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Personal tax

Family friendly matters (Lecture P1155 – 15.20 minutes)

This article considers various pieces of legislation that relate to employees who are parents or are about to become parents including: Shared parental leave and pay; Parental bereavement leave and pay; Extending pregnancy protection and paternity leave and Neonatal leave and pay.

Shared parental leave and pay

This is available to parents, including same sex couples, who are having their own child, or adopting. It enables both parents to share their maternity and adoption leave between them.

The mother or adopter must take a minimum of two weeks leave, which could be extended if they work in a hazardous environment. The balance of the 52-week maximum can be taken as they see fit.

Remember only 39 weeks will be paid:

- 6 weeks at 90% of average weekly earnings;
- 33 weeks at £148.68 per week.

Where the couple wish to take shared parental leave, the mother or adopter must formerly end their leave with eight week's notice to their employer. The couple then decide how to split the remaining weeks between them and are paid at the lower of £148.68 or 90% of average weekly earnings. The split must be taken in week blocks but the maximum number of blocks that the mother or father may take is three. All shared leave must be taken by the first birthday or adoption date of the child.

To qualify for parental leave and pay the employee and partner must have at least 26 weeks service at the qualifying week for maternity or matching week for adoption.

Parental bereavement leave and pay

This is being introduced from 6 April 2020. Where an employee's child dies and is under 18 or they miscarry after 24 weeks of pregnancy then they are entitled to two weeks of leave from day one of employment without notice.

The employee will be eligible for pay during this period if they have 26 weeks service at the date of death and have average weekly earning at or above the Lower Earnings Limit of £118 per week. The amount paid will be the lower of £148.68 or 90% of average weekly earnings. This is recoverable from the government.

The leave can be split but must be taken within 56 weeks of the death, enabling the employee to defer some leave until the anniversary of their child's death.

Extending pregnancy protection and paternity leave

While pregnant and then on maternity leave a mother has a period of protection against discrimination. Where an employer is making staff redundant under a redundancy programme, pregnant women and those on maternity leave are entitled to be offered a suitable alternative where this is available and have priority over other employees.

Having returned to work, women have voiced concerned about being dismissed or being made redundant. As a result, the government put out a consultation considering whether to extend the current pregnancy protection and published its results in July 2019 in "Good Work Plan – Proposals to support families". Although we do not have a start date we know that the plans are to extend the pregnancy protection to start from when the employees informs their employer that they are pregnant and to extend the protection to period by 6 months, making it 6 months after they return to work after maternity or adoption leave.

The government are also looking to extend protection to those who are taking shared protection leave although at present, although it is unclear how this will work.

A further proposal is that provided the father or co-adopter qualifies, with 26 weeks service at the qualifying or matching week and has earnings sat or above the Lower Earnings Limit. If the proposal goes ahead, they could be entitled to 12 weeks of paternity leave and pay as opposed to the current two weeks:

- first four weeks would be paid at 90% of average weekly earnings;
- remaining eight weeks at the statutory rate of £148.68 per week.

However, if the father's earnings are over £100,000, they would not be eligible.

Neonatal leave and pay

In the "Good Work Plan – Proposals to support families" the government is seeking views on their proposals to introduce neonatal leave for all employees from day one of employment, allowing one week for every week that the baby is in neonatal care, with the maximum number of weeks yet to be decided.

Other points

When an employee goes off on maternity or adoption leave, they are entitled to ten Keeping In Touch days, allowing them to come back to work and be paid their normal salary. If the parents go on to take shared parental leave then there are a further split 20 days.

Pregnant workers are entitled to paid time off to attend antenatal appoints, with the partner entitled to unpaid time off for up to two such appointments to accompany the mother. An adopter is entitled to paid time off for five meetings of up to 6.5 hours per visit, with the co-adopter being entitled to attend two unpaid meetings.

A surrogate mother is entitled to maternity leave if she satisfies the normal service requirements and pay levels. The intended parents will be entitled to leave and pay as a child adopter, if eligible.

Created from the Tolley's Online Seminar by Alexandra Durrant

Status determination – a potential minefield

As you know, 2020/21 will see the introduction of the new off-payroll working rules in the private sector and under these new rules, the 'end client' or person engaging the worker will be responsible for:

- deciding if the worker falls within IR35;
- notifying the worker of their decision by issuing a status determination statement explaining the reasons for the decision.

Failure to provide a status determination statement to the worker will mean that the engager will be liable for any tax due under IR35 unless they are contracting with an agency. By passing the status determination statement to the agency, the agency would become liable unless they in turn contract with another intermediary and pass the status determination statement to that intermediary. Responsibility for paying the PAYE and NIC stops with the last person in the supply chain paying the personal service company directly. They become the deemed employer.

Either the worker or the deemed employer can challenge status determination statement giving the engager 45 days to either:

- confirm its determination, with reasons; or
- withdraw and replace the status determination statement with a revised decision

Failure to respond means that PAYE and NIC liability moves back to the engager.

Over the years, we have seen that IR35 can be a minefield and yet engagers are expected to get it right by using HMRC's check employment status for tax (CEST) tool which has been criticised by many as being inadequate.

Colin Ben-Nathan, Chair of CIOT's Employment Taxes Sub-committee, said:

> "Until CEST takes proper account of mutuality of obligation, multiple engagements, contractual benefits - such as holiday pay, maternity/paternity pay - and whether someone is in business on their own account, it is unlikely it will be able to reach the right decision on status. And this is important because otherwise the lack of confidence in CEST will increase disputes between businesses and contractors and so lead to significant time and effort having to be expended by businesses, contractors, HMRC and the courts in trying to resolve them."

To be on the 'safe side', engagers may end up reaching decisions that are too cautious, issuing a determination to deduct PAYE and NIC as standard. This could make it difficult to find contractors who are willing to work for them.

Remittance basis and length of enquiry

Summary – HMRC's approach to investigating the taxpayer's domicile had been reasonable and that the length of their enquiry into her return had been proportionate to the complexity of the issues.

Mrs Roxanne Levy was born in the United States of America and remained a US citizen until her death on 19 August 2018. She moved to London in January 1973 to live with her partner whom she married in 1994. He died in 2012. She had a residence in London from 1973 until her death.

On 22 January 2016 Mrs Levy submitted a self-assessment return for the tax year 2014/15 in which she stated that she was resident in the UK (and had been resident there in at least 12 of the preceding 14 tax years) and in which she made a claim for the remittance basis as a result of having a domicile outside the UK. HMRC opened an enquiry into that return on 13 December 2016 informing her that the focus would be on her domicile status.

In January 2017, with the previous year's enquiry still open, Mrs Levy submitted her self-assessment return for the tax year 2015/16 in which she stated that she was resident in the UK (and had been resident there in at least 17 of the preceding 20 tax years) and once again made a claim for the remittance basis. Not surprisingly, HMRC also opened an enquiry into that return.

Both enquiries were still open when she died in August 2018. On 10 May 2018 an application was made on behalf of Mrs Levy seeking a closure notice in relation to the enquiries.

In a letter dated 29 January 2019, HMRC issued their decision that Mrs Levy had been domiciled in the UK, as she had acquired a domicile of choice. HMRC issued an information notice seeking information about her foreign income and gains that they believed were taxable in the UK.

However, her executors maintained their application for a closure notice and resisted the provision of information concerning income or gains arising outside the UK on the ground that Mrs Levy had, in their view, been domiciled in the USA in the relevant tax years.

Decision

The First Tier Tribunal found that it was reasonable for HMRC to conclude that Mrs Levy had acquired a domicile of choice in the UK. She chose to move to the UK where she lived for the remainder of her life and had made no plans to move back to the USA.

Having reached this conclusion, they did not have sufficient information to be able to work out how much tax was due and so the continuation of the enquiry was needed to determine the foreign income and gains that were taxable.

The First Tier Tribunal also thought that it would be 'difficult, if not impossible' to determine for how long it would be appropriate for the enquiry to continue, adding that HMRC could not be faulted for wanting to consider the totality of the evidence in the round.

Finally, the Tribunal stated that HMRC did not have the power to issue a partial closure notice in respect of Mrs Levy's domicile without specifying the increased amount of tax.

The Executors Of Mrs R W Levy v HMRC (TC07233)

Capital Taxes

The latest main residence decision (Lecture P1152 – 15.08 minutes)

In the First-Tier Tribunal case of Davidson v HMRC (2019), the taxpayer (D) purchased a flat in London SW5 for £555,000 on 10 June 2008. He sold this property for £750,000 on 18 February 2013. D's dispute with HMRC was over the amount of CGT, if any, which was payable in respect of the sale transaction.

HMRC contended that D had never occupied the flat as his only or main residence so that no CGT relief was due. On the other hand, D argued that this was not the correct position and went to make it clear that there were several distinct periods that required consideration:

- The first period began on 10 June 2008, following which substantial refurbishment works were undertaken at the flat. These cost in excess of £60,000. Once they were completed, the flat was let until 7 March 2011;

- Then, from 7 March 2011 to 24 May 2011, i.e.. for a period of just over 11 weeks, D claimed that he and his male partner resided in the flat;

- Finally, the property was let from 24 May 2011 to 29 December 2012. After the tenant's departure, D's flat stood empty for just under two months until it was sold on 18 February 2013.

D, who was a chartered surveyor, also owned a flat in Whitehall where he was resident at the time when he bought the SW5 property. The case report tells us that D's business had been adversely affected by the financial crisis which hit in late 2007 and which led to a significant decrease in the demand for his professional services – hence his decision to rent out the Whitehall flat, which he was able to let for a substantial sum, and to move west to the cheaper environs of SW5. As well as these properties, D owned a country residence near Derby, which he used at weekends and to visit his family, and a small studio flat in Clapham where he lived after he moved out of Whitehall, given that his finances were 'strained to an even greater extent' by the cost of doing up the recently acquired flat in SW5.

However, by early 2011, D's business fortunes had revived and so he felt able to forego the rent from the SW5 property. D, along with his partner, moved in on 7 March 2011 to live there as a main residence. The case report continues:

> 'His evidence is that he intended to live there long term but that, soon after moving into the property, incidents of domestic violence took place between him and his partner (evidenced in documents comprising reports to the police) which subsequently gave rise to each of them vacating the subject property. He said that he did so because the events that had occurred between him and his partner left him with a sense of insecurity when it came to living at that property and bad memories that he associated with that residence.'

In cross-examination, D accepted that he was registered for voting purposes on the electoral roll in Derbyshire and that he did not have a doctor in London. As far as his car was concerned, D said that he had never notified the DVLA that his address was anywhere other than the flat in Whitehall, notwithstanding that this property was now let. D's accountant, who was described by the judges as an 'unimpressive witness', confirmed that he had never advised D, despite the fact that D owned several residential properties, to make a 'main residence' nomination under S222(5) TCGA 1992. In the circumstances, it is perhaps not wholly surprising that HMRC took the line that they did.

Although the judges had relatively little hard evidence on which to come to a conclusion, they did make the following findings of fact:

- The SW5 flat was not D's main place of residence at any time prior to 7 March 2011;

- Despite the fact that D and his partner only occupied the property for a little over 11 weeks, they moved in with the intention of it being their home on a long-term basis. It was therefore D's main place of residence for that period. This appears to be following the Courts' line, as shown in other recent cases (see, for example, the decisions in Bradley v HMRC (2013) and Morgan v HMRC (2013)), of giving considerable weight to the taxpayer's expressed intention at the time of first moving into the property;

- The SW5 flat ceased to be D's main residence as from 24 May 2011.

As a result, D became entitled to what at the time was a 36-month final period exemption (which would of course have covered his actual occupation), together with lettings relief which has a maximum of £40,000. These two factors will have significantly reduced D's chargeable gain.

Contributed by Robert Jamieson

Simplifying the design of IHT (Lectures P1153/1154 – 19.32/15.00 minutes)

Introduction

As part of their review of IHT, following a wide-ranging consultation project, the Office of Tax Simplification (OTS) have now published their second report on the tax. This 103-page report focuses on substantive aspects of the design of IHT, with particular reference to the main reliefs. It follows an earlier report issued in November 2018 which examined the administrative aspects of the tax.

The aim of this latest report is summarised by the OTS as follows:

> 'It is surely a fundamental requirement for the legitimacy of a tax that its framework should be reasonably clear to the majority of those potentially liable to it.
>
> The OTS's extensive consultation exercise revealed many areas where IHT is either poorly understood, counter-intuitive, requires substantial record-keeping, creates distortions or where the application of the law is simply unclear.'

