landlords with lodgers can still choose to prepare a normal property income computation (nowadays using the cash or accruals basis as appropriate) by taking annual rents and deducting any expenses relating to the letting to give a profit or loss.

However most individuals renting out a room in their home prefer instead to take the hassle-free route and calculate profits by simply deducting the annual rent-a-room limit from the annual rents and paying tax on the excess. To this end the rent-a-room limit stands in place of all allowable expenses and circumvents any need to both work out the expenses which relate to the letting or to keep any accompanying records.

The rent-a-room limit was £3,250 until April 1997 and then £4,250 until April 2016 at which point it was generously hiked to £7,500 (which the Government was quick to point out exceeded the average annual cost of renting a room in the UK by over £1,000 a year). What the government was less keen to acknowledge was that this threshold had severely lagged-behind the average cost of renting a room in the UK for the best part of the last decade but that's water under the bridge.

The rent-a-room scheme is only available if the landlord is letting out a room in his only or main residence. Landlord and tenant must therefore be living in the same property, thereby making the tenant a lodger of the landlord.

Where gross rents do not exceed the £7,500 limit, rent-a-room relief applies automatically thereby making the rental income exempt from tax. There is no requirement for taxpayers to report this income. If allowable expenses exceed gross rents, the landlord can claim for the relief not to apply. This will crystallise an allowable loss to either set against profits from the rest of his UK property business or be carried forward against future rental profits.

Where gross rents exceed £7,500, a claim must be made for rent-a-room relief to apply. The claim is typically made via the self-assessment return. The relief will then continue to apply each year until the claim is withdrawn.

The £7,500 limit applies per property and not per tenant.

If a property is jointly owned, half the rent-a-room limit is given to each joint owner (even if the rents are apportioned differently). This is a quirky rule as each joint owner receives half the threshold even in cases where there are more than two joint owners. While this seems like a chance to make hay, planning opportunities here are limited.

The rent-a-room scheme only applies to residential accommodation. It does not apply where a room is used as an office or for any kind of business.

If rent-a-room relief applies, it does not normally affect the availability of Principal Private Residence relief when the owner comes to sell the property. The landlord is treated for PPR purposes as having occupied the part of the house let to the lodger. Care must however be taken if the landlord takes in two or more lodgers as the HMRC CGT Manual at CG64702 says that in this case the landlord will be treated as running a business and PPR relief would then be restricted.

Note also that the property in respect of which rent-a-room relief is claimed does not have to be the same as the one that is the landlord's only or main residence for PPR purposes. For example, an individual with two residences may be letting out a room in his main residence but his second home could be his PPR by nomination. This does not prejudice rent-a-room relief.

The Consultation

Since 1992, the private rental sector has doubled in size. The emergence of online marketplaces and digital platforms such as SpareRoom.co.uk, Roombuddies.co.uk and Airbnb has made it easy for those with spare accommodation in their home to access a global network of potential occupants and make a few quid by renting out a space which would otherwise have been occupied by some empty suitcases, an ironing board and a Swiss ball.

The Government therefore opened a Consultation in 2017 to see if the rent-a-room scheme was still fit for purpose with the aim of:

Finding out more about the use of the relief including who uses the scheme, what kinds of letting activity they are carrying out and why they might choose to let spare accommodation in their main residence;

Establishing whether the relief is working as the government intends and whether rent-a-room continues to be an appropriate relief; and

Looking at potential reform of the relief by taking views on the effectiveness of the relief, what its role should be in the modern housing market, and whether there is consensus around potential reform.

The Feedback

The Government received 178 written responses from individual users of the relief, tax and accountancy groups, trade bodies, accommodation sharing platforms and charities. The feedback has led to the publication of draft legislation intended to take effect from 6 April 2019.

The good news is that rent-a-room relief will be retained with only minor changes. Responses indicated that most individuals would not be prepared to let out their spare rooms if the relief was not available. Rent-a-room relief therefore continues to provide an effective incentive for people to make their spare rooms available for rent.

Respondents were positive about the relief being simple and easy to understand. Complicating the relief could lead to non-compliance or could bring taxpayers unnecessarily into self-assessment. It could also result in those with spare accommodation choosing not to rent it out. Proposals to restrict the relief to longer-term lets of 31 consecutive days or more were rejected on these grounds. It was clear that there is a thriving market for letting rooms for very short periods – sometimes just one or two nights – to people such as tourists or mobile workers looking for a cheap place to stay.

The rent-a-room limit will remain at its current level of £7,500 as this was felt to be "sufficiently generous". This does seem fair if you think of the limit not in terms of the rental returns but in terms of the annual costs to the homeowner of providing that space. Does a spare room costs £625 a month to "run"? Bearing in mind that most of the costs of running the house would have to be incurred anyway, there is an argument that the marginal cost of having the spare room is just pennies. With this in mind, the current limit looks more than fair.

Under the current design of rent-a-room relief, those letting out whole properties as well as spare rooms can benefit. For example, the residents of Wimbledon, London, SW19 can currently let out the whole of their house for a particular fortnight in July and take advantage of the £7,500 rent exemption while simultaneously enjoying a family holiday in Tuscany. This was felt to be incompatible with the intention of the relief.

A new "shared occupancy test" will therefore be incorporated into the relief. The new test will require the taxpayer to be living in the residence and be physically present for at least some part of the letting period for the income to qualify for relief. This amendment is designed to ensure that rent-a-room relief meets its original purpose of incentivising people to let spare rooms rather than whole properties.

Consequently, from 6 April 2019 where a landlord is letting out a whole property, even if it is usually their main residence, they will be unable to claim rent-a-room relief.

The draft amendment to the rent-a-room provisions in S.786 ITTOIA 2005 is that:

> "….the use to which the receipts relate is physical use of the furnished accommodation that overlaps in time (wholly or partly) with the use of the residence as sleeping accommodation by the individual or a member of the individual's household".

The words "overlaps in time" suggest that just one day of shared occupation with the tenants will be enough to trigger the relief. "Sleeping accommodation" confirms that the shared occupation must be overnight. This could feasibly be the first 24-hours of the rental period where the landlord (or any member of his household) stays under the same roof as the tenants overnight to show them where everything is and how everything works etc, before jetting off on holiday. Incorporating this within the rental agreement would be recommended to support the subsequent relief claim.

The shared occupancy test will apply to each separate letting or rental agreement. For example…

Assume that Sean lives in Edinburgh. Sean hates performance art, alternative comedy, physical theatre and everything and everyone associated with it, so every August for the duration of Edinburgh Fringe Festival he goes to live with his friend in New Zealand. His house is let to visiting tourists. From 2019 the rental receipts will not be eligible for rent-a-room relief as there is no shared occupancy during the period of the rental.

The £1,000 property allowance will however be available. On rents income above £1,000, Sean can choose to either deduct the amount of the allowance or deduct the revenue expenses incurred in letting out the property.

On his return from New Zealand in September 2019, Sean lets a room in his house to a tenant who has a 3-month employment contract in Edinburgh. Sean goes on holiday for 2-weeks during the rental period. In this case the receipts from this rental agreement would be eligible for rent-a-room relief because there is shared occupancy between Sean and his tenant for some part of the rental period. Note here that the rent-a-room limit for the second tenancy would still be £7,500. There is no concept of apportioning the relief based on the length of the tenancy.

Conclusion

There were some concerns that once HMRC had turned a Sauron-like eye to the rent-a-room scheme, its days would be numbered. However common sense has prevailed and it’s good to see that a relief which is easy to use, easy to understand and does what it says on the tin has been retained with just a few tweaks. Here’s to another 25 years….

Contributed by Steve Sanders

Capital Taxes

Do sheep pens qualify?

Summary – Land where sheep pens had previously been farmed was a qualifying asset for rollover relief until the earliest of the date of grant of detailed planning permission or demolition of the sheep pens or the commencement of construction.

The 2012/13 tax returns for Mr and Mrs Bell and their Partnership were submitted on 21 January 2014. On 12 January 2015, HMRC intimated that they were checking the Partnership return. Correspondence ensued and the sole unresolved matter was the sale of Chapel Grange and specifically the tax treatment of the proceeds.

Mr and Mrs Bell purchased the whole farm consisting of 667 acres in 1994. They farmed in partnership. At some unspecified date in 2008 outline planning permission was obtained for a dwelling house that was to be erected on the sheep pens at the rear of the cottages. Detailed planning permission was granted in April 2010.

The farm was later was sold as a whole on 28 August 2012 crystalising a gain of £225,146. A new farm was purchased on 31 August 2012. Maurice and Shirley Bell argue that rollover relief should be granted. In the event that that argument was not successful then it was argued that the land on which the property was built was a qualifying asset until the point at which construction work commenced and that therefore the development value was included and eligible for roll-over relief.

HMRC concede that the land would have been a qualifying asset up until the point at which planning permission was granted. They argue that the grant of planning permission and construction of the property clearly changed the nature of the asset. At the point at which outline planning permission was granted, the property would have increased in value and again in 2010 when the detailed planning permission was granted. The grant of that planning permission would have significantly increased the value of the land and changed the nature of the asset.

Decision

The First Tuer Tribunal said that the land was used as sheep pens and farming land up until its use changed, the sheep pens were demolished and construction started. They had no evidence as to the date(s) for any of those other than that all were probably in April or May 2010.

The `tribunal found that the land was a qualifying asset only until the earliest of those points being the date of grant of detailed planning permission or demolition of the sheep pens or the commencement of construction. On and from the day that the earliest of those occurred, the land was not a qualifying asset.

