# Tolley®CPD

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# Personal tax

## Sports radio presenter (Lecture P1211 – 22.13 minutes)

*Summary – Under a hypothetical contract the taxpayer would be treated as an employee. The First Tier Tribunal had erred in its findings on mutuality of obligation and IR35 applied.*

Kickabout Productions Limited is the personal service company of Paul Hawksbee, a sports radio presenter and scriptwriter. The company entered into contracts with Talksport Limited to provide Paul Hawksbee's services on the "Hawksbee & Jacobs Show", a three-hour radio programme broadcast every weekday from 1pm to 4pm.

HMRC sought to claim income tax and national insurance totalling £143,000 on the basis that, under the IR35 rules, Paul Hawksbee was an employee.

By the time of the First Tier Tribunal hearing, Hawksbee and Jacobs had been presenting the show for 18 years and for the three years under appeal, the income that Paul Hawksbee received from these shows represented roughly 90% of his total income. Further, he did not work as a radio presenter for anyone other than Talksport. Throughout the contracts, he was paid a flat fee per show, but had no right to holiday pay, sick pay or employer pension contributions and could not provide a substitute.

The First Tier Tribunal concluded that the arrangement did not fall foul of IR35. However, this was a split decision, decided based on Judge Scott's casting vote. The judges disagreed over mutuality of obligation; the obligation on Talksport to provide work, and the obligation on Paul Hawksbee to be supplied to perform the tasks requested. Both judges agreed that mutuality of obligation was present but Judge Scott considered that mutuality of obligation was not a strong indicator of employment in this case.

HMRC appealed to the Upper Tribunal.

*Decision*

The Upper Tribunal disagreed with the First Tier decision. Under the contracts, Talksport did have an obligation to provide work for Paul Hawksbee, and Kickabout Productions Limited had to make Paul Hawksbee available for that work. Mutuality of obligation was present.

The Upper Tribunal concluded that TalkSport had little control over how Paul Hawksbee carried out his work, but Talksport did have control over the tasks that he performed, as well as when and where he performed those tasks. There was sufficient control by Talksport to indicate an employment contract.

The Upper Tribunal went on to consider the other factors in this case and concluded that, taking all of the relevant factors into account, when viewed as a whole, they were not inconsistent with the hypothetical contracts being contracts of employment and as such IR35 rules applied.

*HMRC v Kickabout Productions Limited [2020] UKUT 0216 (TCC)*

## Cars or vans **(Lecture P1211 – 22.13 minutes)**

*Summary – For a vehicle to be treated as a van, it must be primarily suited to the conveyance of goods. Where there is no primary purpose, the vehicle is taxed as a car.*

In June 2019 we reported on the Upper Tribunal's decision on the treatment of three types of vehicle supplied by Coca-Cola to its employees:

- Kombi 1 and Kombi 2 were vans that were acquired with a second row of seats already fitted but which were removable;

- The Vivaro was a van that was modified to add a second row of two extra removable seats, with some storage space to the side.

Agreeing with the First Tier Tribunal, the Upper Tribunal concluded that if a vehicle is marginally more suited to carrying goods then it is a goods vehicle and found:

- The Kombi vehicles were cars as they could be equally used for passengers and goods;
- The Vivaro was slightly more suited for goods and so was classed as a van.

*Decision*

The Court of Appeal concluded that for a vehicle to be treated as a goods vehicle, and so classified as a van, it had to be predominately or primarily suited to the conveyance of goods. Where a multi-purpose vehicle had no such primary suitability, it could not be a van and should be taxed as a car.

On this basis, the Court of Appeal found that none of the vehicles were goods vehicles, but rather they were all cars.

*Noel Payne and others v HMRC [2020] EWCA Civ 889*

## Failure to consider vital evidence

*Summary – The First Tier Tribunal should have accepted the taxpayer's email evidence as proof that her tax had been settled in full.*

Heather Jones left her employer, Doubletake Studios Limited, on 31 October 2010. Under a compromise agreement, she received a redundancy payment of £36,700 to be paid in four equal monthly instalments of £9,175. She received three such payments, with the fourth payment being just £6,515.04, so short by £2,660. If we do the sums, 40% of £6,700 (£36,700 - £30,000) is £2,680, £20 more than the sum deducted from her final payment.