The OTS make nine principal recommendations in their report. These concentrate on three key areas of IHT:

1. Lifetime gifts, including the liability for paying any tax due on such gifts;

2. The interaction with CGT; and

3. Businesses and farming activities.

Lifetime gifts

The first three chapters of the report deal with the treatment of gifts made during a person's life and the correlation of such gifts with those made on death under the deceased's will.

The OTS are aware that the present array of IHT gift exemptions is complex and creates unnecessary confusion. For example, there are several monetary thresholds to be considered and each applies in a slightly different way. Another concern is that the exemption for regular gifts from disposable after-tax income can require detailed record-keeping and the scope of the exemption is sometimes disputed. Their first recommendation (Recommendation 1) is that the Government should:

- replace the annual exemption of £3,000 and the various exemptions for gifts in consideration of marriage (or civil partnership) with an overall personal gifts allowance which would operate on a yearly basis;

- review the level of the small gifts exemption (the OTS suggestion is to increase the limit from £250 to £1,000 per donee); and

- reform the exemption for normal expenditure out of income by removing the need for the expenditure to be 'regular' and possibly limiting the quantum of the relief to a fixed percentage of the donor's income (alternatively, the exemption could be abolished and replaced by a higher annual personal gifts allowance which would cover gifts made out of both income and capital).

Consultation responses to the OTS indicated that the current seven-year period during which a lifetime gift may become subject to IHT is too long. It can be difficult for personal representatives to obtain records going back that far and it is understood that the latter part of this seven-year period raises very little tax. The record-keeping problem is even greater for individuals who have made gifts into trust where the relevant period can sometimes be as long as 14 years – for example, when working out how much tax is payable on a gift to an inter vivos settlement (which could have been made nearly seven years before the settlor's death), it is necessary to take into account any chargeable lifetime transfers made by the same individual during the seven years prior to the creation of that settlement.

The seven-year period requires substantial amounts of record-keeping, but in fact does not give rise to much tax. An additional complication is that the rate of IHT on chargeable gifts made more than three years before death is reduced by way of a special taper relief. However, it is known that the operation of the IHT taper is widely misunderstood. Most people do not appreciate that this taper is only relevant for taxpayers who make large lifetime gifts totalling more than the nil rate band – it is a relief of tax, and not a relief of value.

Recommendation 2 is that the Government should:

(i) reduce the seven-year period to five years so that gifts to individuals made more than five years before the donor's death are IHT-exempt; and

(ii) abolish taper relief.

Recommendation 3 is that the Government should dispense with the '14-year rule' referred to above.

In their document, the OTS set out two alternative means of changing the way in which the tax operates:

1. on lifetime gifts to individuals; and

2. on chargeable lifetime transfers such as gifts into trust.

They address various issues where aggregate taxable gifts exceed the transferor's nil rate band. Of the two alternatives set out, the most practicable idea is what the OTS call the 'reform option'. This suggests that any IHT due in relation to lifetime gifts to individuals should generally be payable out the estate (and not by the donee) and that the nil rate band should no longer be allocated to lifetime gifts in chronological order but rather should first be allocated pro rata across the total value of all the deceased's taxable lifetime gifts, with the remainder (if any) then being available to the death estate.

Recommendation 4 is that the Government should explore options for simplifying and clarifying the rules dealing with:

- the payment of tax liabilities for lifetime gifts to individuals; and
- the allocation of the deceased's nil rate band.

Interaction with CGT

The scope of this review specifically included looking at the interaction of the tax with CGT and the OTS's conclusion was that the interaction is indeed complex and can certainly distort decision-making. It should be borne in mind that there is normally no CGT charge on death. For CGT purposes, the person inheriting an asset is treated as having acquired it at its market value on the date of death rather than at the amount originally paid for it. This situation is referred to as the 'tax-free uplift on death' and it means that an asset can be sold shortly after death without any CGT being due. Where an asset is exempted or relieved from IHT (e.g. because it passes to a spouse or represents relevant business property), it can be sold shortly after death without either IHT or CGT being payable. With reference to this latter point, the OTS make the following comment:

> 'This can put people off passing on assets to the next generation during their lifetime. It distorts and can complicate the decision-making process around passing on assets to the next generation. The OTS have concluded that this distortion would be best addressed by amending the CGT rules rather than changing IHT.'

Recommendation 5 is that, where a relief or exemption from IHT applies in connection with a death estate, the Government should consider removing the tax-free uplift on death and instead provide that the recipient is treated as acquiring the asset at the historic base cost of the person who has died.

Businesses and farming activities

Trading businesses and farming assets typically qualify for full relief from IHT under the business and agricultural relief provisions. Business relief also extends to the shares of most companies traded on AIM. It is understood that the policy rationale for business and agricultural relief is to prevent the sale or break-up of businesses and farms that might otherwise be necessary in order to finance the payment of IHT following an owner's death.

The IHT requirements about the level of trading activity needed to qualify for business relief are different from the comparable conditions for the main CGT reliefs relating to the disposal of businesses (e.g. entrepreneurs' relief and holdover relief). As the OTS point out:

> 'It is unclear why there are different tests for different tax reliefs relating to the same business, potentially distorting decision-making between transferring a business during one's lifetime or on death. It could simplify decision-making about when to hand assets on to the next generation if the tests were standardised.'

Indirect non-controlling shareholdings in trading companies are another area where complexities in the application of business relief were identified. Two aspects may be problematic from an IHT perspective:

1. joint venture structures; and

2. arrangements where a corporate trading group has an LLP rather than a company as its holding vehicle.

Furnished holiday lettings are not treated consistently because, unlike other sources of income relating to residential property, they are deemed to be trading entities for income tax and CGT purposes but are not regarded as carrying on a trading activity for IHT – however, in this situation, see the interesting decision in Graham v HMRC (2018).

Recommendation 6 is that the Government should:

- consider whether it continues to be appropriate for the level of trading activity for business relief under IHT to be set at a lower level than for the CGT reliefs;

- review the treatment of indirect non-controlling holdings in trading companies in the context of many modern joint venture structures; and

- decide whether to align the IHT treatment of furnished holiday lettings with the income tax and CGT rules which treat such arrangements as trading provided that certain requirements set out in ITTOIA 2005 are met.

Recommendation 7 is that the Government should review the treatment of LLPs to ensure that they are treated appropriately for the purposes of the business relief trading requirement.

Finally, there are two areas of HMRC guidance or practice that would benefit from legislative change covering cases where:

- a farmer has to leave his farmhouse for medical treatment or to go into care; and
- valuations of businesses or farms are needed.

Questions of valuation will become rather more important if the Government decide to increase the level of trading activity needed to qualify for business relief, given that a greater number of business will then become subject to IHT.

Recommendation 8 is that HMRC should review their current approach around the eligibility of farmhouses for agricultural relief purposes, particularly in sensitive cases such as where the farmer needs to leave the farmhouse for medical treatment or to go into care.

Recommendation 9 is that HMRC should be clearer in their guidance as to when a valuation of a business or a farm is required and, if it is required, whether this should be a formal valuation or merely an estimate.

Contributed by Robert Jamieson

Share loss relief and loans to traders

In July 2019, the European Commission formally requested that the UK amend the rules on losses on shares set against income and capital loss relief on irrecoverable loans to traders to ensure that they are compatible with European Union (EU) law. The UK Government failed to act within the two-month deadline, and so the Commission delivered a reasoned opinion to the UK in January 2019. While it is 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 Court of Justice of the European Union (CJEU). Therefore, the Government proposes to change the law with effect from 24 January 2019 via Finance Bill 2020. The draft clauses were published for consultation on 11 July 2019. You should bear in mind that the position may change if the UK leaves the EU.

Summary of the Finance Bill 2020 changes

Provision	***Relief available***	***Non-compliant condition***	***Expected change***
Losses on shares set against income for IT purposes	Capital losses on qualifying shares in unquoted trading companies, can be set against income in the year of the loss and / or the previous tax year	A non-EIS company only qualifies if it carries on its business wholly or mainly in the UK (ITA 2007, s 134(5))	Condition will be repealed for disposals from 24 January 2019. IT relief can be claimed no matter the jurisdiction in which the business is based, if the other conditions are met.

Capital loss on irrecoverable loan to trader	An allowable capital loss may arise where loans made to traders become irrecoverable or a payment is made under guarantee on behalf of a trader	The borrower (i.e. the trader) must be UK resident to qualify (TCGA 1992, s 253)	The condition is amended to insert "if the loan is made before 24 January 2019". Loans made from this date, the residence of the trader does not need to be considered.

What does this mean for taxpayers?

If the Finance Bill 2020 clauses are enacted, the position for taxpayers is as follows:

- for losses arising on or after 24 January 2019 taxpayers are entitled to relief. If the Finance Bill does not receive Royal Assent until after 31 January 2020, the 2018/19 tax return could still be prepared on this basis, but clients should be advised that there is a possibility that the change will not occur, and that in this case an amendment will need to be made to the tax return

- for losses arising before 24 January 2019:
    - open years — a claim can be made by amending the return;
    - closed years — a protective claim can be made.

Adapted from Tolley Guidance summary (6 August 2019)

Administration

Meaning of 'potential lost revenue'

Prior to the introduction of the High Income Child Benefit Charge in January 2013, Mr Robertson was not required to notify his liability to tax to HMRC or to complete a self-assessment return as his income was taxed wholly under PAYE with annual income exceeding £50,000. In 2012/13, 2013/14 and 2014/15 Mrs Robertson received child benefit but they did not elect to stop receiving the benefit. Under the High Income Child Benefit Charge legislation Mr Robertson should have notified HMRC of his liability to tax.

HMRC decided that the high income child benefit charge applied and issued discovery assessments for the three years unpaid HICBC as well as penalties charged at 20% of potential lost revenue for failure to notify chargeability.

Mr Robertson appealed against the penalties but not the assessments.

The First Tier Tribunal concluded that there was no potential lost revenue and so no penalties could be charged.

HMRC appealed to the Upper Tribunal.

Decision

HMRC conceded that the penalties should be charged at 10% of the potential lost revenue, rather 20%.

The Upper Tribunal stated that potential lost revenue is defined under sch 41 para 7 FA 2008) as:

'So much of any income tax … to which P is liable in respect of the tax year as by reason of the failure to notify is unpaid on 31 January following the tax year'

The First-tier Tribunal should have concluded that HMRC had calculated the potential lost revenue correctly based on the unpaid tax liability. Instead, it decided that potential lost revenue was limited to and determined by the tax shown in an assessment, which was an error.

Allowing HMRC's appeal, the judges upheld the penalties calculated at 10% of the potential lost revenue.

HMRC v James Robertson [2019] UKUT 0202 (TCC)

Student loan due

Summary – With HMRC failing to make the taxpayer aware of their actions, the penalties were cancelled.

While Mary Appiah's agent submitted her 2015/16 self-assessment tax return but failed to tick the box stating she had a student loan outstanding. She was out of the country for over 12 months and did not find out that she owed an amount for her student loan until she returned to the UK in April 2018.

In January 2018, she had paid £903, the amount that she believed that she owed for her self-assessment liability for 2016/7. However, this was not set off against her 2016/17 liability but was instead set off against the student loan amount due for the earlier year. Unfortunately, she was not informed of this until 29 October 2018. Until then, as far as she was concerned, all taxes for 2016/17 had been paid.

HMRC cancelled their penalties for 2015/6 but refused to do so for 2016/17 and so Mary Appiah appealed.

Decision

HMRC claimed they had opened an enquiry into her 2015/16 return but there was no evidence to support this nor of when they informed her about how they had allocated her tax payment. In addition, HMRC could not show it had issued a penalty notice. The Tribunal was not satisfied that HMRC had discharged the burden of demonstrating that the penalties were due and so they were dismissed.

In any case, the Tribunal concluded that she had a reasonable excuse for her actions. They accepted that she genuinely and honestly believed, when paying the £903 that she had paid the tax owing for 2016/17, and that she had no outstanding tax liabilities.

Her appeal was allowed.

Mary Appiah v HMRC (TC7159)

Current position with discovery assessments (Lecture P1151 – 19.29 minutes)

When assisting clients with HMRC enquiries it is easy to get absorbed by technical arguments and to overlook the procedural aspects of the case. It doesn't matter how right HMRC are about a technical argument, they can only assess additional tax if they have the power to do so. This is not an issue for HMRC where they have an open enquiry but if not, they have to be able to make a 'discovery' assessment. These notes will seek to consider the relevant points and considers some recent case law showing the limitations on their powers.

The legislation relating to the discovery provisions is at s29 TMA 1970 for individuals with equivalent provisions existing for other taxpayers. All comments below are equally relevant for all the relevant legislation.