Maurice and Shirley Bell v HMRC (TC06575)

Operating corresponding deficiency relief

Summary - Corresponding deficiency relief cannot be used to effectively increase the taxpayer's basic rate band, resulting in more gains being taxed at 20%

In 2006/07 and 2007/08 Andrew Scott had claimed corresponding deficiency relief under s539 ITTOIA 2005). The issue was how s4 TCGA 1992 should determine the rate of tax to be charged on the gains.

Andrew Scott believed that, to the extent that he could not deduct his corresponding deficiency relief from his income, he should be able to use the unrelieved amount to effectively extend his basic rate band and so effectively pay CGT at the lower rate.

Decision

The Upper Tribunal noted that where reliefs and allowances are available as deductions from income, they cannot reduce a taxpayer's income to create a negative number. They considered that the same applied to corresponding deficiency relief. The amount deducted can never be more than the taxpayer's income.

So, if a taxpayer has income of £10,000 and corresponding deficiency relief available to him of £35,000, only £10,000 of relief is used, reducing income to nil for the purposes of calculating his higher rate income tax liability. The taxpayer could not use the remaining corresponding deficiency relief as an extension of the basic rate band, to enable more gains to be taxed at the basic rate.

The taxpayer lost his case.

Andrew Scott v HMRC [2018] UKUT 0236 (TCC)
Adapted from Tax Journal (26 July 2018)

Value shifting and the exercise of control **(Lecture P1093 – 6.59 minutes)**

The First-Tier Tribunal decision in Conegate Ltd v HMRC (2018) involved a lengthy and complicated dispute in which the judges had to consider the position where two (unconnected) shareholders appeared to have exercised control together so that value passed out of some shares. Relief for the resulting capital loss was refused by HMRC on the ground that the transaction was caught by the anti-avoidance provisions in S29 TCGA 1992. The Tribunal concurred with HMRC's stance.

S29(2) TCGA 1992 reads as follows:

> 'If a person having control of a company exercises his control so that value passes out of shares in the company owned by him or a person with whom he is connected, or out of rights over the company exercisable by him or by a person with whom he is connected, and passes into other shares in or rights over the company, that shall be a disposal of the shares or rights out of which the value passes by the person by whom they were owned or exercisable.'

S29(3) TCGA 1992 goes on to state that a loss on such a disposal will not be an allowable loss for capital gains purposes to the extent that it is attributable to value which has passed out of the shares or rights.

Importantly, the Tribunal rejected the contention that, in order for the value shifting regime to apply, the two shareholders acting together needed to be connected. The judges noted that in the earlier case of Floor v Davis (1979) – which was a decision of the House of Lords – the shareholders were in fact connected with each other, but they did not consider that this was relevant to the Floor v Davis (1979) conclusion on the exercise of control. In other words, it is not a prerequisite under S29 TCGA 1992 that the parties are connected.

Contributed by Robert Jamieson

New Q&As on deemed-domicile rules

The CIOT, STEP, ICAEW and the Law Society have prepared a new set of questions and answers on the extension of IHT to overseas property representing UK residential property interests, intended to highlight areas of uncertainty in the deemed domicile legislation introduced with effect from 6 April 2017.

This latest set is added to Q&As already prepared for the provisions on trust protections, mixed fund cleansing and rebasing.

These documents are also published as TAXguides by the ICAEW Tax F

These draft Q&As have been sent to HMRC for comment, but have not yet been agreed and should not be taken as representing HMRC's views.

www.tax.org.uk/policy-technical/technical-news/finance-no-2-act-2017-taxation-non-uk-domiciliaries

Trusts for tax planning as well as practical purposes (Lecture P1094/ P1095 – 18.54/ 9.40 minutes)

Trusts and their uses - family provision and will planning for spouses

Transfers between spouses and civil partners – s18 IHTA 1984 - Transfers between spouses are exempt where they are direct transfers. This applies whether the transfer is made in lifetime or on death. The exceptions are where:

- The transfer takes effect on the termination, after transfer of any interest or period
- It depends upon a condition which is not satisfied within 12 months
- Transferor spouse/ civil partner is UK domiciled but transferee is non UK domiciled.

Transfer of a deceased spouse's unused nil rate band – s10 & Sch 4 FA 2008

Since 9 October 2007, it has been possible to transfer any balance of unused nil rate band (or the current £325,000 limit in the case of transfers to a non-UK domiciled spouse/civil partner). However, if the first death was before March 1975, the full amount may not be transferable as the amount of spouse exemption was limited then under the provisions of Estate Duty.

The transfer is not determined by the balance of the nil rate band unused, but the proportion of the nil rate band that was unused, in accordance with s8A IHTA 1984.

The history of spouse exemption

If the pre-deceased spouse's death (the first death) was before March 1975, the full amount may not be transferable as the amount of spouse exemption was limited then under the provisions of Estate Duty. The history of IHT and the spouse exemption was as follows, and specialist advice should be taken in cases that apply:

- prior to 21 March 1972 – no spouse exemption and therefore likely the nil rate band was used

- 21 March 1972 to 13 March 1975 – Estate Duty applied and there was a transfer of only £15,000. If this was unused, it is likely there would be a balance to transfer

- 13 March 1975 to 18 March 1986 – Capital Transfer Tax applied and the spouse exemption would apply as new rules under Inheritance Tax

Making a claim on form IHT402

If a spouse or civil partner has died previously, they may have some unused nil rate band available that the personal representatives will need to make a formal claim for, when dealing with the estate of the second spouse. This is claimed on form IHT402 that accompanies the inheritance tax return form IHT400.

At the time of the first death, there may not be (or may not have been) a considerable amount of compliance to adhere to, especially if the will or intestacy rules were such that the deceased spouse's estate is transferred to the other spouse, or otherwise simply.

Information that will be required to support the claim for any unused nil rate band will include:

- The death certificate of the first spouse, or civil partner

- The marriage certificate or civil partnership certificate

- The previous will, if relevant

- A copy of the grant of probate (or confirmation in Scotland)

- Any other documentation that would support the amount of nil rate band that is being claimed, such as a deed of variation and a copy of any IHT return forms.

The important point here is that any evidence of the previous spouse's unused nil rate band needs to be recorded thoroughly to avoid problems collating this information at the time of the second death.

Inheritance tax planning on first death

Reasons to utilise the nil rate band on death of the first spouse or civil partner include:

- Bank it, don't lose it – it is possible to improve the loss of any exemption by banking the nil rate band on first death;
- Assets can grow outside an estate – rather than have assets growing in value within the estate of a surviving spouse or civil partner, with the reliance on the transferable nil rate band, consider banking the nil rate band on first death and pass the assets into a trust – any growth on those assets could fall outside everyone's estate for IHT, particularly if the trust is a discretionary trust;
- Building in protection of capital for future beneficiaries – rather than give wealth to a spouse on first death and risk the loss of capital for future beneficiaries, use the nil rate band to ensure the assets are passed to the other beneficiaries or protected within a trust wrapper, for future beneficiaries;
- A maximum of only one transferable nil rate band - note that a spouse or civil partner will only receive the additional benefit of a maximum of one unused nil rate band and therefore if they have been widowed twice, the balance of the unused nil rate bands must be determined, and then capped to the level of one additional nil rate band. A separate claim must be made for each spouse or civil partner that predeceased the individual. Consider utilising and therefore banking the nil rate bands on death to avoid the potential loss of relief;
- To avoid a reservation of benefit – very often, the passing of assets over to a surviving spouse or civil partner generates no IHT due to the luxury of spouse exemption. However, the problem then consists of the whole joint estate being now in the hands of the survivor with the urgency of lifetime IHT planning. Consider the gifting away of assets to other beneficiaries on the first death, using as many IHT reliefs as possible, to avoid the survivor having to gift assets with the limitation of the seven year survival period and potentially falling into the GWROB provisions.

Using a discretionary trust on death for the interest in the family home

When measuring the amount of the transfer of value, consideration must be made for any part of the asset being owned by a spouse or civil partner. Where spouses or civil partners are the co-owners, it is necessary to consider the related property rules (s161 IHTA 1984).

<u>Example - Related party valuation of land</u>

Jill owned land worth £500,000.

Her husband, Jack, owns the adjacent land that is worth £400,000. However, the combined plots of land are worth £1,300,000.

When Jill died, the personal representatives have the task of valuing her share of land to calculate the amount of IHT payable on her estate.

They will need to consider the related property rules.

The value will be calculated as follows:

$$£1{,}300{,}000\, x \frac{£500{,}000}{£500{,}000 + {,}400{,}000} = £722{,}222$$

The family home – valuation of property owned by spouses and civil partners

Where spouses or civil partners are the co-owners, it is necessary to consider the related property rules under s161 IHTA 1984 and whether the Capital Taxes Office would value the property resisting any discounts. Where the value of any property comprised in a person's estate would be less than the appropriate portion of the aggregate value of that property and any related property, the value shall be the appropriate portion of that aggregate.

S161 IHTA 1984 suggests that the related property valuation rules would apply to a transfer of value which would realise an enhanced price if sold together with 'related property'.

In the case of Price v HMRC (2010) UKFTT 474 (TC) the First Tier Tribunal rejected the claim for discount on the valuation of property even though the property could not be sold with vacant possession.

The family home – the valuation of property – undivided shares

The law relating to undivided shares can be found in the Trusts of Land and Appointment of Trustees Act 1996 (TLATA 1996) and the Law of Property Act 1925. Whilst the distinction of a joint tenancy and a tenancy in common can be important in determining the extent of a co-owner's interest, once the extent of the interest has been ascertained, the valuation approach will in practice be the same.