The P14 submitted by Doubletake Studios Limited showed that tax of £1,340 (6,700 x 20%) had been deducted from the final payment of £9,175 and this was the amount that the company had paid over to HMRC. Clearly this differed to what Heather had actually received.

Heather Jones did not declare the redundancy payment in excess of the £30,000 in her tax return for 2010/11 and Doubletake Studios Limited subsequently went into liquidation.

HMRC approached the liquidators but were unable to determine how the final payment was calculated. Based on the P14 information available to them, HMRC raised a discovery assessment for the balance she owed in respect of the higher rate tax (40%) that was due.

The burden of proof lay with Heather Jones to provide evidence to either reduce or set aside HMRC's figures. Unfortunately, by the time of the hearing she had failed to do so and the First Tier Tribunal concluded that she had not discharged that burden.

In January 2018 Heather Jones applied to set aside the First Tier Tribunal's decision. She had discovered an e-mail chain with her employer's lawyer. She had emailed him to query why the final payment had come through as £6,515 rather than £9,175. He had replied stating: "As expected the answer lies with the tax". Unfortunately the rate of 40% was not mentioned in this correspondence and so the First Tier refused to set aside the decision as the deduction was at a rate just less than 40%.

Further, the First Tier Tribunal noted from its own re-examination of the bank statements that an additional payment of £9,175 had been made that neither party had referred to at the hearing. The Tribunal concluded that four payments of £9,175 had been made and tax deducted from none of them. The payment of £6,515.04 was an entirely separate payment, possibly relating to non-taxable expenses or something similar.

On 14 October 2019, the Tribunal granted Heather Jones permission to appeal to the Upper Tribunal.

*Decision*

The Upper Tribunal found that the First Tier Tribunal had misread Heather Jones' bank statement. She had transferred £9,175 out of her account to her deposit account. The First Tier Tribunal had incorrectly read this as a receipt of income.

When deciding not to consider the email correspondence submitted after the hearing, the Upper Tribunal concluded that the First Tier Tribunal had erred in law. This trail clearly showed that Heather Jones had asked her former employer to explain the reduced instalment and the employer had assured her that the shortfall was entirely tax withheld at source. She had never argued that 40% had been deducted from the final instalment and accepted that the deduction was equivalent to 39.7%. The First Tier Tribunal could not have expected Heather Jones to ever show that a deduction of 40% had been made. It seemed likely that her employer had simply made a small calculation error.

HMRC had not proven that its discovery assessment was valid and Heather Jones appeal was upheld.

*Heather Jones v HMRC [2020] UKUT 0229 (TCC)*

## Construction sites and temporary workplace **(Lecture P1211 – 22.13 minutes)**

*Summary – Subsistence and travel expenses at a number of construction sites were disallowed, as there were no substantial changes in travel time between sites. The sites should be viewed as one workplace, at which the employee had worked for more than 24 months.*

Narinder Sambhi lived in Birmingham and since 2007 he had worked for companies in the Lend Lease Construction group. For a number of years he was required to work at sites around Birmingham but from September 2013, he worked in London, living there from Monday to Friday each week. During this time he lived in Ilford and Walthamstow but most of his work was either in south or central London.

His employer reimbursed his travel and subsistence costs, and deducted PAYE and national insurance from these payments.

Narinder Sambhi believed that each site qualified as a temporary workplace and so he claimed relief for his travel and subsistence. He had not worked at any of the sites individually, for more than two years.

HMRC disallowed the claims in his self-assessment tax returns totalling £20,000 in 2015/16 and 2016/17 arguing that his work at a number of sites in Greater London should be viewed as one site and in total that work had exceeded two years.