There are two basic ingredients for a discovery assessment to be valid:

- HMRC must show they have 'discovered' that there is an underpayment of tax;
- The underpayment must be attributable to the careless or deliberate actions of the taxpayer unless the information on the tax return would not have been sufficient to alert a hypothetical tax officer to a potential underpayment of tax.

The nature of the behaviour then determines the length of time HMRC have to make an assessment from the end of the tax year:

- Discovery but behaviour not careless or deliberate – 4 years
- Careless – 6 years
- Deliberate – 20 years

With HMRC taking much longer to finalise enquiries under the current regime, it is not unusual to find HMRC missing the 6-year deadline and then having to argue deliberate behaviour in order to justify the discovery assessment.

The discovery

There are again two stages to the question of whether a discovery has been made. Firstly, what do we mean by saying that HMRC have 'discovered' that there has been an underassessment of tax? Secondly, have they acted on this before it has become stale?

In HMRC v Charlton (and others) [2012] UKUT 770 the following comment was made:

> 'All that is required is that it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment. That can be for any reason, including a change of view, change or opinion, or correction of an oversight.'

This seems to cover every possible situation but 'discover' for tax purposes means more than to just find something or become aware of something as it must fall within one of three categories:

1. That any income which ought to have been assessed to income tax or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed; or
2. That an assessment to tax is or has become insufficient; or
3. That any relief that has been given is or has become excessive.

This leads to some anomalies as, for example, the High Income Child Benefit Charge and the tax charge for unauthorised members pension payments do not fall within these provisions for technical reasons about the way the charges are levied.

Returning to the general point though, it is easy to see this in a situation where an HMRC officer finds evidence that income has been diverted or where they make a decision that a tax avoidance scheme does not work (even though that might need to be confirmed by the Courts). However, a mere suspicion would not be sufficient to meet this test and should be challenged. From HMRC's perspective, they may want to issue an assessment in order to meet a deadline and may not have concrete evidence but they do need to make that discovery so the assessment is valid. HMRC will often use the phrase 'protective assessment' but this concept is not recognised in law and such assessments, whilst reasonable from an operational perspective, may not actually be valid.

When there is no firm evidence of wrongdoing, then HMRC might look at ways of inferring that there has been a loss of tax. These might include capital statements or business economics exercises. In the case of Jonas v Bamford [1973] 51TC1, the Inland Revenue prepared capital statements for a taxpayer who appeared to have insufficient income to support his lifestyle. It was held:

> 'There can be no doubt at all that the Inspector of Taxes discovered that Mr Jonas was the possessor of resources which could not be explained by reference to known sources of capital and income. This is virtually the classic case of discovery.'

The Courts have, however, been less willing to accept business economics exercises as being acceptable in proving discovery. They may identify areas of risk but that is not enough to show that tax has been underpaid. This was reinforced in the case of Scott v Anor (t/a Farthings Steak House) v McDonald [1996] SpC91 which was a disaster for HMRC:

> 'The Inland Revenue have failed to find any unaccounted for bankings or unaccounted for expenditure or any unaccounted for capital accretions. Their efforts have thus been devoted to the preparation of several business economics exercises, several of which have been shown to be inaccurate or just plain wrong. In any event in my judgement business economic exercises alone can rarely if ever justify the sort of attack mounted by the Inland Revenue in these appeals.'

There is a presumption of continuity. This means that if they find an underpayment of tax in one year then the actions that have led to that are presumed to have happened in other years unless the circumstances are clearly different. This was demonstrated recently in the case of Stirling Jewellers (Dudley) Ltd v HMRC [2019] UKFTT TC06940 where a business whose turnover had increased dramatically due to a change in business model and whose accounting methods had not kept up with those changes was found not to have underpaid tax for earlier years because the presumption of continuity was successfully challenged.

Finally, there is the question of whether the actions of others can be indicative of the actions of a taxpayer. This is controversial. In Anderson v HMRC [2018] UKUT 159, a discovery assessment was upheld on the basis that other participants in the tax avoidance scheme clearly spent insufficient time working to be entitled to loss relief and it could be inferred that the same applied to the appellant. If the tax avoidance scheme had failed for more generic reasons, then that might be relevant but this does seem like a harsh judgement.

The second point is then when the discovery is made and how quickly it should be acted on. A discovery has to have a quality of 'newness' for the assessment to be valid. This was explored in the recent case of Beagles v HMRC [2018] UKUT 380. Mr Beagles had entered into a marketed tax avoidance scheme that had been correctly disclosed but HMRC overlooked the reporting and did not open an enquiry into the relevant return, which would have needed to be done by 31 January 2004. They realised this in June 2004 but did not act. It was decided that the scheme should be challenged in August 2005 and they pursued a case involving another participant which was found in HMRC's favour in August 2007. HMRC issued a discovery assessment on Mr Beagles in January 2008 but the Courts found that the discovery had been made in August 2005 and so it was 'stale' by the time the assessment was issued in 2008. No time limit has been placed on how long it takes for a discovery to lose its newness but here 2½ years was too long.

Another very recent case shows how HMRC's own internal procedures can often fail them. The case of Kothari and others [2019] TC 07238 related to an SDLT mitigation scheme that had been used by six individuals. HMRC had undertaken a huge review of the scheme, which had been utilised by thousands of individuals, with a team of officers delegated to make and issue discovery assessments when HMRC decided it did not work. The assessments were issued in batches close to the assessing window closing but the appellants in this case did not receive their assessments until three years later when they received a 'nudge' letter and were then issued with a copy of the assessment. HMRC argued it was the point at which the assessment was made which was relevant and not when they were delivered, having accepted they were not delivered at the time they were made. The judge accepted they had been made in February 2013 but did not accept that they could then be delivered at HMRC's convenience. This was therefore not an enforceable assessment.

Another issue that is relevant here is the question of whether one officer reaching a conclusion which has previously been reached by other officers looking at similar cases would qualify as discovery. In HMRC v Charlton (and others) [2012] UKUT 770, it was found this was a discovery as it was a fresh decision in relation to the particular taxpayers. However, it has been recognised, correctly, that simply passing the file to a new officer who makes the same decision again, would not be sufficient to refresh an otherwise stale discovery.

One final point to note - A discovery does not become stale just because it takes a long time for the officer dealing with the case to notice that something is wrong. In Sanderson v HMRC [2013] UKUT 0623 the officer only belatedly realised that tax had not been correctly assessed even though he had had the relevant information for some time. This was still a discovery – albeit one that he should have made sooner! This does mean that you can still make a discovery even where a matter has obviously been overlooked although it becomes more difficult for HMRC to justify this if it has been explicitly agreed and they cannot do this if a matter has been concluded under s54 TMA 1970 (although this is quite rare under self-assessment).

The culpability

As noted above, the time limit that HMRC has to work to depends on the behaviour of the taxpayer.

If there is not careless or deliberate behaviour, then HMRC has to be able to prove that they could not have known about the potential understatement of tax at the time that the enquiry window closed. Cases on this point have tended to favour HMRC as the Courts have not needed them to look very hard to identify the issue. However, if a full disclosure has been made on the return and the potential technical issue clearly identified then it is possible to argue that any reasonable competent officer would have known there was something to look at.

This point has been addressed in a recent case which commented on the taxpayer's capacity versus that of HMRC.

In Cooke [2018] TC06239 HMRC argued that the taxpayer's accountant was careless in not identifying that a DTR claim was excessive, but at the same time argued that an HMRC officer could not have been expected to pick the point up. On the other side the taxpayer argued that the accountant was not careless but an HMRC officer should have been able to spot the problem. The FTT agreed with the taxpayer as HMRC's officers should be tax specialists whereas the general practice accountant was not a tax specialist. The discovery assessment was not valid.

If we are looking at proving some culpability, which HMRC will want to do as those arguments seem easier for them, then it is important to realise that the loss of tax has to be brought about carelessly or deliberately. Filing a return late, for example, might be seen as careless but can HMRC show that the mere filing of the return late is the action that led to the under-assessment of tax? That one would be difficult.

The discovery provisions talk about careless or deliberate conduct by the taxpayer or someone acting on their behalf. This is important and distinguishes the discovery provisions from the penalty provisions (since penalties can only be levied where it is the taxpayer who has behaved in this way). This also means that the taxpayer could be entirely unaware of conduct by another person affecting their tax position but still be vulnerable to a discovery assessment. 'Acting on his behalf' does have limitations because someone passively providing information (such as a bank providing an incorrect interest certificate) would not be acting on behalf of a taxpayer even if they might be providing information for the return.

Carelessness is 'exercising a lack of reasonable care'. This can take many forms. Failing to take necessary advice when you are aware that there is a complication in your tax affairs would fall within this definition, as would having inadequate accounting records to be able to prepare accurate accounts. HMRC tend to take the view that most offences are, at the very least, down to careless behaviour but this is not always the case. However, we are all allowed to make mistakes and if you make a mistake despite trying to get things right, this is not careless.

In Bubb [2016] TC04922 the taxpayer understated income on his return but had encountered problems submitting returns online from France as the computer did not recognise his French address and appeared to random change the figures he was entering. It was found his behaviour was not careless. In the recent case of Negka [2019] TC06966, the FTT allowed an appeal against a discovery assessment relating to expenses claimed relating to repairs on a property since the taxpayer had repeatedly been given incorrect advice by HMRC. Conversely, in Atherton v R&C Commrs [2019] BTC507 it was found that the taxpayer had acted carelessly as neither he nor his advisor had taken advice as to how to correctly complete the tax return in a situation where there were complex issues to address.

The moral of this is probably that you need to keep an audit trail of everything you do (within reason!) to try and get your tax return correct.

This neatly brings us back to the question of relying on a third party and how this impacts on a carelessness argument. If the accountant is careless then this can be treated as if the taxpayer has been careless. In the case of Rotberg [2014] TC03780, the accountant had omitted gains on shares on the mistaken belief that rollover relief was due. Although this had been confirmed in a brief conversation with an HMRC advisor, the Tribunal still found that the advisor had been careless and therefore so had the taxpayer. Contrast this with the case of Anderson [2016] TC05092 where the market value of shares used by the taxpayer was found to be lower than the figure arrived at by Shares and Assets Valuation team in HMRC. However, the taxpayer had taken advice from a leading firm of accountants and so was found not to have acted carelessly.

How useful are white-space disclosures? This is a matter of great debate. It is probably true to say that a white-space disclosure highlighting an area of doubt and explaining why a particular view has been taken is probably an indication of having taken reasonable care. However, not having disclosed something is not an automatic indication of lack of reasonable care. The thing that has caused the underpayment of tax is not the writing of something in the return; it is the underlying transaction. This view is not necessarily accepted by HMRC who will argue that not bringing something to their attention can be careless but what about a situation where you have, say, Counsel's opinion that something is not taxable? Note, of course, that there are specific provisions now where such opinion is 'tainted' i.e. because the Counsel is promoting a particular scheme.

Deliberate behaviour is submitting a return that you know to be incorrect or where it is suspected that it is incorrect (and you deliberately do not check). It is actually a more straightforward argument in most cases than careless because there will normally be evidence which demonstrates the point.

The point was neatly summed up in the case of Contractors 4 U Ltd v HMRC [2016] UKFTT17:

> 'the term deliberate should be interpreted as being an action taken consciously where there was an appreciation that there was a choice'

Although this has been expanded now as there probably has to be dishonest intent.

It is not always straightforward. In Scott v HMRC [2016] UKFTT599 HMRC argued that the actions of the taxpayers must have been deliberate because the discrepancy between the returned income and the actual income was so significant that they must have realised. However, the Tribunal stated:

'Our overall impression was that Mr and Mrs Scott had a somewhat disorganised approach to their personal finances, as witnessed by the complete lack of underlying records as regards cash receipts and banking. We therefore consider it quite possible that any under declaration was caused by carelessness rather than by deliberate default. Using the same logic for the uncertainty surrounding the tax assessments we therefore find that HMRC have failed to discharge the burden of proof on them to demonstrate under declaration of income by Mrs Scott'.

An important point: the burden of proof is on HMRC to prove deliberate conduct.

However, in the recent case of HMRC and Raymond Tooth [20019] EWCA Civ826, there was some worrying commentary on this point. The Court of Appeal actually found that no discovery had been made but Mr Tooth had put employment losses on the partnership page of his return due to a technical issue meaning he could not put them in the right place. Although not relevant, two of the judges stated that including the losses in the wrong place meant the return was inaccurate and that inaccuracy would have been deliberate, as it was known by the taxpayer. This is very unhelpful to the overall discussion in this area.

The conclusion?

In the end, it is not always an easy area to address but it is important not to assume that HMRC are correct when they issue assessment and their actions should always be scrutinised in order to determine if there are any grounds for appealing against these on procedural grounds.