Where at the valuation date any co-owner remains in occupation of the property, as their main residence, the normal approach is to take half the freehold vacant possession value and deduct 15%. This approach is in accordance with the Lands Tribunal decision of Wight and Moss v CIR (264/932/82).

Where, at the valuation date, a co-owner has a right to occupy the property as their main residence but by choice does not actually occupy, it is necessary to consider the purpose behind the trust for sale or trust of land. If this purpose still exists and is capable of being fulfilled, the discount would normally be 15% and in other cases, 10%.

Example

Mr A owns a half share of the family home (valued at say £300,000) with his wife, Mrs A. They own the property equally as tenants in common as they have each stipulated in their wills that their shares of the property will pass to their son, Malcolm, on their death.

When Mr A died, his share passed to Malcolm and at that point, it seems unlikely that a discount would be available due to the related property rules.

If the son Malcolm was to die before his mother, Mrs A, his share of the property would be valued with a 15% discount as the purpose behind the trust for sale or trust of land still exists (ie, Mrs A is still alive). However, if Mrs A was to die before Malcolm, her half share of the property would be valued with a 10% discount.

Provided the shareowner is deriving some current benefit from the ownership of the share, but where they have no rights of occupation as a main residence, the valuation of this half share would be by taking the full value of the property and making an allowance of 10% from the share fraction. The Lands Tribunal endorsed this principle in the case of James Anson St Clair-Ford v HMRC (2006).

Minority shares - In cases where the prospects of a Court granting an order for sale are thought to be less than 'highly likely' or the costs of such an action would be prohibitive, then some greater discount than 10% would be appropriate – and it is suggested this could be up to 20%

Majority shares – A majority shareholder is normally in a more powerful position than a minority one but still has its disadvantages and therefore a discount of up to 10% should be applied in normal circumstances.

Further guidance can be obtained by visiting the Valuation Office Agency website at - http://www.voa.gov.uk/corporate/Publications/Manuals/InheritanceTaxManual/sections/r-section_18/b-iht-man-s18.html

The family home – the case of Woodhall v CIR - was there an IIP?

In the case of Woodhall v CIR a father died leaving his home to his two children for their lifetime. One of the children occupied the house and died in occupation. The case established that there was an interest in possession of just 50% and not 100% even though the other child did not occupy the property. The purpose and effect was to give each child a determinable life interest.

The family home – the case of Faulkner - was there an IIP?

In the case of Faulkner (Adams Trustee) 2001, Mr Adams died leaving a will and a letter of wishes stating that Mr and Mrs Harrison could live in the property during their lifetimes. It was held that the will established an interest in possession and not, as the taxpayers claimed, a licence to occupy.

Contributed by Amanda Fisher

Administration

Tax-related penalty

Summary – The Court of Appeal set aside the penalties imposed by the Upper Tribunal and proceeded to remake the decision as this was the preference of the parties.

Mr Tager, a barrister, had submitted his tax returns for the years 2008/09 to 2010/11 during in April 2012. He had failed to comply with information notices relating to those returns. In the meantime, Mr Tager's father had died and Mr Tager had become liable to IHT. Once again, information notices were issued in relation to the IHT return and penalties for non-compliance were imposed. HMRC had applied for permission from the Upper Tribunal to impose a tax-related penalty (FA 2008 Sch 36 para 50).

The Upper Tribunal had imposed a penalty of over £1m (representing 100% of the tax due) for the appellant's repeated failures to comply with information notices.

Evetually, Mr Tager provided the relevant information to HMRC who agreed that his income tax liability was £1,250 and the IHT due was £195,471.

Decision

The Court of Appeal found that the Upper Tribunal should not have accepted HMRC's figure for the tax unpaid in circumstances where it was clearly subject to uncertainties and a discount was therefore appropriate. The court concluded: 'The imposition of a tax-related penalty under paragraph 50 is a serious matter, and there has to be a solid foundation for the tribunal's own assessment of the amount of tax unpaid or likely to be unpaid.'

The court added that the Upper Tribunal had been wrong to refer to FA 2009 Sch 55 and, in particular, the notion of deliberate concealment, as in FA 2008 Sch 36 para 50, Parliament had deliberately refrained from enacting a prescriptive regime. Furthermore, HMRC's case had never been that Mr Tager was guilty of conduct of that nature; although Mr Tager's conduct had been 'deplorable', it had not been dishonest.

The court therefore set aside the penalties imposed by the Upper Tribunal and proceeded to remake the decision as this was the preference of the parties, and remitting the case to the Upper Tribunal would mean remitting it to a differently constituted Upper Tribunal following the retirement of Judge Bishopp. When assessing the penalty, the court observed that it is not 'always necessary to show a demonstrable link between the tax unpaid and the penalty imposed'. The court imposed a £20,000 penalty for the failure to comply with the income tax notices and a £200,000 penalty in relation to the IHT notices, noting that: 'The lamentable history … would be wholly unacceptable from any taxpayer, let alone a leading and successful barrister.'

R Tager and the personal representatives of the estate of O Tager v HMRC [2018] EWCA Civ 1727

Adapted from Tax Journal (27 July 2018)

Payrolling Benefits - Option for Employers (Lecture B1093 – 15.23 minutes)

In order to reduce the number of P11D returns that require processing HMRC introduced from April 2016 the option for employers to payroll most benefits in kind. The RTI system supports the payrolling of BiKs giving employers the ability to report BiKs that have been taxed each pay run alongside taxable pay. With regard to Universal Credits the government has indicated that in the longer term earnings calculations may include an amount for BiKs where applicable.

The changes made to the PAYE regulations allows employers to payroll all benefits in kind except employer provided accommodation and beneficial loans. Where an employer opts to payroll benefits in kind their obligation to make a return, form P11D, will no longer apply, but only for those BiKs payrolled. Employers will report the value of the payrolled BiKs through Real Time Information.

Timing is key: An employer who wishes to payroll benefits must make an online application for authorisation using HMRC's payroll registration service. This must be completed BEFORE the start of the tax year. If the deadline is missed the employer will have to wait until the following tax year to start payrolling the BiKs. The application must give the employer's PAYE scheme details, select the employees and the benefit(s) which will be payrolled. Where an employer wants to stop payrolling they can make an application to withdraw from being an authorised employer. The withdrawal takes effect from the end of the tax year in which notification is given to HMRC.

Informing employees that payrolling benefits –The employer must provide their employees with letter explaining that benefits are being payrolled and what it means to them. In addition, although no P11d is required, the employer must give their employees the following information, via the payslip or a letter or note, before 1st June after the end of each tax year:

- Details of the benefits that have been payrolled
- The cash equivalent of each payrolled benefit
- Separate details of any benefits not payrolled

The employer calculates the "cash equivalent" of the benefit for payrolling in the same way as for reporting on the P11D. If the value of the benefit is not known the employer can use an estimate and adjust later in the tax year. The cash equivalent figure is then divided by the number of pay periods in the year. The result is the taxable benefit per pay day and that figure must be added to the employee's gross pay and tax calculated as usual based on the new tax code issued by HMRC.

Potential issue when payrolling BiKs and NIL pay – The payrolling of benefits works well for one off benefits with a readily identifiable cost or ongoing benefits where the cost remains the same – medical cover, gym subs. When payrolling BiKs there may be some pay periods where there is low or even NIL pay so tax cannot be collected, e.g. long term maternity, paternity or sick leave where the employee still receives their benefit. In order to protect employee's take home pay in a given period HMRC state that employers must only deduct tax to the value of 50% of an employee's gross taxable pay. This is called the overriding regulatory limit.

In that situation the employer has two options:

- Remove the benefit and employee from payrolling using the online service. If they are excluded for the rest of the tax year the benefit will be brought back into their tax code so they could over or under pay tax. A P11D will then be required. If the employer wants to restart them for payrolling in the new tax year they will have to wait until after filing the P11D as that will trigger the tax code amendment

- Retain the benefit and employee within the payrolling and carry forward any tax underpaid into the next payday for collection if possible

"Making good"

Where the employee pays towards the cost of the benefit, "makes good", the cash equivalent is reduced, e.g. private medical. This will apply if the employee makes good during the year or is expected to have made good the full amount by the end of the tax year. But if the employee fails to make good by the final pay period of the year the employer must work out the benefit still to be taxed, add to final salary for tax year and calculate tax due. The tax must be deducted in full unless it exceeds the 50% limit.

Making good for car and van fuel benefit – it is possible that the employer may not know how much fuel has been purchased at the end of the tax year because the invoice has not been received or the employee has not worked out their private mileage at 5th April. Once the figures are known the employee has until 1 June to make good the amount. If they fail to do so the employer must work out the fuel benefit charge and add in full to the next payrun on or after 1 June to calculate the PAYE. Where the benefit continues after 1 June the employer must recalculate the car or van fuel benefit for the current tax year, ignoring making good, and include each payday.

Making good for credit tokens – where the employer has an arrangement with an employee for them to use the business credit card and repay any private costs incurred the amount due may not be known by 5 April. The employee has until 1 June to make the cost of any benefit received. If they do not then the employer must work out the benefit to be taxed and add to first payment of salary on or after 1 June. In addition payroll the cost of any use of the credit card without taking into account the making good for the current tax year.