Contributed by Ros Martin

The New Points-Based Penalty System (Lecture B1154 – 10.11 minutes)

Introduction

In the Autumn 2017 Budget, the Chancellor announced plans to “reform the penalty system for late or missing tax returns, adopting a new points-based approach”. This was on the back of responses to consultations where most respondents indicated that they favoured a points-based model due, largely due to its comparative simplicity.

A new points-based penalty system will therefore be introduced apply to ‘regular’ returns being those filed monthly, quarterly and annually. This will replace the current system under which taxpayers who submit returns late face an instant fine (plus further penalties for prolonged delays). The new system will operate in conjunction with Making Tax Digital (MTD).

Draft legislation was originally issued for inclusion in the Finance Bill 2019 with a view to rolling-out the new system from April 2020. However, mandatory MTD for income tax reporting has since been deferred to 2021 at the earliest, and the new points-based regime has also been delayed in line with it. The legislation has accordingly been pulled from Finance Bill 2019 in order to allow HMRC “more time to consider further the communications needed for successful implementation”. The next target-date for the roll-out is April 2021.

Returns to which the new rules will apply

The draft clauses contain Tables listing the types of returns - split alphabetically into different ‘groups’ - to which the new regime will apply. There are three Tables – Table 1 for annual returns, Table 2 for quarterly returns and Table 3 for monthly returns. For example, annual self-assessment returns for income tax will fall into Table 1 Group 7. Quarterly VAT returns will fall into Table 2 Group 15.

The points-based system will initially apply to VAT returns with the system first being implemented for VAT returns filed on or after 1 April 2021 at the earliest. Income tax returns are next in the queue although no dates have yet been put forward. Corporation Tax returns will join the party 'in due course'. This will ultimately signal the end of the flat £100 penalty for the late submission of a self-assessment return which will be abolished at "an appropriate point in the future after an appropriate notice period". [Flat-rate penalties are something of a money-spinner for the Government with nearly 1 million taxpayers last year reportedly submitted their SA returns late. No doubt plans are afoot to replace this lost revenue.]

The new system will (eventually) apply to all returns including a variety of less high-profile returns such as those for ATED, excise duty, aggregates levy, climate change levy, IPT, landfill tax and air passenger duty. Ad-hoc or irregular returns in relation to more unpredictable transactions – for example, IHT returns, NRCGT returns Land Transaction returns for SDLT – will not be brought within the points-based system. We wait and see whether these returns will continue to be liable to the existing penalties or whether new provisions will be brought-in.

The points system

The new regime is intended to benefit those genuine law-abiding citizens who occasionally make an error of judgement or miss a deadline. These good people will typically receive the proverbial 'yellow card' but nothing more. While the penalty rates under the new regime have not been discussed, one imagines that once the yellow card has turned red, the penalty loading will be significantly heavier that it currently is, thereby increasing the punishment for those miscreants who persistently fail to meet their filing obligations.

As stated in their Policy Objective: "The government wishes to encourage compliance with regular return submission obligations but does not want to punish taxpayers who make occasional mistakes. This measure is designed to be proportionate, penalising only the small minority who persistently fall foul of the rules."

The idea of the new system is that where a regular tax return is submitted late, instead of an automatic penalty, the taxpayer will be awarded penalty points. [The draft clauses talk about HMRC 'awarding' penalty points. It's not the verb I would have chosen but if we think of this 'award' being a preferable alternative to the imposition of a fine, then we can live with it.]

An award of penalty points does not mean that a monetary penalty will be levied. A penalty will only be charged when a pre-defined points threshold has been reached. Once the accumulated points hit the magic number, a penalty will then be charged for each subsequent submission failure.

The comparison with driving-license points is obvious and like road-traffic misdemeanours, the accumulated points will be expunged after a defined period of compliance by the taxpayer.

Penalty points can be appealed and reviewed. HMRC will publish further details in due course. No penalty points will be awarded if the taxpayer has a reasonable excuse for the failure. The draft clauses helpfully tell us that insufficiency of funds and reliance on another person are not (usually) reasonable excuses, but we've heard this before.

As mentioned above, at the time of writing no penalty rates have yet been announced, but these should be forthcoming soon.

The VAT default surcharge system

As VAT is the first cab off the rank, a reminder of the current system is in order.

The default surcharge system is presently in situ for VAT. A default surcharge is a penalty levied on businesses that either submit VAT returns late or make their VAT payments late.

There is no penalty for a first offence. Instead where a return is late, the business is issued with a Surcharge Liability Notice (SLN). The SLN applies for 12 months from the end of the period of default. If VAT returns are submitted late within the SLN period, a monetary penalty will apply. This penalty starts at 2% of the VAT due for the return period, increasing to 5%, then 10% up to a maximum of 15%.

Smaller businesses with a turnover of less than £150,000 are treated more leniently and no SLN is issued on the first default. Instead HMRC issues them with a guidance letter to help with future compliance. If another default occurs within 12 months of the letter, the business will enter the surcharge liability period.

The system has been criticised and is due for overhaul. We all agree that businesses should submit their returns and pay their taxes on time, and we like the idea of system which contains sanctions to encourage compliance. However, businesses are currently being hit with massive fines in cases where the return or payment is fractionally late. The punishment often seems harsh compared to the crime.

The existing penalty regime for VAT will be carried over into the MTD for VAT regime which kicks-in from April 2019. The VAT default surcharge regime will remain in place for at least 2019/20 and 2020/21. This is despite the fact that the penalty point model seems to be much better suited to MTD than the default penalty regime that is far more administratively complex.

The new system

The current VAT default surcharge regime will be replaced by a points-based penalty system. This will apply for the late submission of VAT returns. It will not apply for late payment of VAT (new rules are being introduced here which are beyond the scope of these notes).

A business will automatically receive one penalty point every time it fails to submit a VAT return on time. Points continue to be awarded until the taxpayer reaches the statutory maximum. This is the point at which the system loses patience and starts handing-down penalties. Monetary fines will duly kick-in for subsequent failures. Whether these penalties will bite harder than the old ones under the default surcharge remains to be seen.

No further points are awarded if the accumulated penalty points have reached the statutory maximum. The maximum number of points before fines are triggered depends on the frequency of the return submission obligation. For annual returns the maximum is 2 points, for quarterly returns it is 4 points and for monthly returns it is 5 points. Businesses filing VAT returns on a quarterly basis can therefore have 4 strikes before a monetary fine is incurred. This is far more generous than the current default surcharge system where the 4th failure would usually trigger a 10% penalty (which can be horrendously expensive for large businesses).

After the maximum is reached, each late submission will attract a penalty. The draft clauses contain provisions for the imposition of penalties once the maximum number of penalty points is reached with paragraph 16(4) helpfully telling us that "The amount of a penalty under this paragraph is £[x]."

The HMRC blurb that accompanied the publication of the draft clauses and explanatory notes uses the words "fixed penalties". Certainly £[x] seems like a fixed number. Taken at face value, this suggests that the penalty will be a set amount and will not be a percentage of the VAT due on the return. This is (potentially) very welcome news as there is no reason why the same failures by two separate businesses should be punished with hugely different fines just becomes one business happens to sell more stuff than the other.

Whatever the quantum of the penalty, a penalty notice must be issued which will require settlement of the penalty within 30 days. Penalties will then continue to be levied for compliance failures until the taxpayer has:

- Met all their submission obligations by the relevant deadline for 24 months; and
- Provided any outstanding submissions for the preceding 24 months.

At that stage the points total will be reset to zero and we start again with a clean sheet.

Example

ABC Ltd is a VAT registered business. Its VAT return for the quarter ended 30 April 2021 is due on 31 May 2021. The return is filed on 25 June 2021.

ABC Ltd will be liable to a penalty point. To award a penalty point, HMRC must issue a notice to ABC Ltd and state the failure in respect of which the penalty point is awarded and the group of returns for which the penalty point is awarded. Here the VAT penalty would fall into "Table 2 Group 15" being the group for quarterly VAT returns.

HMRC has 3 months to issue this notice otherwise it is out of time (the time limit is 12 months for annual returns and 1 month for monthly returns).

Any subsequent failures will attract penalty points up to a maximum of 4. Penalties will be levied for failures after that maximum is reached.

If ABC Ltd file all their quarterly VAT returns on time between 1 May 2021 and 30 April 2023, the points total will be reset to zero.

Special provisions

There are several special provisions, perhaps the most relevant one being the provision which deals with instances where a taxpayer changes the frequency of his return submissions and moves between Tables.

This could happen if a VAT registered business shifts from quarterly to annual accounting and moves from Table 2 to Table 1 (or vice versa). In this case any existing points loading would be adjusted (as otherwise the mere shifting of return frequency could either take the points total over the statutory maximum or increase the maximum giving scope for extra penalty-free failures).

For example, a business moving from quarterly to annual VAT accounting would have 2 penalty points removed from his total (and 2 added for businesses going the other way).

Late payment penalties

The points-based system deals only with the late submission of returns. Changes are also being introduced to penalties for the late payment of tax, again intended to be rolled-out for VAT from April 2021 (other taxes to follow). These will be the subject of a separate session.

Contributed by Steve Sanders

Deadlines

1 September 2019

- Corporation tax due for periods to 30 November 2018 if not paying by instalments
- Check HMRC website for changes to car mileage fuel rates.

7 September 2019

- VAT return and payment for 31 July 2019 quarter end (electronic payment).

14 September 2019

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

19 September 2019

- PAYE/NIC/student loan/CIS payments for month to 5 September 2019 if by cheque
- File monthly CIS return

21 September 2019

- File online monthly EC sales list
- submit Intrastat supplementary declarations for August 2019

22 September 2019

- PAYE/NIC /student loan/CIS payments for month to 5 September 2019 if paid online

30 September 2019

- Accounts to Companies House for:
    - private companies with 31 December 2018 year end
    - public limited companies with 31 March 2019 year end
- Corporation tax SA returns filed for accounting periods ended 30 September 2018
- End of CT61 quarterly return period
- Businesses to reclaim EC VAT chargeable in 2018

News

Spotlight 53

HMRC is aware of a number of schemes designed to avoid Income Tax and National Insurance contributions through a combination of capital advances and complex offshore joint (or mutual) share ownership arrangements.

Under the arrangements, a contractor becomes an employee of an umbrella company or a connected entity, such as an offshore company. The employee may sign a loan or capital advance agreement and a joint (or mutual) share ownership agreement, confirming how their salaries are to be paid, by the employer company.

The employee is paid through 2 separate payments, on a weekly or monthly basis. The first payment represents a nominal salary, resulting in payment of little or no Income Tax and NICs. The second payment may involve 'capital advances', paid in the form of weekly or monthly loans.

The employer company then carries out various share transactions, involving an offshore joint (or mutual) share ownership trust. These are said to result in financial gains for the employee. The shares may also attract a dividend for the employee. The employee has no direct involvement in the share transactions, but receives monthly or yearly summaries that show their outstanding loans have been repaid as a result of the capital gains and dividends.

Through this process, these schemes attempt to disguise an employee's earnings, which would ordinarily be subject to Income Tax and NICs. By using capital gains or dividends that attract other tax reliefs, the employer company attempts to avoid its tax liabilities as well.

HMRC's view is that these and other similar schemes do not work and are notifiable under the Disclosure of Tax Avoidance Schemes (DOTAS) legislation.

HMRC will challenge these schemes:

- For transactions that took place after 16 July 2013, HMRC will consider whether the General Anti-Abuse Rule (GAAR) applies.

- Transactions after 14 September 2016, where the GAAR applies, are subject to a 60% GAAR penalty.

- Taxpayers may also be charged a penalty for an inaccurate tax return.

www.gov.uk/guidance/disguised-remuneration-tax-avoidance-using-capital-advances-joint-and-mutual-share-ownership-agreements-spotlight-53

Doctor’s pensions

The Department of Health and Social Care is to put forward a new set of proposals to address the problem of pension tax charges faced by GPs and senior NHS doctors for breaching their pensions annual allowance, which has lead many to retire early or turn down additional work. A survey by the BMA revealed that 42% of GPs and 30% of consultants had already reduced their working hours over pension tax charges.

The new rules would allow doctors to set the exact level of their pension accrual at the start of each year and give employers the option to recycle unused contributions back into salaries. The new proposals replace the ‘50:50’ option set out in a consultation in July.

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

Business Taxation

Non-purchase payments as trading losses

Summary – Losses incurred as a result of failing to complete on two off plan property plots were not trading losses.

Gordon Lim filed his 2010/11 self-assessment return on 31 January 2012, including self-employment pages giving a commencement date for property trading of 5 April 2011. No income was shown but losses of £122,213 were claimed. £62,997 of the losses were set against his income for 2010/11 and £53,366 carried back to 2009/10.

On 7 January 2013 HMRC opened an enquiry into the return.

Dr Lim and Ms Tzemin Wah, Gordon's son and daughter in law had contracted to buy two plots of land in Leeds paying a 10% deposit of £31,957. They had exchanged contracts without having the security of a mortgage offer. On completion they were unable to complete the purchases and their deposits were forfeited.

Manor Mills LLP pursued a County Court action against Dr Lim and his wife for losses arising from breach of contract totalling £122,213 to include legal costs. This amount had been received from Gordon Lim, stating it was:

> "...in full settlement for the non-purchase of plot 189 and plot 274 at Manor Mills, Holbeck, Leeds for which deposits were paid in September 2006 but these units were not purchased on building completion."

Gordon Lim claimed that, as the plots had been acquired on trust for him, he had been trading in property so that the expenditure in respect of the forfeited deposits constituted allowable losses.

HMRC accepted that Gordon Lim was trading as a property developer and that any commercial losses could be offset against his general income in accordance with s 64 ITA 2007. However, they argued that an acquisition does not occur on exchange of contracts, but rather, on completion. HMRC claimed that in this case there were no sales of property. There was no property to sell. There were no trading transactions giving rise to either a profit or loss for income tax purposes and therefore the appellant was not trading.

Decision

In the Tribunal's view Gordon Lim's trading intention was to purchase (usually off plan properties) at a discount and eventually make a profit on their sale. There was really no reason why he would contract to purchase numerous unbuilt properties, unless he intended to resell them on completion at a profit or rent them so as to derive an income. He intended to trade in property.

The First Tier Tribunal disagreed with HMRC argument. They stated that if a contract is not completed it does not necessarily mean that because legal title to the property did not transfer from one entity to another the parties cannot have been trading.

However, there was no clear evidence that the Leeds properties were part of his property dealings. Dr Lim and his wife entered into formal legal relations with Manor Mills LLP. They agreed a binding completion date. They paid the deposits from their own resources. There was no evidence, at the point of exchange, that the obligation to complete the purchase was Gordon Lim's.

The Tribunal said that Gordon Lim would have known from a legal perspective that the losses incurred by his son and daughter in law were theirs and not his. He may have mistakenly assumed that he could retrospectively take over those losses to set off against his own income, but that would have been an unreasonable presumption and if he had sought professional advice that should have been immediately dispelled.

The appeal was dismissed with the inaccuracy for the penalties being deliberate, not careless.

Gordon Lim v HMRC (TC07248)

Admission and departure of partners (Lecture B1151 – 11.52 minutes)

Partnerships are always treated as continuing for any person who was a member both before and after the change in personnel. For such partners, the only effect is a change in profit share arrangements, as they continue to be assessed under current year basis rules.

Changing from a sole trader to a partnership (by taking on a partner), or becoming a sole trader when the other partner leaves, are covered under the above rules. The business is treated as continuing for the person who was, or is becoming, a sole trader.

For any outgoing partners, the closing year rules for unincorporated businesses apply. Their final accounting period will end on the day they left the partnership.

New joiners are taxed under the opening year rules, their first accounting period beginning on the date they joined the partnership.

Practical issues – example

Consider a partnership with a December year-end and a new joiner on 1 November 2018. Why does this provide a practical problem?

The partnership will only provide figures to December, so an estimate will be needed for the joiner's assessable profits and basis periods.

2018/19 – "Actual basis" (1.11.18-5.4.19) - 2m to 31.12.18 plus (approx.) 3m of y/e 31.12.19

The joiner's tax return needs to be marked as containing provisional figures and a disclosure note needs to be added to the return, stating the:

- basis for the estimate, and
- anticipated date when the final trading profit figure will be known.

Contributed by Kevin Read

Topic update: non-resident corporate landlords

There have been recent changes on the tax treatment of non-residents companies in respect of chargeable gains and from April 2020 there will also be further changes when non-UK resident companies are chargeable to corporation tax rather than to income tax on profits of a UK property business and 'other UK property income'.

Chargeable disposals

Prior to April 2013, non-resident companies were typically not within the scope of UK corporation tax on chargeable gains, save in respect of capital assets which were used as part of a UK permanent establishment. This offered a particular incentive to non-resident companies investing in UK land. However, from April 2013, there has been a gradual erosion of this tax benefit.

The following legislative measures have diminished the attractiveness of investing in UK immovable property for non-resident persons:

- From 6 April 2013, disposals of high value UK residential property by non-resident companies, partnerships with a corporate member and collective investment schemes became subject to CGT at a rate of 28% where the property was chargeable to the annual tax on enveloped dwellings (ATED-related gains);

- From 6 April 2015, a CGT charge applied more generally to non-UK residents disposing of UK residential property. The charge applied to a much broader class of non-UK residents and irrespective of the value of the residential property held. From this date, non-UK resident individuals, closely-held companies, trustees, personal representatives and funds disposing of UK residential property were within the scope of CGT;

From April 2019 the scope of UK tax on non-residents holding interests in UK land was further extended by the Finance Act 2019 regime (in this note referred to as the FA 19 NRCGT regime). The changes bring disposals of UK commercial property as well as disposals of shares in 'property rich' companies (broadly, one where at least 75% of its gross asset value is from UK land) within the charge to tax for the first time.

As a result, from 6 April 2019, significantly more non-residents are chargeable to tax on capital gains where they arise, directly or indirectly, from UK land. The Government has also harmonised the ATED-related gains provisions with the FA19 NRCGT regime, thereby simplifying the number of capital gains regimes that apply to disposals made on or after 6 April 2019.

In summary, from 6 April 2019:

- direct disposals of all UK land, both residential and commercial, by non-resident persons are subject to UK tax;

- indirect disposals of 'property rich' companies by non-resident persons are subject to UK tax where they hold an investment of 25% or more in the company. There is an exemption where the land held by the company is used for trading purposes;

- for both direct and indirect disposals, companies are chargeable to corporation tax on capital gains and non-corporate persons are subject to CGT;

- non-resident investors are, where applicable, able to claim capital gains reliefs which were previously only available to UK residents. These include, for non-resident companies, the substantial shareholdings exemption and no gain / no loss treatment under TCGA 1992, s 171 on intra-group transfers;

- the ATED-related gains regime is abolished and does not apply to disposals made on or after this date.

Calculation summary

For assets acquired on or after 6 April 2019, any gain or loss on the direct disposal is calculated under normal principles. For those assets acquired prior to 6 April 2019, there is a form of rebasing required when calculating what proportion of the gain on the asset is chargeable to UK tax.

The rebasing mechanism is dependent on to what extent the direct disposal was chargeable to tax prior to 6 April 2019. There are three categories of disposal provided for in the legislation:

- direct disposals not chargeable before 6 April 2019;

- direct disposals of pre-April 2015 assets fully chargeable before 6 April 2019;

- direct disposals of assets partially chargeable before 6 April 2019.

Rebasing is the default method of calculation for all types of direct disposals where the interest was acquired before 6 April 2019. However, it is possible to make an irrecoverable election to use an alternative method of calculation.

The gain or loss on an indirect disposal is calculated using the value of the shares being disposed of, rather than the value of the underlying UK land. The normal rules for share disposals therefore apply. This has the potential to create some peculiar outcomes and to bring non-UK assets that are not the intended target of the rules within the scope of UK tax.

For the purposes of indirect disposals where the shares were held prior to 6 April 2019, rebasing applies. All indirect disposals are, by default, rebased to their value as at 5 April 2019. It is also possible to elect to use the retrospective method of calculation. If a loss arises on an indirect disposal, it is only allowable if calculated under the default method (i.e. rebasing). The loss can be used in the same way as any other allowable UK capital loss. However, if the retrospective method is used, the capital loss is disallowed. (TCGA 1992, Sch 4AA, Part 2, paras 2(1), 4; FA 2019, Sch 1, Part 1, para 17)

Consideration should also be given as to whether the disposal meets the conditions for SSE. If it does, SSE applies automatically and no claim is required. Therefore, it is necessary to firstly consider if the indirect disposal is within the scope of the FA19 NRCGT regime and, if it is, whether SSE applies to the disposal.

Practical points

There are some key points coming out of the FA19 NRCGT rules that advisers need to keep in mind, particularly when taking on new non-resident clients or when existing clients become non-resident:

- valuations of properties may be required at 5 April 2015 and again at 5 April 2019 for some properties. It will be important that appropriate valuations are recorded at each stage and that any capital gains base cost history is tracked on a continuous basis, rather than being done retrospectively. This will be particularly relevant to non-resident investors that are subject to CGT, who must comply with a much stricter compliance timeframe than non-resident companies;

- as the rules can apply if the property has ever been suitable for use as a dwelling since 6 April 2015 or the date of purchase if later (rather than just being suitable for use as a dwelling at the date of disposal), this should be considered for any property disposal, whether or not it was suitable for use as a dwelling on the disposal date. It would also be advisable to consider this during a due diligence exercise where the assets of a non-resident company are being sold, some of which are UK land;

- for non-resident companies, all chargeable disposals are subject to UK corporation tax rather than CGT. For those companies holding residential property that would have been within the scope of the ATED–related gains provisions which applied prior to 6 April 2019, the FA19 NRCGT regime offers a significant saving in terms of applicable tax rates (corporation tax of 19% on disposals made on or after 6 April 2019 compared to 28% CGT for disposals before that date);

- the compliance framework under the FA19 NRCGT regime is much more relaxed than under the FA 2015 NRCGT regime for non-resident companies. For disposals made on or after 6 April 2019, any gain or loss is reported under normal corporation tax self-assessment (CTSA) procedures rather than having to be reported within 30 days of the completion date.

Capital losses

Any NRCGT losses arising from disposals by non-resident companies on or after 6 April 2019 can be used in the same way as any other allowable UK capital loss. (CG73920 (draft HMRC guidance) TCGA 1992, s 171A).

Hence, capital losses arising to a non-resident company on disposals of chargeable assets will be available to offset against the company's own gains, and, where the relevant conditions are met, gains of other members of its capital gains group.

The only exception is where the loss arises on an indirect disposal and the retrospective method of calculation has been elected for by the taxpayer. In such cases, the capital loss is disallowed and is not available for relief.

Any unused ATED related CGT or NRCGT losses in the periods to 5 April 2019 can be carried forward and allowed in the same way as any other brought forward capital loss, even though they would have accrued at a time when the company would have paid CGT in respect of such gains and not corporation tax.

This concession may prove particularly useful for corporate groups where a non-resident company has losses brought forward (either under FA 2015 NRCGT or ATED) and a capital gain is anticipated by a UK company within the group. Prior to 6 April 2019, such losses would have been ring-fenced and not available for relief generally.

Companies becoming UK resident

In order not to disincentivise onshoring, companies that become UK resident after 5 April 2019 can retain the ability to use the rebasing methods for direct and indirect disposals, despite the fact that they would be UK resident at the time of disposal. The exact rebasing method used will depend on whether it is a direct or indirect disposal of UK land and in the case of direct disposals, whether the UK land was fully or partially residential before 6 April 2019.

Non-resident corporate landlords — the move to corporation tax

From 6 April 2020, non-UK resident companies are chargeable to corporation tax rather than to income tax on profits from a UK property business and 'other UK property income'.

Profits of a UK property business include profits from loan relationships or derivatives that enable the company to generate the property income. It is only loan relationship debits and credits that relate to the UK property business that are within the scope of UK corporation tax. Therefore, if the non-resident company carries on other activities (for example, it owns non-UK properties), it will be necessary to stream the relevant UK and non-UK loan relationship debits and credits. It will be important that businesses review their internal accounting systems to ensure the correct amount of interest can be allocated to the UK business, particularly for companies with multiple or complex loan facilities. (CTA 2009, ss 5(3A), 301(1A); FA 2019, Sch 5, Part 1, para 3, Part 2, para 15)

'Other UK property income' includes rent receivable in connection with specific types of UK land, such as mines or quarries, as well as post-cessation rental receipts. (CTA 2009, s 5(5); FA 2019, Sch 5, Part 1, para 5)

Broadly, the rules that apply to non-resident companies from 6 April 2020 mirror the existing regime that applies to UK resident companies carrying on a UK property business, but with transitional rules to accommodate the difference in regimes (discussed below).

The move to corporation tax marks a significant change in the taxation of non-resident corporate landlords in the UK. While the transition will result in rental profits being subject to a lower rate of tax (corporation tax of 17% rather than income tax of 20%), it will also bring non-resident companies into several complex corporation tax regimes and will, for many, likely increase compliance time and related costs. The main areas of change are:

- deductibility of finance costs;
- relief for carried forward losses;
- group relief;
- payment of tax;
- submission of tax returns;
- contaminated or derelict land relief.