Class 1A NIC - a point to note for employers is that the payrolling of BiKs will deal only with the collection of the tax that is due. There is no employee NIC to pay on BiKs but there is employer's Class1A NIC payable to HMRC by 19 July after the tax year. So even though the employer may no longer have to file the P11Ds they will still have to calculate the Class 1A NIC due on the BiKs payrolled and file a P11D(b).

Where employer has registered to payroll benefits then for 2018/19:

- If all benefits for all employees have been payrolled, no P11Ds are required;

- If some benefits have been payrolled then P11Ds must be filed for the non payrolled benefits/expenses;

- If some benefits for some employees have not been payrolled, P11Ds are required

Contributed by Alexandra Durrant

PAYE penalties –risk-based approach to continue

HMRC has again reviewed the effectiveness of the risk-based approach to late filing PAYE penalties and has decided to continue this approach for the tax year beginning 6 April 2018.

This means that late filing penalties will continue to be reviewed on a risk-assessed basis rather than be issued automatically. The first penalties for the tax year beginning 6 April 2018 will be issued in September 2018.018.

The approach will also include continuing to not charge penalties automatically if a FPS is filed late but within 3 days of the payment date and there is no pattern of persistent late-filing. This is not an extension to the statutory filing date which remains unchanged. Employers are still required to file their submissions on or before each payment date unless the circumstances set out in the 'Sending an FPS after payday' guidance are met. Employers who persistently file after the statutory filing date but within three days will continue to be monitored and may be contacted or considered for a late filing penalty.

Similarly, late payment penalties will also continue to be raised on a risk-assessed basis rather than automatically, focusing on penalising those who persistently pay late and are of greatest risk.

HMRC will continue to review their approach to PAYE penalties beyond 5 April 2019 in line with the wider review of penalties and will continue to focus on penalising those who deliberately and persistently fail to meet statutory deadlines, rather than those who make occasional and genuine errors for which other responses might be more appropriate.

PAYE Settlement Agreements and Scottish Income Tax

The PSA1 form that employers complete to submit PAYE Settlement Agreements (PSAs) will be changing for the 2018 to 2019 tax year.

This is to incorporate the rates and threshold changes for Scottish Income Tax. When completing a PSA1 form for the 2018 to 2019 tax year you will be asked whether the Expense or Benefit is for a Rest of the UK (rUK) taxpayer or a Scottish taxpayer. This will allow you to provide HMRC with accurate PSA details for all of your employees.

NRCGT Tax Return filing — inconsistency reigns

The NRCGT Tax Return now has to be made to HMRC within 30 days of the date of completion but many people did not know about this deadline, as they were not UK resident when the law changed. When a return is filed late, a penalty is charged even if no CGT is due.

The law allows the penalty to be waived if the taxpayer has a reasonable excuse and here is where the inconsistency lies.

Is ignorance of the law a reasonable excuse?

A number of taxpayers have appealed to the Tax Tribunal on the basis that they had a reasonable excuse as they did not know about the change in the law and only submitted the NRCGT Return when they realised they needed to do so.

The Tribunal decision in 2017 in the case McGreevy v HMRC gave encouragement to other taxpayers who had received similar penalties for late filing of NRCGT Returns. At least one other Judge took a similar view, but others have said that ignorance of the law cannot be a reasonable excuse for the late filing of a return and have upheld the penalty assessments:

NRCGT late filing penalty case	Reasonable excuse?
Ann Rowan-Smith v HMRC (2018)	Yes
Ian Smith v HMRC	Yes
Pidcock v HMRC [2018]	No
Bradshaw v HMRC [2018]	Yes
Cobb and another v HMRC [2018]	No
Nugent v HMRC [2018]	No
Scowcroft v HMRC [2018]	Yes
Wong v HMRC [2018]	No
Harrop v HMRC [2018]	No
Hart v HMRC [2018]	Yes (reasonable excuse due to reliance on an adviser)
Jackson v HMRC [2018]	No (penalty reduced due to special circumstances)
Hesketh v HMRC [2017]	No
Welland v HMRC [2017]	No (penalty reduced due to special circumstances)
Saunders v HMRC [2017]	Yes
McGreevy v HMRC [2017]	Yes

There appears to be a fundamental disagreement between Tribunal judges on this point and much as a taxpayer might want to have their appeal listed before a particular Judge, there is no power to pick and choose.

Does it matter?

The issue here is that decisions of the First-tier Tribunal do not create precedent with each judge free to decide on the correct interpretation of the law regardless of what another Judge might think. Ideally we need a case to be taken to the Upper Tribunal and higher courts so that a precedent is created and we have a definitive ruling on the issue.

Voice identification: HMRC privacy notice

HMRC say that Voice identification will:

- make it easier for you to pass the security process;
- reduce the time you wait to speak to an advisor;
- help prevent anyone else accessing your HMRC account.

Currently taxpayers can use voice identification for:

- PAYE;
- Chid Benefit;
- National insurance;
- Tax credits debt management;
- Self Assessment debt management.

This privacy notice explains how HMRC collects and uses your voice identification data.

How HMRC collect your voice identification data

When registering for voice identification, HMRC will ask the person to repeat the phrase 'my voice is my password' up to 5 times. HMRC stores voice recordings, and converts them into biometric data by using the sound and rhythm of the voice to identify a numerical pattern. This pattern is unique to each person and still works if the individual is unwell.

HMRC will keep voice identification data for 6 years from the date it was last used, unless:

- Consent is withdrawn;
- The voice identification system is replaced.

Personal data is encrypted and stored in HMRC's UK data centre and never shared with anyone outside HMRC.

www.gov.uk/government/publications/voice-identification-privacy-notice

Deadlines

1 September 2018

- Payment of corporation tax liabilities for periods ended 30 November 2017 if not liable to pay by instalments

7 September 2018

- Due date for VAT return/ electronic payment for 31 July 2018 quarter

14 September 2018

- Quarterly corporation tax instalment payment for large companies.
- Monthly EC sales list if paper return used

19 September 2018

- Pay PAYE/CIS liabilities for month ended 5 September 2018 if by cheque
- File monthly CIS return

21 September 2018

- File online monthly EC sales list
- Intrastat — submit supplementary declarations for August 2018

22 September 2018

- PAYE/NIC/student loan/CIS payments due if paid online

30 September 2018

- Private companies - 31 December 2017 accounts to Companies House
- Public limited companies - 31 March 2018 accounts to Companies House
- CTSA returns filed for periods ended 30 September 2017
- End of CT61 quarterly return period
- 2017-18 Small business relief claims deadline to local authority
- Businesses to reclaim EC VAT chargeable in 2017

1 October 2018

- Payment of corporation tax liabilities for periods ended 31 December 2017 if not liable to pay by instalments

5 October 2018

- Notify HMRC of chargeability to income tax and CGT for 2017/18

News

EC Infringement proceedings issued

The European Commission has issued letters of formal notice to the UK government, requesting information in respect of share loss relief (CTA 2010, s68) and CGT relief for irrecoverable loans to trader (TCGA 1992 s253) on grounds that both reliefs contravene EU law on free movement of capital.

The Commission has asked the UK to align its rules with EU law on income tax relief for losses on disposals of shares by extending the rules to cover shares in companies which carry out their business activities wholly or mainly EU member states rather than just the UK.

UK legislation allows for the write off of an irrecoverable 'qualifying loan' against its liability to capital gains tax or to corporation tax on chargeable gains. However, the rules differentiate between the tax treatment of 'irrecoverable loans' granted to UK residents and those granted to non-UK resident borrowers. This imposes an unjustified restriction on the free movement of capital (Article 63 TFEU).

The UK has two months to respond to the Commission's request.

As a member state, the UK is required to comply with the reasoned opinion and, if it fails to comply, proceedings would be brought before the CJEU. However, if referred to the CJEU, the case may take a number of years to be heard and it is currently unclear on how this would proceed if the UK is no longer bound by the CJEU on leaving the EU.

europa.eu/rapid/press-release_MEMO-18-4486_en.htm

EC advances infringement proceedings against UK on VAT MOSS

The 'reasoned opinion' is the second step in the Commission's infringement procedure, which follows the issue of a 'letter of formal notice'.

The European Commission sent a letter of formal notice in January 2018 and on 19 July 2018, they sent their 'reasoned opinion' to the UK authorities, requesting the UK to share with other Member States the bank account details of traders registered for the VAT mini one-stop-shop, in order to comply with the EU administrative cooperation regulation.

The UK practice violates EU rules on administrative cooperation and exchange of information (Council Regulation 904/2010 and Commission Implementing Regulation 815/2012). At the moment, Member States who want to refund taxable persons in the UK have to collect additional information on a case-by-case basis, which is burdensome and delays refunds. If the United Kingdom does not act within the next two months, the Commission may decide to bring the case before the Court of Justice of the EU.

The UK has two months to respond to a reasoned opinion. Failure to comply at that stage may lead to a referral to the CJEU.

europa.eu/rapid/press-release_MEMO-18-4486_en.htm

PAYE equivalent for online platform workers?

The OTS has published its third paper on the platform, or 'gig', economy, looking at how to simplify the tax experience of the increasing number of individuals who work on a self-employed basis through online platforms such as taxi or delivery firms.

The paper suggests a system like PAYE for self-employed platform workers, which would see operators taking on the responsibility for fulfilling the tax obligations of their workers, but without affecting their employment status.

It is believed that such an arrangement might prevent quite large numbers of individuals having to submit self-assessment tax returns and a computation of their self-employment income.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/726943/OTS_platform_paper.pdf

Beneficial ownership register published

The government has published in draft the Registration of Overseas Entities Bill that sets out provisions to establish a new beneficial ownership register of overseas entities that own UK property.