Transitional rules

In order to alleviate some of the tax consequences arising from the change in regime for non-resident companies from 6 April 2020, a series of transitional rules are set out in FA 2019, Sch 5.

Duty to notify chargeability to corporation tax

A company does not have to give notice of chargeability to corporation tax for an accounting period if its liability to tax is fully offset by tax deducted at source and it has no chargeable gains in that period.

Property rental losses

Typically, on a change of regime, the property business is treated as ceasing and any unused property losses expire.

However, under transitional rules, it will be possible to carry over any realised property losses existing on 5 April 2020 from income tax to corporation tax. While it will be possible to offset these losses against future rental profits arising after 5 April 2020, there will be certain restrictions on how the losses can be used. (FA 2019, Sch 5, Part 3, para 37)

Firstly, it will only be possible to offset the losses against income arising to the non-resident company that relates to the UK property business (e.g. future UK rental profits or related loan relationships or derivatives). Secondly, it is not possible to group relieve the property losses to other group companies that are chargeable to UK tax.

The offset against future UK property profits will be automatic. Therefore, no claim is needed, but, equally, it is not possible to tailor the amount of losses utilised.

Losses existing at 5 April 2020 will take priority over post 5 April 2020 property rental losses. Practically, it will therefore be necessary to stream these losses from other property rental losses that arise on or after 6 April 2020 and maintain adequate records of the different losses in future periods.

It will be possible to utilise losses arising post 5 April 2020 in the usual way for property rental losses, but the restriction applicable to corporate losses arising from 1 April 2017 that are carried forward will also apply.

Capital allowances

As there is a cessation of the income tax business on transition, it is possible that balancing adjustments would be created on the transfer to corporation tax. To alleviate this, the change in tax regime will not be regarded as a disposal event under CAA 2001, s 61.

As a result, capital allowances will be transferred on a tax-neutral basis at tax written down value, thereby avoiding any large balancing charges on the transfer to the corporation tax regime.

Foreign permanent establishments (PE) of non-UK resident companies

Companies can elect for the relevant profits or losses of a PE carried on outside the UK to be left out of accounts when calculating the charge to UK corporation tax.

It will not be possible to make this election in relation to profits or losses of the company's UK property business, other UK property income of the company or profits arising from loan relationships or derivative contracts that the company is a party to in relation to the UK property business or UK property income.

Derivatives and the disregard regulations

The disregard regulations will be available to companies with property income once they are brought within corporation tax. FA 2019 provides that just and reasonable adjustments are to be made where there is 'tax asymmetry' between the two regimes.

Quarterly instalments

The corporation tax quarterly instalment provisions will not have effect for the company's first corporation tax accounting period that straddles 6 April 2020. Essentially, this will mean that any corporation tax liability will instead be due nine months and one day after the company's accounting period.

Administrative matters

The transition will involve the non-resident's income tax property business ceasing on 5 April 2020 and the commencement of a new corporation tax period on 6 April 2020. A non-resident company that has a period of account that straddles 5 April 2020 will therefore be required to submit two tax returns — one under the income tax regime for any profits arising up to and including 5 April 2020, and one under the corporation tax regime for profits arising from 6 April 2020.

As many non-resident companies have a March or December year-end, this will involve an exercise to apportion income and expenses to each period.

It will be necessary for non-resident companies, including those already known to HMRC from registration under the non-resident landlord scheme, to register with HMRC for corporation tax. Companies will also need to refile details of their tax agents if those agents are to continue acting on their behalf for corporation tax, as no automatic carry-over of income tax authorisation is expected.

Contributed by Joanne Houghton

Profit fragmentation – impact on smaller businesses (Lecture B1152 – 11.21 minutes)

A new provision was introduced as part of Finance Act 2019 that could potentially have a significant impact if HMRC decide to use it aggressively. It is part of a wider clampdown on offshore tax avoidance. The new provisions apply from 1 April 2019 for corporates and 6 April 2019 for individuals.

Many of the provisions already introduced, such as Diverted Profits Tax, have limited impact due to the fact that they have a threshold before they can apply. The profit fragmentation rules do not have such a threshold and are seen as largely being targeted at individuals, partnerships and SMEs. However, there are other pieces of legislation that might also apply and it is important to acknowledge that the profit fragmentation provisions are only relevant if those do not apply.

So you still need to consider if legislation such as the transfer of assets abroad provisions apply. If other legislation only partially corrects a tax mismatch then the profit fragmentation provisions will apply to 'mop up' the unassessed amounts.

These are complex provisions but in broad terms require affected persons to self-assess an additional tax charge where profits are moved out of the UK in circumstances where there is a tax mismatch. This is defined as a situation where the overseas recipient pays tax at less than 80% of the rate that would apply to the UK transferor.

The rules can apply to all UK resident individual, partnerships and companies. It is unlikely to apply to more complex businesses because they will already have to consider transfer pricing (if they are corporates) or other legislation. For example, a large private equity business will be unlikely to be in a situation where profit fragmentation is occurring since they will need to make sure that the disguised investment management fee provisions do not apply to them.

What would trigger a charge under these provisions?

The starting point is that it applies to any transaction or action of any type between an overseas person and a UK resident that leads to value transferring out of the UK. However, there must be a resident party, an overseas party and a related individual. The resident party is the one subject to the legislation and to whom the rules apply. The overseas party is the person to whom the value is transferred and must be resident or established abroad (so a non-UK company which was charged to UK corporation tax as it is centrally controlled and managed in the UK could not be the overseas party). The related individual is the person who can benefit from the value transferred and can the resident party, a member of partnership of which the resident party is a partner or a participator in a company which is the resident party. The related individual must be an individual who is involved in the business of the resident party.

An example from the HMRC guidance goes as follows:

> C Ltd is a UK resident company which trades as a management consultancy firm and which has a 20% shareholder, D. He is responsible for all the company's overseas business and works from the UK but he is the sole shareholder in a BVI company and he agrees that the overseas customers of C Ltd should make payments to the BVI company. C Ltd is the resident company, D is the related individual and the BVI company is the overseas party.

Another example of a situation where this might catch a commercial arrangement would be if a group of partners in a UK partnership set up an overseas partnership with some individuals being partners in both. In this case, the conditions could be met if transactions are not on an arm's length basis.

So whilst the basic premise is incredibly wide, there are specific conditions that need to be met.

Condition 1

There must be an arrangement resulting in a transfer of value that results in profits derived from UK business activities being transferred abroad. The legislation contains a non-exhaustive list of what this means:

- sales, contracts and other transactions made otherwise than for full consideration or for more than full consideration;
- any method by which any property or right, or the control of any property or right, is transferred or transmitted by assigning share capital or other rights in a company, rights in a partnership, or an interest in settled property;
- the creation of an option affecting the disposition of any property or right and the giving of consideration for granting it;
- the creation of a requirement for consent affecting such a disposition and the giving of consideration for granting it;
- the creation of an embargo affecting such a disposition and the giving of consideration for releasing it and
- the disposal of any property or right on the winding up, dissolution or termination of a company, partnership or trust.

Value can be traced through any number of entities to meet the conditions.

Condition 2

The transaction must be otherwise than at arm's length. This is the same principle as applies for transfer pricing purposes although the profit fragmentation rules do not give statutory effect to the OECD transfer pricing guidelines.

Condition 3

It must be reasonable to suppose that the value transferred relates to assets that a relevant individual is entitled or to an activity undertaken by such an individual.

Condition 4

This condition is that either the enjoyment condition or the procurer condition is met. The enjoyment condition is that it is reasonable to suppose that the individual, or someone connected with them, will have the power to enjoy the transferred profits at some point. Power to enjoy is broadly that the person will get some benefit at some point in the future. The procurer test is met where the related individual procures the transfer of value with the intention of the enjoyment condition being avoided. This latter one might apply in a complex situation where HMRC cannot demonstrate how the relevant individual will benefit but where they are clearly involved in the arrangements.

Condition 5

There has to be a tax mismatch which, as noted above, means that the overseas person or entity receiving the transferred profits will pay less than 80% of the tax that the UK person would have paid.

For corporates, any jurisdiction where the tax rate is less than 15% would need to be investigated. Currently this includes Andorra, Bosnia and Herzegovina, Cyprus, Estonia, Hungary, Moldova, Georgia, Ireland, Bulgaria, Qatar, Uzbekistan, Montenegro and Liechtenstein as well as more traditional tax havens such as the Bahamas, Barbados, Bahrain, Bermuda, BVI, Cayman Islands, the Channel Islands, the Isle of Man, Kuwait, Saudi Arabia and UAE. It would also include any jurisdiction that offers a preferential rate to certain types of business such as the Netherlands which taxes intellectual property profits at 7% or to small businesses (which includes places such as Croatia, Israel, Hong Kong and Singapore).

For individuals who might be paying tax at 45%, the comparative tax rate is 36% and it is hard to think of any jurisdiction that has corporate tax rates as high as that. Of course if transferring profit to another individual, then the rates could be variable and need to be checked.

Condition 6

The main purpose or one of the main purposes of the transfer of value was to obtain a tax advantage. Clearly here you need to be able to argue that the tax saving was not a significant consideration compared with other advantages.

Examples

A UK company offering the consultancy services of its only shareholder establishes a company in a low-cost country to outsource work with that same individual holding all of the shares. Are the conditions met?

Is there a transfer of value? - Any payment for work done will be a transfer of value

Is the transaction otherwise than at arm's length? - This will need to be determined using general principles. Of course, this does take into account the relative value of work done in the different jurisdictions but it is still not a straightforward calculation to do.

Does the value relate to assets that a relevant individual is entitled to? - The UK shareholder has shares in the overseas company so this condition will be met

Does a relevant individual have the power to enjoy the income? - The UK shareholders will benefit from the income as it can be extracted from the overseas company, so this condition will be met.

Is there a tax mismatch? - This will have to be ascertained but as established above, this condition is met for many jurisdictions.

Is the main purpose to obtain a tax advantage? Here you would need to consider whether the costs saved by outsourcing in this way dwarf the tax saving.

Examples are all from HMRC published guidance

A management consultant is resident in the UK and provides professional services for both UK and overseas customers. A proportion of these services is attributed to the UK business, with those receipts reported by the UK business and taxed in the UK. However, the remaining receipts are paid by customers directly to an offshore company in a tax haven, owned by a trust based in the tax haven. These are paid in return for consultancy services allegedly provided by the offshore company, which has no assets apart from access to the skills and services of the management consultant himself, neither of which is exercised to any material extent in the tax haven. The management consultant in the UK is expressly excluded from benefiting from the trust but relatives can benefit. The underlying reality is that all income derives from a single underlying activity (namely the skills of the consultant, who is a UK resident), that no or negligible services are performed by that person in the low tax jurisdiction itself, and consequently the full profits should be taxed in the UK as profits of the consultant.

J, a UK resident and domiciled individual, owns all of the share capital in a UK resident company which makes a payment of £150,000 to an overseas company. The overseas company is owned by an overseas trust of which J is both the settlor and beneficiary. Following enquiries, it transpires that the payment is made for services provided by the overseas company though the payments being made are inflated. The value of the services if they had been undertaken at arm's length are £100,000 not £150,000 though full amount of this receipt is treated as income in the overseas company's accounts. It is assumed for the purpose of this example that no other legislation applies. The conditions for both the transfer of assets abroad regime and the profit fragmentation regime apply. The TOAA regime will tax the full amount of income under s720 ITA2007 so the profit fragmentation provisions will not apply.

In 2016 Company A, a UK resident research and development company, (‘A Ltd’) created a new type of high-tech micro-chip used in mobile phones. The technology was ahead of its time on creation and the company did not anticipate that it would need any technological maintenance for at least 4 years. In 2018 the patent for the micro-chip was transferred to Company B (‘B Ltd’). B Ltd is another group company, based in the British Virgin Islands (BVI), which holds all of the group's patents and exploits them all over the world. This transfer took place on arm's length terms: B Ltd paid a significant sum to A Ltd. in return for the patent.

B Ltd. has a workforce based in the BVI responsible for exploiting the group's patents to customers. During the accounting period ending 31 December 2019 B Ltd. generated income of $1m from its customers relating to the patent. The Profit Fragmentation legislation will not apply to the transfer of the patent in 2016 because the transfer took place in advance of the legislation applying. Furthermore, it will not apply to the income generated by B Ltd during the APE 31 December 2019 as this income is not properly attributable to the UK business. However, let us consider the situation where the micro-chips need updating to ensure the technology remains current. B Ltd. does not have the necessary expertise to update them, so A Ltd. updates the technology for B Ltd. but does not receive any remuneration for doing this. The service of updating the technology by A Ltd without receiving any remuneration results in a transfer of value to B Ltd. The Profit Fragmentation legislation could apply to this transfer of value at the time this occurs (in this example this is during the accounting period ended 31 December 2020) provided the arrangements are Profit Fragmentation Arrangements and the exception conditions don't apply.