The Bill follows the commitment made at the anti-corruption summit in 2016 to establish such a register, in order to combat money laundering and achieve greater transparency in the UK property market. As announced in January 2018, the government expects to introduce the Bill formally to Parliament in 2019. Following royal assent and the making of secondary legislation, it intends the register to become operational in 2021.

The draft Bill is open for consultation until 17 September 2018.

The Department for Business, Energy and Industrial Strategy is inviting views on:

- overseas entities that may not have beneficial owners or managing officers;
- the power to exempt some overseas entities, such as foreign governments or public authorities, from the requirement to join the land register;
- the power to modify the application of the regime for overseas entities already disclosing beneficial ownership information to an 'equivalent' public register;
- the registration of entities unable to identify their beneficial owners;
- the scope of the prohibitions to dispositions relating to land;
- the power to disapply the effect of the prohibitions placed on land; and
- exceptions to prohibitions placed on land.

https://www.gov.uk/government/consultations/draft-registration-of-overseas-entities-bill

OTS business lifecycle - scoping document

The first business life cycle review by the OTS addressed the tax charges and reliefs applicable at key stages or events over the course of the life of a business (Start up, Incorporation, Finance, Succession and Disposal). The primary focus was on external events such as the raising of capital or a change in ownership.

In this second review, the focus will be on internal events looking at the direct and indirect tax issues facing unincorporated and incorporated businesses in the course of their ordinary operations, focusing on smaller businesses, particularly those with £2m turnover or less or fewer than 10 employees.

The review will consider issues such as:

- the accessibility and clarity of guidance and support in relation to the process of setting up a business, including the information on gov.uk (linking to the OTS's wider work on guidance), including issues arising from the interaction between an individual's personal and business affairs;
- how a business works out and administers its taxes (taking into account matters such as Making Tax Digital, record-keeping, filing returns, understanding allowable deductions);
- sources of error and unnecessary complexity, and ways these could be eased or mitigated;
- the way the tax system handles unprofitable years or shorter-term cash flow issues (for example through the loss rules and time to pay arrangements) and the extent to which the tax system helps businesses manage the cash flow demands of paying tax more generally;
- the impact of taking on the businesses' first employee and subsequent employees (with regard to payroll taxes, completing P11Ds in relation to benefits, employment allowance);
- the impact and any distortive effect of thresholds (recognising the significance of issues of this kind that the OTS drew attention to its 2017 VAT report);
- issues arising in relation to relevant tax reliefs such as R&D tax credits;
- making overseas sales or purchasing goods or services from abroad for the first time;
- issues arising as the business develops, for example moving to new premises.

www.gov.uk/government/publications/ots-scoping-document-for-further-review-of-business-life-cycle

Late payment interest rates to rise

On 2 August 2018, the Bank of England Monetary Policy Committee voted unanimously to increase the Bank of England base rate to 0.75%.

As HMRC interest rates are linked to the Bank of England base rate, HMRC interest rates for late payment will be increased with the changes coming into into effect on:

- 13 August 2018 for quarterly instalment payments (1.5% to 1.75%)
- 21 August 2018 for non-quarterly instalment payments (3% to 3.25%)

The new rates will be announced shortly.

Repayment interest rates remain unchanged at 0.5%

www.gov.uk/government/news/hmrc-late-payment-interest-rates-to-be-revised-after-bank-of-england-rate-rise

Business Taxation

Income from conditional fee agreements

Summary – An adjustment to bring conditional fee arrangement income into the accounts on an earnings basis was needed. if the taxpayer and HMRC could not agree the figure, then either party may apply to the Tribunal within 90 days of the date of release of the decision for the Tribunal to determine the adjustment for them.

Siraj Ahmed is a practising barrister. The issue between the parties was the treatment of conditional fee agreement income and more specifically, the basis period on which the income should be recognised. It was common ground that no income was to be accounted for until a fee becomes payable, so in other words, when the case had been successfully concluded.

The issue was essentially one of timing. HMRC took the view that there must be cases where the case outcome was known at the end of the basis period but where payment of the fee had not been made. Rather than review each case individually, HMRC estimated the income which fell due for payment before the end of the basis period but which was not paid until after the end of the basis period looking at the ratio of payments made to Siraj Ahmed in the 3 months following the period end compared to debtors less than 12 months old at the period end.

Decision

Given that HMRC chose to focus on conditional fee arrangements, the Tribunal said that they did not see how the ratio would give an accurate estimate. The figures included all fees received on non- conditional fee agreement work, on conditional fee agreement work where the case has been both won and paid in that period and on conditional fee agreement work where the case has been won on or before 31 March 2010 but not paid until after that date. Going on to apply the resulting percentage to debtors less than 12 months old did not in their view give a meaningful figure. The Tribunal concluded that the method of calculation did not provide any sort of proxy or give any reliable estimate for the amount of conditional fee agreement cases paid after the year-end that had been won before the year end.

The Tribunal was satisfied that as a result of the approach taken by the officer the closure notice was likely to overstate the adjustment necessary. However, Siraj Ahmed did not satisfy them that no adjustment was necessary; on the evidence before them, they could not say what adjustments ought to be made. The tribunal said that the parties will now have to consider what if any adjustment ought to have been made and if they are unable to agree that adjustment then either party may apply to the Tribunal within 90 days of the date of release of this decision for the Tribunal to determine the adjustment.

It seemed to the judge that there was at least one obvious approach to take so that the accounts properly reflected the earnings basis. Using the payments schedule for the 3 months following the year end, it is easy to identify non- conditional fee agreement cases which had been billed before the year end and which were paid after the year end. That income would be properly taxable in the year prior to payment. In relation to the conditional fee agreement income, each case or a sample of cases could be looked at to consider when as a matter of fact the case had been won so as to trigger the right to payment.

It would then be straightforward to identify what proportion of all payments received in the 3 months following the year-end should properly be accounted for as earnings in the tax year prior to payment. For the purposes of the enquiry, the respondents could have looked at each relevant year end and carried out a similar exercise, or extrapolated using the figures for 31 March 2010 and payments in the following 3 months.

Siraj Ahmed V HMRC (TC06569)

Capital allowances on hydroelectric project

Summary – The company was eligible for plant and machinery capital allowances on some expenditure incurred in the construction and rectification works at an underground hydroelectric power scheme but some was not.

SSE Generation Ltd is part of a group of energy companies, involved in the generation, transmission, distribution and supply of electricity, the production, storage, distribution and supply of gas and various associated energy services.

SSE Generation Ltd constructed the first large-scale hydroelectric scheme with a conventional hydraulic head feed built in the UK in the last 50 years, capable of producing 100MW of power. Construction began in February 2006 and was completed in December 2008. Shortly after being opened by Her Majesty the Queen on 29 June 2009, it was discovered that major remedial works were required to deal with problems caused by a subterranean rockfall. Those rectification works commenced in 2010, the Scheme only becoming fully operational again in August 2012.

This case considers the eligibility for plant and machinery allowances of various components of the Scheme both during original construction as well as the remedial work. The total cost was some £300 million. Capital allowances were claimed on some £260 million but HMRC accepted only £34 million. Approximately £227 million remained in dispute. The Scheme consisted of a number of different elements, and there was disagreement about the treatment, for capital allowance purposes, of most of them.

The parties are agreed that the Scheme should be considered "on a piecemeal basis by looking at the function of each of the items in dispute" and HMRC accepted the piecemeal approach but disputed applying it, at least for the purposes of the Lists in sections 21 to 23 CAA 2001, by reference to the function of the items.

Decision

The First Tier Tribunal decided that they should firstly establish whether the relevant items were "plant" at all, before becoming entangled in the statutory exclusions of and savings contained within Ss 21 to 23 CAA 2001. In reaching their final decision, the Tribunal concluded that some items were plant while others were not. Items excluded were:

- the cost of constructing the "Cut and cover" reinforced concrete conduit (but costs of excavation and subsequent re-covering were allowable in full);
- the cost of excavating the caverns (but the costs of erecting the reinforced concrete structures within the power cavern in order to mount the crane and the generating equipment properly were allowable along with the steel access hatches allowing the crane to perform its function;

Some tunnels were allowable while others were not:

- Main access tunnel – not allowable;
- Turbine outflow tunnel – allowable in full;
- Drainage and dewatering tunnels – allowable in full;
- Connection tunnel and emergency tunnel – not allowable;
- Transformer cable tunnel – allowable in full.

SSE Generation Ltd v HMRC (TC06618)

UK-resident companies receiving dividends from overseas companies

Prudential Assurance Company was a test claimant in litigation concerning the tax treatment of UK-resident companies that received dividends from shareholdings in overseas companies between 1990 and 2009.

Decision

The Supreme Court confirmed that the tax credit was set by reference to the foreign nominal tax rate. It allowed HMRC's appeals against compound interest and a restitution claim, and allowed the taxpayer's cross-appeals on the order of set-off for advance corporation tax and franked investment income.

On interest, the Supreme Court said, since the House of Lords ruled in Sempra Metals Ltd v CIR [2007] STC 1559 that compound interest should be paid on unlawfully levied advance corporation tax, developments indicated that the decision had not had regard to tax legislation, created problems in the law of limitation, and caused disruption in public finances. The court said there was no right to interest on the basis that HMRC was unjustly enriched by the opportunity to use the money owed to the taxpayer.

Prudential Assurance Company Ltd v CRC, Supreme Court, 25 July 2018

Adapted from Taxation (2 August 2018)

VAT

R&C Brief 7/2018: VAT - motor dealer deposit contributions

This brief explains HMRC's policy on the VAT accounting treatment of promotions where payments are said to be made by motor dealers to finance companies on behalf of the end customer. These are often but not exclusively referred to as dealer deposit contributions (DDC) in the motor retail trade.

This brief is not concerned with manufacturer deposit contributions (MDC), which are promotions where the manufacturer or importer of the vehicle make a contribution to reduce the amount that the customer has to pay for the vehicle. The manufacturer or importer can continue to make adjustments to the VAT they have accounted for as explained in VAT information sheet 03/14: treatment of refunds made by manufacturerson the National Archives website.

Dealer deposit contributions

Normally, when a vehicle is sold on finance the purchase price is agreed between the customer and the dealer and the dealer completes all the documentation on behalf of the finance company.

There is a sale by the dealer to the finance company and an immediate onward sale by the finance company to the customer.

The customer knows and agrees the final selling price (consideration), including the amount of any deposit and the finance terms, when the agreement with the dealer is made and the documentation is completed.

In marketing material DDCs are described as a financial contribution by the dealer towards the deposit required from the customer by the finance company.

For example a finance company may require a deposit from the customer of £8,000 on a £28,000 car. Under a DDC promotion the dealer is said to contribute (say) £2,000 towards the deposit. The effect being that the customer only has to pay £26,000 for the vehicle (plus finance charges).

Some dealers and finance companies account for VAT based on the headline price (£28,000) with the DDC then deducted from the payment due. By deducting the DDCafter the VAT has been calculated and by bearing the burden of the DDC (£2,000) dealers are over paying VAT as they account for more VAT than the customer pays.

Some dealers have tried to correct this by making an adjustment to their VAT account based on VAT Regulation 38ZA.

HMRC views DDCs as a discount on the headline price charged by the dealer. The DDCis shown on the finance and sales documentation and is agreed by all the parties to the transactions before these take place. There is no retrospective adjustment to the amount the customer will pay, nor the amount the finance company will pay the dealer.

VAT is therefore due on the discounted amount actually charged to the finance company and the customer.

For example, the headline price of a car is stated as £28,000, this is shown as being funded by £20,000 finance, a deposit (including part exchange) of £6,000 from the customer and a DDC of £2,000. HMRC views the selling price from which VAT is due as £26,000 (£28,000 headline price less the £2,000 discount/contribution from the dealer).

https://www.gov.uk/government/publications/revenue-and-customs-brief-7-2018-vat-motor-dealer-deposit-contributions/revenue-and-customs-brief-7-2018-vat-motor-dealer-deposit-contributions

R&C Brief 8/2018: VAT liability of bicarbonate of soda

This brief sets out a change of HMRC policy following the decision of the First-tier Tribunal in Phoenix Foods Ltd. HMRC will now treat supplies of bicarbonate of soda as zero-rated where they are sold in small tubs as a baking ingredient, similar to those made by Phoenix. Repayment claims may be made, subject to the statutory 4-year time limit. Bicarbonate of soda sold in larger quantities, or marketed for non-culinary purposes, will remain standard-rated.

www.gov.uk/government/publications/revenue-and-customs-brief-8-2018-vat-liability-of-bicarbonate-of-soda

R&C Brief 9/2018: VAT on damp-proofing products

This brief clarifies that HMRC does not regard damp-proofing products, such as paints, creams or gels (typically applied to the exterior walls of houses), as energy-saving materials that qualify for the reduced rate of VAT. From 1 September 2018, businesses must account for VAT at the standard rate on all sales and applications of these products.

Businesses that make supplies of installing certain energy-saving materials in residential accommodation to final customers qualify for the reduced rate of VAT.

HMRC has become aware of a number of businesses that are marketing damp proofing products such as paints, creams and gels as energy-saving materials so implying that such supplies applied the walls of residential accommodation are eligible for the reduced rate. This treatment is supported by the Tribunal in the case Safeguard Europe Ltd v HMRC [2013] UKFTT 145 (TC) ("Safeguard"), which decided that one such product known as Stormdry qualified as an energy-saving material. However, this is a First-tier Tribunal decision, it is not binding and cannot be used as a precedent.

HMRC has concluded that these products do not qualify as ESMs for the following reasons:

- the dominant purpose of these products is to water-proof exterior walls rather than improving thermal efficiency
- there is no conclusive evidence that these products improve the thermal efficiency of brickwork

- if such evidence became available, it is likely that any improved thermal efficiency would be incidental to the dominant purpose of the products
- the products are not normally described as insulators
- the products are sold as water-and-damp proofing products and not insulators
- legislation refers to energy-saving materials as being “installed”, which indicates that the legislation more naturally refers to typical insulators such as cavity wall insulation rather than the damp proofing products which are ‘applied’

HMRC will apply this policy with effect from 1 September 2018 to give businesses time to change their marketing and update their systems.

www.gov.uk/government/publications/revenue-and-customs-brief-9-2018-vat-damp-proofing-products

R&C Brief 10/2018: VAT cost-sharing exemption

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

This exemption allows small providers who cannot afford to acquire assets on their own account to benefit from the same overall VAT position as larger providers who can afford to purchase the assets themselves. The circumstances where the CSE applies are fully explained in the VAT Cost Sharing Exemption manual CSE 1010.

Luxembourg has a rule where residual costs used by a CSG could be treated as qualifying for exemption under the CSE if up to 30% of those costs were also used by the members to make taxable supplies. The UK has a similar test but with a lower percentage of 15%. This is referred to in this brief and the former guidance as the ‘directly necessary’ test.

The Advocate General in Commission v Luxembourg (Case C-274/15) said that the CSE could not be used for such costs and this was confirmed by the Court in its judgment. The current tests for directly relevant services are therefore withdrawn from 15 August 2018.

This means some CSGs will have to register for VAT if they go above the current registration threshold, however they may not need to do this before 31 December 2018 because of the transitional arrangements.

Changes to HMRC’s policy

The Court in its judgment held that the CSE was not restricted to CSGs whose members exclusively carried on exempt or non-business activities. Services which are bought by the CSG for mixed use could qualify for the CSE, but only to the extent that they were directly necessary for exempt or non-business activities by the members of the CSG.

HMRC is therefore introducing guidance on a suitable apportionment calculation that may be used where it is practicable to do so, and the conditions for its use can be met.

Apportionment of the recharge of costs by the CSG to its members will be allowed if the CSG can carry it out fairly and keep records necessary for HMRC to verify the calculation. Full details are in the updated VAT Cost Sharing Exemption manual pages CSE3850 to CSE 3895.

HMRC reserves the right to refuse the exemption:

- if the records to justify the apportionment used have not been keep;
- in any case of avoidance or abuse.

Transitional arrangements

CSGs that have correctly used the previous guidance can continue to use the previous tests for directly necessary services until 31 December 2018, to give them time to make sure the correct records are set up and kept.

The transitional arrangements cannot be used or relied on in cases:

- of tax avoidance;
- where there is likely to be a distortion of competition.

Services invoiced or paid for before 31 December 2018 will only benefit from the transitional arrangements to the extent that they're performed before that date (specifically the basic tax point under section 6(3) of the VAT Act 1994 will apply).

Where prepayment or invoices cover services to be performed both before and after that date, then a reasonable apportionment will be needed.

www.gov.uk/government/publications/revenue-and-customs-brief-10-2018-vat-cost-share-exemption

Tackling offshore looping

Providers of financial services generally cannot reclaim the VAT they incur on their costs because their services are VAT exempt. An off-shore loop is a cross-border structure that enables these VAT costs to be recovered by routing services primarily carried out in the UK via a body located in a non-VAT territory. Those services, typically found in the insurance sector, are then used to provide insurance and other financial services back into the UK market. This is contrary to the intention of the VAT system and distorts competition to the disadvantage of domestic UK suppliers.

The government will amend UK law using secondary legislation later in the year. This will reduce the scope of the current VAT relief for exporters of financial services by excluding financial intermediation in supplies made ultimately to UK customers. This will mean that the UK providers of these financial services will no longer be able to gain a VAT advantage by acting as an agent for an overseas associate when the services are in fact being provided to their UK customers. The draft legislation and explanatory note will be published today and will be available on the gov.uk website.

HM Treasury has published a draft order to prevent VAT avoidance schemes of the type successfully defended by Hastings Insurance Services at the First-tier Tribunal, involving recovery of VAT on exempt financial services by routing these services through offshore entities outside the EU.

www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-07-19/HCWS889

Deduction of input tax

Summary – JDI International Leasing Ltd was not entitled to deduct input tax on the acquisition of tools, even though it carried on the taxable activity of supplying spare parts.

JDI International Leasing Ltd is a Cayman Islands incorporated company which is a member of the Baker Hughes Group. The company acquired a number of highly specialised oilfield drilling tools and intellectual property rights relating to the Tools pursuant to an intra-group reorganisation largely carried out in October 2012.

The dispute relates to the UK tools that JDI International Leasing Ltd leased to a Dutch company, Baker Hughes Nederland BV (“BHN”), which in turn subleased them to operating companies in the Baker Hughes Group (the “Operating Companies”). The Operating Companies make the Tools available to third parties engaged in oil exploration and production activities.

Ownership of the Intellectual Property entitles JDI International Leasing Ltd to manufacture or procure the manufacture of further Tools, spare parts and other consumables relating to the Tools (“Spare Parts”). JDI International Leasing Ltd procures the manufacture of Spare Parts from other group companies and supplies them to the Operating Companies.