Practical advice

So what practical advice would you give to SMEs to protect them from being caught out by these rules?

Review current transactions and structures to see if a tax mismatch arises, which would potentially lead to the increase in the foreign tax being less than 80% of the reduction in the UK taxation as a result of the transaction.

Where a mismatch arises, consider whether the ‘enjoyment’ condition is satisfied so that a UK relevant person can benefit from the profits that are not taxed in the UK.

If both of the above conditions are met, consider whether the transaction is at arm’s length and therefore not excessive when compared to the activities being undertaken.

It is then recommended that the company considers and evidences, as appropriate, why the main purposes, or one of the main purposes, of the transaction was not to obtain a tax advantage and, therefore, why the company believes that the anti-fragmentation provisions do not apply.

Contributed by Ros Martin

Deferred tax – Changes in tax rates (Lecture B1153 - 16.23 minutes)

Deferred tax is not permitted to be booked when using FRS 105 but must be booked when using FRS 102 or IFRS (IAS 12).

One of the aims of deferred tax is to assist in aligning the tax expense more closely with the accounting profit, even where tax law would charge or relieve certain items in different periods to when they appear in the profit and loss account.

In other words, deferred tax assists in trying to make the effective rate of tax in the profit and loss account closer to (if not fully aligned with) the statutory rate applying for that period.

Example – accelerated capital allowances

	DT Provided	DT not provided
	£	£
Profit before tax	1,100	1,100
Capital allowances minus depreciation	(100)	(100)
PCTCT	1,000	1,000
Current tax at 19%	190	190
Deferred tax at 19%	19	N/A
Total tax expense	209	190
Effective tax rate on PBT	19%	17.3%

Deferred tax in this case aligns the effective rate of tax with the statutory rate.

Examples of timing differences

Pension cost expense: Only deductible for tax purposes when paid by the company, but recognised on accruals basis in the financial statements.

Capital allowances: 100% AIA may be available on purchase of certain fixed assets, if not then18% pa or 8% pa reducing balance. The depreciation policy decided by directors – to expense the cost over the asset's useful life. This will not be same as the capital allowance rate.

Example – pension costs

A company with a March year-end accrues its March 2020 defined contribution pension cost of £10,000 (leaving it with a profit of £200,000). This will be paid in mid-April 2020 when it will become tax-deductible

Assuming a tax rate of 19% throughout, prepare a summary P&L:

- Using FRS 105
- Using FRS 102

	FRS 105	FRS 102
Profit before tax	200,000	200,000
Current tax expense (19% on £210,000)	39,900	39,900
Deferred tax (timing difference £10,000 @ 19%)	N/A	(1,900)
Total tax expense	39,900	38,000
Profit after tax	160,100	162,000
Effective tax rate	19.95%	19%

Dealing with a rate change

For FRS 102 and IFRS we must use the rate applicable when timing difference reverses, based on enacted or substantively enacted tax rates at year-end. The corporation tax rate has been enacted to change:

- Since 1 April 2017: 19% (enacted 2015);
- From 1 April 2020: 17% (enacted September 2016).

Deferred tax needs to take these rates into account. This makes the tax reconciliation more complicated (covered in a separate session) and the effective tax rate in the first year won't appear to make much sense.

Solution to previous example using live tax rates

	FRS 105	FRS 102
Profit before tax	**200,000**	**200,000**
Current tax expense (19% on £210,000)	39,900	39,900
Deferred tax (timing difference £10,000 @ 17%)	N/A	(1,700)
Total tax expense	**39,900**	**38,200**
Profit after tax	160,100	161,800
Effective tax rate	*19.95%*	*19.1%*

Capital allowances and deferred tax

The timing difference is the difference between the net book value ("NBV"), and the tax written down value ("TWDV") as is widely known. This difference gradually reverses over a long period of time.

When tax rates change, strictly, we need to estimate reversals year by year and tax rates that will therefore apply to them. Judgement will be needed in practice and materiality needs to be considered.

If different tax rates will not have material effect on the DT amount, it may not be worth over-complicating the process. Remember that something is not material if a primary user reading the accounts wouldn't have made any different economic decisions if the strictly correct figures had been used.

For OMBs where the owners rely on dividends for their income, they can be very sensitive to the profit after tax figure, so materiality of the tax figure may be quite small.

Example – single asset

A company acquired a fixed asset on 1 January 2016 at a cost of £80,000. The company's depreciation policy is to depreciate on a straight-line basis over 5 years to a zero residual value.

The company will make accounting profits after depreciation of £100,000 in each of the next 5 years.

Assume a tax rate of 20% throughout and that the expenditure qualifies for 100% AIA.

Show how the P&L would look if:

- No deferred tax was booked (FRS 105)
- Deferred tax is booked in accordance with FRS 102

Solution – FRS 105

	2016	2017	2018	2019	2020
Profit before tax	100,000	100,000	100,000	100,000	100,000
+ Depreciation	16,000	16,000	16,000	16,000	16,000
- AIA	(80,000)	nil	nil	nil	nil
Taxable profit	36,000	116,000	116,000	116,000	116,000
Current Tax: 20%	7,200	23,200	23,200	23,200	23,200
Profit after tax	92,800	76,800	76,800	76,800	76,800
Effective tax rate	7.2%	23.2%	23.2%	23.2%	23.2%

Solution – FRS 102

	2016	2017	2018	2019	2020
Net book value	64,000	48,000	32,000	16,000	Nil
Tax WDV	Nil	Nil	Nil	Nil	Nil
Timing difference	64,000	48,000	32,000	16,000	Nil
DT liability 20%	12,800	9,600	6,400	3,200	Nil
DT P&L expense / (income)*	12,800	(3,200)	(3,200)	(3,200)	(3,200)

	2016	2017	2018	2019	2020
Profit before tax	100,000	100,000	100,000	100,000	100,000
Current tax*	7,200	23,200	23,200	23,200	23,200
Deferred tax	12,800	(3,200)	(3,200)	(3,200)	(3,200)
Tax expense	20,000	20,000	20,000	20,000	20,000
Profit after tax	80,000	80,000	80,000	80,000	80,000
Effective tax rate	20%	20%	20%	20%	20%

Example - Same details as before but using live tax rates.

Solution – FRS 105

	2016	2017	2018	2019	2020
Profit before tax	100,000	100,000	100,000	100,000	100,000
+ Depreciation	16,000	16,000	16,000	16,000	16,000
- AIA	(80,000)	nil	nil	nil	nil
Taxable profit	36,000	116,000	116,000	116,000	116,000
Tax: 20%	7,200				
19.25%		22,330			
19%			22,040	22,040	
17.5%					20,300
Profit after tax	92,800	83,830	84,040	84,040	85,300
Effective tax rate	7.2%	22.33%	22.04%	22.04%	20.3%

Solution – FRS 102

	2016	2017	2018	2019	2020
Book value	64,000	48,000	32,000	16,000	Nil
Tax WDV	Nil	Nil	Nil	Nil	Nil
Timing difference	64,000	48,000	32,000	16,000	Nil
Reversal of TD:	**2016**	**2017**	**2018**	**2019**	**2020**
2017: 16,000 @ 19.25%	3,080*				
2018: 16,000 @ 19.00%	3,040*	3,040			
2019: 16,000 @ 19.00%	3,040*	3,040	3,040		
2020: 16,000 @ 17.50%	2,800*	2,800	2,800	2,800	
DT liability 31 Dec	**11,960**	**8,880**	**5,840**	**2,800**	**Nil**

* These individual amounts represent the DT P&L movement each year

	2016	2017	2018	2019	2020
Profit before tax	100,000	100,000	100,000	100,000	100,000
Current tax	7,200	22,330	22,040	22,040	20,300
Deferred tax	11,960	(3,080)	(3,040)	(3,040)	(2,800)
Tax expense	19,160	19,250	19,000	19,000	17,500
Profit after tax	80,840	80,750	81,000	81,000	82,500
Effective tax rate	19.16%	19.25%*	19%*	19%*	17.5%*

* Same as the statutory rate for these periods

Contributed by Malcolm Greenbaum

Jersey consults on taxing enveloped property

The government of Jersey is consulting until 14 October on proposals to introduce a charge equivalent to stamp duty on transfers of Jersey real estate held within corporate bodies. The new tax charge will cover transactions that result in the acquisition of a 'significant benefit' (> 50%) in entities holding Jersey property.

Transactions would include where Jersey real estate is owned by:

- a company and the transaction is a transfer of the legal/beneficial ownership of the shares of that company;
- a guarantee company and the transaction is a transfer/creation for the benefit of the transferee of any right or interest in that guarantee company;
- a foundation and the transaction has the effect of conferring a 'significant benefit' on the transferee in respect of Jersey real estate;
- the trustees of a trust and the transfer is a transfer/creation of any interest in that trust or of any expectation that the trustees of the trust will confer any 'significant benefit' on the transferee in respect of Jersey real estate; or
- a partnership (LP, ILP, SLP, LLP) and the transaction is a transfer/creation of any interest in such partnerships.

This will apply whether or not any of the parties to the transaction are present or resident in Jersey, or whether or not any legal person being the owner of the property is registered or has a presence in Jersey.

www.gov.je/Government/Consultations/Pages/TaxationOfTransactionsInvolvingEnvelopedProperty.aspx

VAT

Failure to register

Summary – It seemed unlikely that the taxpayer was simply an employee responsible for taking orders, cooking and delivering pizzas. It was more probable than not that the failure to register was due to the taxpayer's deliberate, attempted concealment.

Between 2013 and 2017, Mohammed Malik worked for a company, Newham Pizza Limited Ltd, which operated a pizza franchise in East London.

Following investigation, HMRC concluded that the takings had been supressed and that the company should have been registered for VAT from early 2014. They imposed a penalty on Newham of £138,692.40 under schedule 41 FA2008 in respect of its failure to notify HMRC of its obligation to register for VAT.

As they had been informed that an application had been made to strike the company off the Companies House register, HMRC also sent personal liability notices one of which was sent to Mohammed Malik making him liable to pay 50% of the penalty that had been imposed on Newham.

Mohammed Malik did not dispute the penalty that was levied on the company but appealed his personal liability notice, claiming that he was not an 'officer' of the company as required for him to be made liable. He was adamant that he held no significant role within the business and that he was simply an employee.

Decision

The First Tier Tribunal established that several different companies had run the pizza franchise and Mohammed Malik had been involved in several of them, including as director of two.

At a meeting with HMRC, Mohammed Malik was the person who was able to provide all the detailed information about the company's finances and the way in which the business operated. The First Tier Tribunal was satisfied that Mohammed Malik was a 'manager'. It seemed unlikely that he was simply an employee responsible for taking orders, cooking and delivering pizzas. Failure to register was due to his deliberate, attempted concealment.

The appeal was dismissed.

Mohammed Abdul Malik v HMRC (TC07198)

Input tax recovery for universities

Summary - In raising and collecting donations and endowments, the university was not acting as a taxable person.

The University of Cambridge, in addition to its principal activity of providing exempt educational services, makes taxable supplies, including commercial research and the sale of publications.

It recovers input tax under a partial exemption special method.

The activities of the university are financed in part through donations and endowments that are placed into a fund that is managed by a third party. The issue was whether input tax incurred on the fund management fees was deductible. This depended on whether it was possible to make the necessary link between those costs and the university's economic activities, so that the fees were a cost component of the university's taxable supplies.

Decision

The CJEU observed that the donations and endowments, which were essentially made for subjective reasons on charitable grounds and on a random basis, were not consideration for any economic activity so that the raising and collection of the funds did not fall within the scope of the VAT Directive.

The CJEU found that the investment of the funds should be treated in the same way as the non-economic activity consisting in the collection of donations and endowments; it was a 'direct continuation of it'.

HMRC v The Chancellor, Masters and Scholars of the University of Cambridge (Case C-316/18)

Adapted from case summary in Tax journal (12 July 2019)

R&C Brief 5/2019: VAT rule changes for Higher Education

As a result of changes being made to the way in which providers will be funded by the Office for Students (OfS) from the start of the 2019 to 2020 academic year, from 1 August 2019 the following changes are being made to Higher Education (HE) providers in England only..

Going forward, to receive the exemption, such providers must be registered with the Office for Students in the 'Approved (fee cap)' category under the Higher Education and Research Act 2017. All English HE providers who become registered in the Approved (fee cap) category will also be entitled to exempt their future supplies, the guidance in VAT information sheet 08/18 remains applicable.

The exemption will not be backdated for bodies that have not registered by 1 August.

The exemptions that relate to further education are unaffected, although some providers of both higher and further education may wish to register with the OfS in the Approved (fee cap) category.

Paragraph 4.1 of VAT Notice 701/30 (Education and Vocational training) will be amended to define an eligible body as:

With effect from 1 August 2019, an eligible body is:

- a school, sixth form college, tertiary college or further education college or other centrally funded further education institution (defined as such under the Education Acts);
- a centrally funded higher education institution in Wales, Scotland and Northern Ireland (defined as such under the Education Acts);
- the governing body of one of these institutions:
  - a local authority;
  - a government department or executive agency;
  - a non-profit making body that carries out duties of an essentially public nature similar to those carried out by a local authority or government department;
  - health authority;
- •a non-profit making organisation that meets certain conditions;
- •a commercial provider of tuition in English as a Foreign Language, in which case special rules will apply (see section 9;
- •a university.

www.gov.uk/government/publications/revenue-and-customs-brief-5-2019-vat-rule-changes-for-higher-education

"Free" bottle of wine

Summary – The £10 charged for three food dishes and a free bottle of wine should be apportioned between the food and wine.

"Dine In for Two – £10 – with Free Wine" was a promotion offered by Marks and Spencer PLC (M&S) that allowed a customer to choose three food dishes on payment of £10 and obtain a bottle of wine (or other non-alcoholic beverage) which was described as being provided "free".

Food items sold separately are zero rated for VAT but wine is taxable at the standard rate. The issue in this appeal is whether the £10 should be apportioned between the food and wine, as HMRC contend, or whether, as M&S contends, the wine was supplied free of charge for VAT purposes.

The First Tier Tribunal decided that the £10 should be apportioned between the food and wine.

M&S appealed to the Upper Tribunal.

HMRC argued that, under this scheme, the customer was buying four items for £10 that should be apportioned on a fair basis. The commercial and economic reality was that there was no ‘free’ wine.

M&S argued that the First Tier Tribunal had erred in law when they decided that the wine was not supplied free of charge and the £10 consideration should be allocated across all four items. M&S argued that there were two separate commercial offers:

- three food items for £10; and
- “free wine”.

If the Upper Tribunal decided that the wine was supplied free of charge, M&S argued that the supply of “free” wine would fall within the terms of a Bespoke Retail Scheme Agreement entered into between M&S and HMRC and no VAT would be due. (Appendix 5 of this agreement contained details of how various promotions should be treated for VAT including ‘Buy on get one free’ offers, ‘3 for 2’ offers and ‘free’ gifts). However, both parties agreed that if the Upper Tribunal decided that the £10 should be apportioned between food and wine, the Bespoke Retail Scheme Agreement was not relevant.

Decision

The Upper Tribunal agreed with the First Tier Tribunal concluding that the consideration should be spread across all four items. The consideration was paid in return for three food items and the wine, and must be apportioned.

Although the second ground of appeal fell away, the Upper Tribunal considered that the terms of the Bespoke Retail Scheme Agreement were clear and applicable; if they had concluded that the wine was “free”, the Tribunal would have agreed that the scheme required HMRC to treat the wine in the way that M&S had contended.

The appeal was dismissed.

Marks and Spencer PLC [2019] UKUT 0182 (TCC)

Extension or annexe?

Summary – The construction of an annexe by a charity running a day nursery and school was zero rated in accordance with Items 2 and 4 in Group 5 of Schedule 8 VATA 1994.

Yeshivas Lubavitch Manchester is a charity providing education for children between the ages of 3 and 16 in the Jewish community in Manchester and the North West of England. It is not registered for VAT.

The charity owns and maintains Oholei Yosef Yitzchok Lubavitch Schools (OYY Schools), which runs a day ‘nursery’ for boys and girls between the ages of 3 and 5, and a day ‘school’ for girls between the ages of 5 and 16. It was decided to move OYY Schools to a newly acquired site (an old detached residential property, with a basement and three further floors). The existing building was to remain, requiring only minor internal works. An existing single story extension to the rear of the building was to be demolished and a new single storey building was then to be built at the rear of the existing building.

Discussions took place whereby HMRC indicated that they would not view the original plan as qualifying for zero rating. The plans were changed so that when the works were finally completed, there was no internal access from the existing building to any of the new structure at all. The back wall of the existing building in effect became a party wall to the whole of the new structure. The former main door to the existing building remained its main door. The entrance to the corridor abutting the existing building became the main entrance to the new structure. The corridor abutting the existing building, rather than being an entrance area to the existing building as originally envisaged, ultimately became the main entrance area to the new structure. The uses for which the existing building and the new structure were physically capable of being put, and the functions which they were capable of performing, were different. The large open space in the new structure would be capable of being used, for instance, as a school hall or gymnasium. The rooms in the existing building would not be capable of such use, but rather for classrooms.

The charity accepted that the work on the existing building was standard rated but argued that the new structure should be zero-rated. The charity's case is that the new structure qualifies for zero rating under Items 2 and 4 in Group 5 of Schedule 8 VATA 1994. They claim that these works are not excluded by Note 16 because the new structure is not an "enlargement of, or extension to" the existing building (Note 16(b)), but rather, an "annexe" that is capable of functioning independently from the existing building, with the new structure and the existing building each having their own means of access (Note 16(c) and Note 17).

Despite the discussions during construction, HMRC later issued a decision concluding that the work was standard rated. That decision was subsequently upheld in a 1 February 2017 HMRC review decision. HMRC argued that the work on both the existing building and the new structure was undertaken pursuant to a single contract for a single scheme of works to convert and alter the existing building for use as a school premises, and that the VAT treatment of the new structure cannot be determined in isolation from the scheme of works as a whole. HMRC argued that the new structure is not an annexe, and that in any event it is not capable of functioning independently and does not have its own main access.

Even if the requirements of Note 17(a) and (b) were satisfied, the new structure would only qualify for zero rating if it was intended for use solely for a relevant charitable purpose and this requirement would not be satisfied if the new structure was intended for use "in the course or furtherance of a business" (Note 6(a)). HMRC argued, and the charity disputed, that the new structure was intended for use "in the course or furtherance of a business".

The charity appealed the decision.

Decision

The Tribunal confirmed that supplies of services and building materials for the construction of an annexe are zero rated if the relevant requirements are satisfied. The statutory requirements do not expressly include the need for the construction of the annexe to take place independently of any construction work on the existing building.

The Tribunal stated that determining whether works constitute an "extension" or "annexe" to an existing building requires a comparison of the building before and after the works have been completed, and the extent to which the new structure is integrated with the existing building is a significant factor in reaching the final decision:

- The Tribunal concluded that on a balance of probability that the decision to proceed with the new layout had been taken prior to 7 March 2016, the earliest date identified by HMRC as the date of supply and so their decision was made based on the adapted building after discussions with HMRC referred to above;

- The Tribunal found that the new structure was not integrated enough to be considered an extension to the existing building.

- The Tribunal found that the new building was an annexe for purposes of Note 16 and Note 17 "Capable of functioning independently" from the old building.

The school and the nursery were run on a non-profit basis with a substantial number of the children at the school and nursery coming from financially disadvantaged backgrounds. The Nursery was located in the new annexe and the Tribunal considered whether this constituted activities 'otherwise than in the furtherance of a business'. The charity clearly needed to finance its activities, which it did through amounts paid by the parents of children attending the school and nursery, and through donations and grants. The Tribunal found that the fees were set at a level designed to ensure that they covered their costs. Donations were then used to subsidise the fees of a proportion of these children. The Tribunal found that the amount of fees charged for children attending the nursery was not sufficient for the nursery to break even. Consequently, the Tribunal found that the provision of educational services to children attending the nursery was not a supply "for remuneration" within the meaning of the Wakefield College test. The making of such supplies was accordingly not an "economic activity" within the meaning of Article 9(1) of the Directive, and was not a "business" for purposes Note 6. The Tribunal found that the annexe when constructed was "intended for use solely for ... a relevant charitable purpose" within the meaning of Item 2.

The appeal was allowed.

Yeshivas Lubavitch Manchester v HMRC (TC07242)

HMRC's liable not liable policy (Lecture B1155 – 11.01 minutes)

What is the 'liable not liable concession'?

If a business is late registering for VAT, then the registration is backdated to when it first should have registered. This outcome will mean that a long period return will need to be completed between the registration date and the application date. However, it is possible that the business turnover might have fallen after the compulsory registration date, perhaps because of declining sales or a business owner working less hours, and this is where the 'liable not liable' concession becomes relevant i.e. HMRC will recognise time periods when the annual taxable sales fell below the deregistration threshold and therefore the business does not need to be treated as registered for this period during the long return window and therefore not account for output tax on its sales.

Secret policy

To add a twist to the tale, the 'Liable Not Liable' concession is not mentioned in HMRC's Registration manual, in other words there is no indication of how the months or years when it is applied are calculated. There is an allocation of policy notes between VATREG28050 and VATREG28550 but they all state: "This content has been withheld because of exemption in the Freedom of Information Act 2000". But it is important for advisers to be aware of it if any clients have a late registration problem. It is important to ask HMRC for the concession (if appropriate) in case they don't offer it.

Stanley Chmiel (TC7112)

This case produced a routine win for HMRC. His company called Kudos Building and Electrical Services Ltd was late registering for VAT, which HMRC decided was due to 'deliberate not concealed behaviour' so as well as assessing the company for belated tax of £12,143, the officer also issued a 35% penalty for 'deliberate not concealed' behaviour, which became the subject of a personal liability notice against the director when the company failed to pay the tax or penalty. HMRC can do this in the case of 'deliberate' behaviour, using powers given by para 1, Sch 41, FA 2008 and Mr Chmiel's appeal against the penalty failed.

However, the most interesting issue about the case was the way that HMRC applied its 'liable no longer liable' policy in relation to the late registration period:

- The company exceeded the compulsory threshold on 31 January 2012, so was liable to be registered from 1 March 2012. So far, so good.

- The company's rolling 12-month turnover thereafter continued to be above the deregistration threshold until the year ended 31 August 2013 (£79,000 at the time and turnover was £78,319). The deregistration threshold is £2,000 less than the registration threshold. But it then exceeded the threshold again for the final time in the year to 30 September 2013 (£80,289), thereafter being below.

HMRC therefore treated the late registration period as being from 1 March 2012 to 31 July 2013, even though the company continued to trade until March 2016.

The end result was that the 'liable no longer liable' concession meant that the company's belated period was treated by HMRC as being for just 17 months until July 2013. This is an excellent outcome compared to 49 months if it had not been applied.

Learning points

The interesting fact was how Kudos' period of registration ceased on 31 July 2013. I would have thought the fact that the annual sales figure to August 2013 was so close to the de-registration threshold, then exceeding it again in September 2013, would have produced a deregistration date of 30 September 2013 under the liable no longer liable process. A two-month bonus for the taxpayer, I feel. The later periods were more clearcut (e.g. turnover in the 12-month period to 31 October 2013 was a much reduced £55,041).

Tim Hughes (TC6609)

This case also produced a routine victory for HMRC – the taxpayer's guest house business should have registered for VAT on 1 July 2011 because he exceeded the threshold on 31 May 2011. And because it was not picked up until HMRC's Hidden Economy Team came knocking in 2015, he could not argue against a late registration penalty either.

Mr Hughes felt he had been given a bad deal by HMRC, an assessment for £9,685 and a late registration penalty of £1,937 (20% of the tax due). However, it could have been a lot worse:

HMRC generously applied the Liable Not Liable concession so that his actual period of registration was only between July 2011 and November 2012.

Mr Hughes turnover fell below the deregistration threshold after November 2012, so his registration period was cut short on this date rather than continued until 2015.

Key messages

- Be aware of the 'liable not liable concession' and see if it is relevant for any clients who are late registering for VAT;

- In some situations, it is not beneficial to utilise the concession, on the basis that all customers (or most customers) relevant to the late period are VAT registered and able to claim input tax, so will accept a VAT only invoice covering the late period. The business can then claim input tax on its own expenses for all of the late period, subject to the normal rules;

- As shown by the Chmiel case, HMRC can sometimes be extremely generous when making their calculations to work out the period when the business was not liable to be registered. It is important to encourage HMRC to adopt the best possible outcome for your clients when considering the figures for the late period – if you don't ask, then you don't get, so to speak!

Contributed by Neil Warren