It was accepted that, in order to obtain a deduction for input tax, JDI International Leasing Ltd must establish that the VAT it incurred on the supply of the UK tools would have been recoverable as input tax if JDI International Leasing Ltd had been a taxable person carrying on its activities in the UK.

It was common ground that the leasing of the UK tools to BHN did not constitute an economic activity since it was for no consideration. In addition, the First Tier Tribunal had found that JDI International Leasing Ltd had failed to establish a direct and immediate link between the acquisition of the tools and its economic activity of supplying spare parts. This was the issue of the appeal.

Decision

The Upper Tribunal agreed with the First Tier Tribunal’s decision. It noted that the principal VAT directive arts 17 and 168 both require the relevant goods to be 'used' for the purpose of taxable transactions. It added that this had been expressed 'both in terms of “direct and immediate link” and in terms of a cost component of output transactions'; however, the underlying requirement was based on use as established in both Iberdrola (Case C-132/16) and Sveda (Case C-126/14). The Upper Tribunal accepted that the spare parts were designed for use with the tools; however, this 'close relationship' between the two supplies was not sufficient to satisfy a test which was based on use.

JDI International Leasing Ltd v HMRC [2018] UKUT 0214 (TCC)

Extended VAT grouping

Currently, membership of a VAT group is limited to corporate bodies. Partnerships or individuals are unable to join VAT groups even if they control corporate subsidiaries which themselves have come together to form a VAT group.

It has been clear since the European Court of Justice (CJEU) decisions in Larentia + Minerva and Marenave (Cases C-108/14 and C-109/14) that the UK's current VAT grouping rules sit uncomfortably with EU legislation in their blanket exclusion of non-corporate bodies.

HMRC has published concrete plans to extend the scope of VAT grouping to allow persons who are not 'corporate bodies' to join VAT groups if the individual or partnership:

- controls the corporate body or all of the corporate bodies in the VAT group;
- has a business establishment in the UK; and
- is liable or entitled to register for VAT under Sc1 VATA 1994.

The plans are set to come into effect after Royal Assent to the Finance Bill 2019 and on a day to be appointed by Treasury regulations. They will come by way of amendments to VATA 1994, s 43A and the introduction of a new VATA 1994, s 43AZA.

Remember group members are jointly and severally liable for the group's VAT debts. Individuals and partnerships will need to carefully consider whether are are willing to take on this additional personal risk by becoming part of such a VAT group.

Totel's appeal against VAT 'pay-first' requirement lost

Summary - The Supreme Court held that the UK requirement to 'pay-first' when appealing VAT assessments did not breach the EU principle of equivalence because VAT, which places the economic burden upon consumers rather than traders, has no true comparator among other UK taxes against which it can be said to receive less favourable treatment.

Under s84 VATA 1994, traders wishing to appeal against UK VAT assessments are required, to first pay or deposit the tax with HMRC, unless they can demonstrate that to do so would cause them to suffer hardship.

Totel Ltd appealed a number of assessments to VAT but has been unable to demonstrate that a requirement to pay or deposit the tax in dispute would cause the company hardship. Totel claims the requirement to pay or deposit the disputed tax, as a pre-condition for an appeal, offends against the EU law principle of equivalence.

Decision

The Supreme Court said that the principle of equivalence requires a true comparator for it to be able to operate at all. Identification of one or more true comparators was therefore the essential first step.

They said that whether any proposed domestic claim is a true comparator with an EU law claim is context specific. The "pay-first" requirement is not a condition for appealing assessments to Income Tax, Capital Gains Tax, Corporation Tax or Stamp Duty Land Tax.

Applying the context-specific analysis, the Court of Appeal was correct to conclude that none of the domestic taxes constituted true comparators with VAT. A trader seeking to appeal a VAT assessment is typically in a significantly different position from a taxpayer seeking to appeal an assessment to any of those other taxes .

VAT's economic burden falls upon the consumer, but it is collected by the trader from the consumer and accounted for by the trader to HMRC. Taxpayers appealing Income Tax, for example, are being required to pay something of which the economic burden falls on them and which they have not collected from anyone else. Therefore, it is no less than appropriate that traders assessed to VAT should be required to pay or deposit the tax in dispute, which they have or should have collected. This logical connection is sufficient to justify the conclusion that VAT is different to those other taxes in this context regardless of the actual legislative reason for the imposition of the pay-first requirement.

Totel Ltd v HMRC [2018] UKSC 44

VAT treatment of ambulance services

Summary – The provision of emergency ambulance services could not be treated as zero rated and so were exempt.

Ambulance services are normally exempt from VAT because they constitute "the supply of transport services for sick or injured persons in vehicles specially designed for that purpose" within Item 11 of Group 7 of Schedule 9 VATA 1994.

However, under Group 8 Sch 8 VATA 1994 patient transfer services could also be zero rated as Item. 4(a) includes any vehicle designed or adapted to carry not less than 10 passengers. So it was It was common ground that patient transport services were both exempt and zero-rated but zero-rating takes precedence under s30 VATA 1994.

The issue was about the emergency ambulance services provided by Jigsaw using vehicles specially converted and fitted out for stretchers and other equipment. Should they be treated in the same way?

Schedule 8 contains a note relating to Item 4. Note 4D provides:

> "Item 4(a) includes the transport of passengers in a vehicle –
>
> > (a) which is designed or substantially and permanently adapted for the safe carriage of a person in a wheelchair or two or more such persons; and
> >
> > (b) which, if it were not so designed or adapted would be capable of carrying no less than 10 persons."

Thus the decision depended on the interpretation of this note.

The First Tier Tribunal's said that:

> "In our view, the correct approach is to look at the vehicle itself and to determine whether or not that vehicle can, without complete rebuilding, be converted into a vehicle capable of carrying ten or more persons."

They considered that the fact that the emergency ambulances were capable of being converted into ten (or more) seater vehicles was determinative. The fact that this involved removal not just of the adaptations to accommodate the wheelchair, but also the removal of the stretcher, was held to be irrelevant to the test contained in Note 4D. On this basis, the company's appeal was allowed.

Decision

The Upper Tribunal said that it was necessary to begin with Item 4(a), and to ask whether the vehicle in question was designed or adapted to carry not less than ten passengers. None of the vehicles used by Jigsaw could, at the time the supplies were rendered, carry not less than ten passengers given their purpose. The maximum was seven or eight, depending on the vehicle. On this basis, the Supplies fell outside the ambit of Item 4(a).

Does Note 4D change this? The Upper Tribunal gave a useful example to explain their interpretation of Note 4D:

> "To take a simple example: suppose a van has the capacity to carry 12 passengers provided there are no wheelchair modifications. The vehicle plainly falls within Item 4(a). Suppose, however, the consequence of making wheelchair modifications involves the removal of four seats. The capacity of the vehicle is now maximally nine (eight ordinary passenger seats plus one wheelchair passenger). Supposing the wheelchair modifications were not made, what would happen? Self-evidently, in this example, four ordinary passenger seats would be added back in, and the vehicle capacity would be 12."

They concluded that in this case, no seating was actually taken out in order to configure an emergency vehicle with wheelchair modifications. All that was done was to add the restraints enabling a wheelchair safely to be carried.

The Upper Tribunal rejected the First Tier Tribunal's wide approach that had consisted in simply asking whether the relevant vehicle <u>could</u> be converted into a vehicle capable of carrying ten or more people. They observed that this approach was bound to lead to absurd results. It could include a luxury vehicle designed to carry only eight people but which could be rebuilt to carry ten people.

HMRC's appeal was allowed.

HMRC v Jigsaw Medical Services [2018] UKUT 222

MTD – getting the basics right (Lecture B1094 – 13.41 minutes)

Which businesses will need to adopt MTD?

MTD will apply to all VAT registered business that trade over the registration threshold on 1 April 2019 or which exceed the threshold on any rolling 12-month basis thereafter. If the taxable sales of a business are always less than the registration threshold, it will have no need to worry about MTD. This means that all VAT returns for businesses affected by MTD will have to be submitted via compatible software which uses an API (Application Programming Interface) to transmit data to HMRC.

<u>Planning point</u>: A business that is voluntarily registered for VAT can still join MTD if it wishes.

Opportunity to keep out of MTD: Only taxable sales are included in the threshold, so any income that is outside the scope of VAT or exempt from VAT is excluded from the calculations. For example, most B2B services supplied to customers outside the UK are outside the scope of VAT (place of supply is the customer's country) so these sales are excluded.

Warning: Once a business exceeds the registration threshold in any rolling 12-month period, it must adopt digital record keeping, and cannot withdraw if turnover falls below the threshold in the future. So once you are in, you must stay in.

Confusion with HMRC Public Notice 700/22:

HMRC recently published VAT Notice 700/22 headed Making Tax Digital for VAT, and also the stakeholder communications pack that is mentioned in my article. There is one sentence in para 2.1 of the Notice that is misleading, namely the comment that: "Only businesses with taxable turnover that has never exceeded the VAT registration threshold (currently £85,000) will be exempt from Making Tax Digital." This is suggesting that if a business used to achieve annual taxable sales of, say, £110,000 but is now down to £60,000 each year (and is still VAT registered), then it must join the MTD bandwagon in April 2019 because it has exceeded the threshold in the past.

However, the good news is that the stakeholder communications pack issued by HMRC offers clarity at para 12.15 with the question: What if my taxable VAT turnover is below the threshold? The answer confirms as follows: "Businesses already have to check their turnover for the last 12 months at the end of each month to see if it exceeds the VAT threshold. If it does then MTD applies from the first day of the following month." So as long as a business has annual taxable sales of less than £85,000 for the 12-month period ending 31 March 2019 and every rolling 12-month period thereafter, it has no MTD worries.

What is the actual start date for MTD?

VAT periods beginning on or after 1 April 2019.

Example 1 – a business completing VAT returns to the end of February, May, August and November will adopt digital record keeping from 1 June 2019.

Will a business have to adopt MTD if it has never used a computer to keep its records?

This question is best answered with an example that relates to an exact query I dealt with, and I also share the response of HMRC's press office to the question.

Example 2 – manual records

Eric is VAT registered as a sole trader and repairs and services vehicles. He has been in business since 1983 and is 58 years of age. He has always used manual accounting records that have been immaculately kept and he does his own VAT returns. He delivers the records each year to his accountant who completes his self-assessment tax return. His accountant has never discovered any VAT errors in his record keeping.

For the first time in 35 years, Eric must change from manual bookkeeping to digital recordkeeping. He cannot afford to pay his accountant to do this so will have to learn the system and do it himself. This is a major challenge.

HMRC reply:

> "We recognise that this will be a significant change for some customers, particularly if they've been keeping records the same way for many years. Keeping records digitally and providing updates direct from those records will result in more timely and accurate record-keeping and help prevent errors that can happen when businesses are doing manual calculations or transcribing information from one format into another."

Opportunity: HMRC has published a list of those developers with products at the prototype stage on GOV.UK. The expectation is that the market will offer products that customers will find easy to use and time-saving, with some software available at low cost to businesses (eg as low as £10 a month depending on business functionality).

What about spreadsheets?

I will consider spreadsheet issues in my next session on MTD headed "MTD challenges"

What records need to be kept in a digital format?

Permanent data – eg name, address, VAT number and schemes used;

VAT account – figures and calculations making up the figures in the nine boxes of the VAT return; links between different parts of accounting system (including journals)

Transaction data - recording of all sales and purchase invoices – for sales invoices, the data to be recorded includes the net amount; the VAT rate for each amount on the invoice; date (time of supply). Purchase invoices must show the VAT rate, net amount, time of supply and the amount of input tax being claimed.

There is no need to raise sales invoices in a digital format.

Retailers – must record daily gross takings – this has always been a legal requirement. There is no need to digitally record transactions that make up the daily figure.

Key point – each invoice received and issued must be processed and not bundled together.

Example – a garage doing an MoT test charge on the same invoice as his services will need to split the invoice when it is entered into the records.

Will there be any exemptions for MTD record keeping?

A business will not have to follow the MTD rules where HMRC is satisfied that:

- the business is run entirely by practicing members of a religious society whose beliefs are incompatible with the requirements of the regulations (for example, those religious beliefs prevent them from using computers);
- it is not reasonably practicable for the business to use digital tools to keep its business records or submit returns, for reasons of age, disability, remoteness of location or for any other reason;
- the business is subject to an insolvency procedure

Note – there are no exemptions for charities or non-profit making bodies – they must follow the same rules as a commercial business.

If any of the above situations are relevant, then the business owner (or agent) will need to contact HMRC's VAT helpline to discuss alternative arrangements.

Where can I find out more information about MTD?

VAT Notice 700/22 was published on 13 July 2018 and gives a lot of guidance and detail about the new regulations. It is a must-read for advisers and clients affected by MTD.

What about penalties for non-compliance?

HMRC will not generally impose penalties for non-compliance in the first 12 months of MTD.

Contributed by Neil Warren

MTD – four practical challenges (Lecture B1095 – 15.20 minutes)

Cash accounting scheme

The new MTD regulations will take effect from 1 April 2019 and will need to be considered by all VAT registered businesses in the UK. There are a number of practical challenges with the regulations, including an important issue with the cash accounting scheme.

Example 1

Jean is a public relations consultant, who is very creative but struggles with record keeping. She uses a simple spreadsheet system, recording all of the income and expenditure into and out of her bank account and she adopts the cash accounting scheme for VAT. She is confused by her accountant's advice that she will need to obtain bridging software to complete her VAT returns after April 2019. She is also concerned by his comment that she will need to process every single purchase and sales invoice - at the moment she only posts payments received and made through her bank account. For example, she uses one subcontractor who raises an invoice for every contract he works on each week but she only pays him once a month (so this means she receives up to 20 purchase invoices each month).

Key question:

With MTD, will it be acceptable for Jean to just post one payment entry a month for her subcontractor or must she process all 20 invoices separately? If the latter, is this not increasing rather than reducing the risk of making errors?

HMRC reply

VAT record keeping requirements are the same whether or not you use the scheme. There are some additional record keeping rules under this scheme. Records must clearly cross-refer payments:

- received to the corresponding sales invoice;
- made to the corresponding purchase invoice;

- made or received to the normal commercial evidence, such as bank statements, cheque stubs or paying-in slips.

MTD does not change any of the above, So, as now, Jean will be required to process all 20 invoices separately otherwise it could create errors. Currently some businesses use figures directly from their bank account and apply the VAT fraction. This is a source of errors as they may assume all purchases are standard rated so if there is anything in the invoices that is not standard rated they will overclaim input tax."

Flat rate scheme (FRS)

Is there an opportunity for reduced MTD record keeping here? Does a user of the FRS need to record purchase invoices digitally if it is not claiming input tax? Scheme users only claim input tax on capital expenditure goods costing more than £2,000 including VAT.

Example 2

Caroline is a hairdresser who uses the FRS. She keeps a record of her daily gross takings in a manual book and at the end of each VAT quarter, she calculates the total takings for the period and applies her flat rate percentage to this figure. With regard to purchase invoices, she staples all of her invoices together for her financial year and gives them to her accountant, who produces her annual accounts.

Key question:

Under the new MTD system, will Caroline need to process all of her purchase invoices in a digital format even though she claims no input tax on her VAT return because she uses the FRS? Will she also need to digitally process her daily takings figures as well?

HMRC reply

HMRC is not making changes to VAT schemes as part of MTD. Businesses such as Caroline's will be eligible to continue using such schemes and MTD requirements will allow for this. Businesses that qualify for MTD using these schemes will be required to comply with MTD digital record keeping requirements and provide VAT returns using functional compatible software.

Under MTD we have replicated the existing relaxations on record keeping for FRS users in the digital record-keeping obligations. Therefore, scheme users within MTD will not need to keep a digital record of:

- purchases (unless they are capital expenditure goods on which input tax can be claimed (Author note – ie costing more than £2,000 including VAT); or
- the relevant goods used to determine if they need to apply the limited cost business rate.

Spreadsheets

There is still confusion about how a business will comply with the MTD regulations if it adopts spreadsheet accounting and wants to continue to do so.

The HMRC approach is that spreadsheet accounting is fine as long as the business adopts bridging software that links the spreadsheets to the digital VAT return submission. This is a software issue rather than VAT issue but there are hundreds of thousands of businesses which use spreadsheets for their records, often linked with the cash accounting scheme which I considered in the last section. The following are extracts from HMRC Notice 700/22, para 3.2.1:

> "Data transfer or exchange within and between software programs, applications or products that make up functional compatible software must be digital where the information continues to form part of the digital records. Once data has been entered into software used to keep and maintain digital records, any further transfer, recapture or modification of that data must be done using digital links. Each piece of software must be digitally linked to other pieces of software to create the digital journey".
>
> "It follows that transferring data manually within or between different parts of a set of software programs, products or applications that make up functional compatible software is not acceptable under Making Tax Digital. For example, noting down details from an invoice in one ledger and then using that handwritten information to manually update another part of the business functional compatible software system".
>
> "A 'digital link' is one where a transfer or exchange of data is made, or can be made, electronically between software programs, products or applications. That is without the involvement or need for manual intervention such as the copying over of information by hand or the manual transposition of data between 2 or more pieces of software."
>
> "A digital link includes linked cells in spreadsheets, for example, if you have a formula in one sheet that mirrors the source's value in another cell, then the cells are linked."
>
> "HMRC will allow a period of time ('the soft landing period') for businesses to have in place digital links between all parts of their functional compatible software."
>
> "For the first year of mandation (VAT periods commencing between 1 April 2019 and 31 March 2020) businesses will not be required to have digital links between software programs. The one exception to this is where data is transferred, following preparation of the information required for the VAT Return, to another product (for example, a bridging product) that is API-enabled solely for the purpose of submitting the 9 Box VAT Return data to HMRC. The transfer of data to this product must be digital."
>
> "For the first year of mandation (VAT periods commencing between 1 April 2019 and 31 March 2020), where a digital link has not been established between software programs, HMRC will accept the use of cut and paste as being a digital link for these VAT periods."

Deregistration

An easy way to avoid MTD is if your clients are eligible to deregister from VAT before April next year ie taxable sales are expected to be less than £83,000 in the following 12 months. You might think that it will not be a problem anyway if VAT registered clients always trade below the registration threshold of £85,000 and this is correct. But there is always the risk that a business might get a one-off good order and therefore exceed the threshold in one rolling 12-month period after April 2019. Once this has happened, the business is captured by MTD and cannot withdraw if turnover falls below the threshold again. If a business that is not VAT registered has a 'one off' period where it exceeds the threshold, then it always has the opportunity to request an exception to being registered ie on the basis that taxable sales in the following 12 months will be less than the deregistration threshold of £83,000.

Reference: HMRC Notice 700/1, para 3.7.

Contributed by Neil Warren