*Decision*

The First Tier Tribunal stated that the only issue to address in this case was whether s339(7) ITEPA 2003 applied. When determining where a temporary workplace is, this section ignores any modification of the place at which duties are performed if it does not, or would not, have any substantial effect on the employee's journey, or expenses of travelling, to and from the place where they are performed.

The First Tier Tribunal looked at the journey times to each site from his accommodation, concluding that as no travel time differed by more than half an hour from another, and that the cost varied by no more than £14, the change of worksites was not substantial. His work at various sites in Greater London should be treated as one workplace that he had been working at since 2013. He had worked too long at this workplace for it to be considered temporary.

The appeal was dismissed.

*Narinder Sambhi v HMRC (TC07717)*

## Bonus payments to LLP members (Lecture P1211 – 22.13 minutes)

*Summary –Bonus payments, made to former employees who had become members of an LLP, should be treated as earnings.*

Charles Tyrwhitt LLP sells shirts and other items of clothing. The LLP operated a bonus system for its employees called the Long Term Incentive Plan. Under the scheme, bonus payments were made but only once certain conditions had been met.

Five employees received bonuses under the scheme but at a time when they had become LLP members. The issue was whether the bonus payments were:

- fixed amounts of partnership profits so taxable as self-employed income; or
- deferred remuneration in respect of their earlier periods of employment.

HMRC argued the latter and sought to collect Class 1 primary and secondary National Insurance Contributions as earnings of employed earners.

The taxpayers claimed that as members of an LLP they could not receive employment income from an LLP. The accrued bonus payments remained contingent and provisional until all requirements for payment had been satisfied and this only happened after the employees had become members; no prior entitlement had arisen. As they were members of the LLP at the time of payment, they could only receive the payments as a share of trading profits.

*Decision*

The First Tier Tribunal concluded that the bonus payments were not made solely because each individual was an LLP member. They were made because each LLP member had complied with all of the conditions of a scheme open only to employees. The bonus payments should be treated as earnings received from employment.

In a postscript, the Tribunal stated that there might have been a shorter route to reach the same conclusion, which they explained as follows:

- The remuneration of an employee of an LLP is a contractual obligation between the LLP in its capacity as a legal person and each employee;
- The profit shares of members of the LLP are a matter between the members;
- When the five employees became LLP members, the parties did not agree that the five individuals would surrender their contractual rights against the LLP to a prospective bonus, in return for equivalent fixed amounts of additional profit share;
- In the absence of that, the payments must have been made in satisfaction of the LLP's contractual obligations under the bonus agreements, so part of the terms of employment.

*Charles Tyrwhitt LLP v HMRC (TC07756)*

## Joint ownership **(Lecture P1212/ 1213 – 13.15 /7.24 minutes)**

Tax issues in relation to jointly owned assets are quite straight-forward, right? Simply split income and gains 50:50 and if one of the co-owners dies, charge IHT on the value of a 50% interest. Job done.

Well, yes and no. This is the UK tax system so things are never as simple as they may seem.

This article will consider jointly owned assets and in particular:

- How income is allocated between spouses;
- How income is allocated between joint owners who are not spouses.

This article will concentrate on income from jointly owned land and buildings (and in particular residential dwellings) simply because these are the assets which generate the most queries.

All references to "spouses" in this article should be taken to include civil partners and any legal references are to the law in England and Wales.

*Legal and beneficial interests*

Let's get the legal stuff out of the way before we start.

Under English law, there can be separation of legal title and beneficial ownership. For example those persons holding the legal title of asset (ie, the owner of the property as registered at the Land Registry) may not necessarily be the same as those who hold the beneficial (ie, the financial) interest.

A person can be said to have a beneficial interest in land or property if he has a right to the income from the property (or the right to a share of it) or a right to the proceeds from the sale of the property (or part of those proceeds). Beneficial owners are not registered on the title deeds at the Land Registry.

A legal interest therefore gives the owner a right of control over the property. A beneficial interest is a right to benefit from the property (ie, an economic benefit). Where the legal and beneficial owners are different, the arrangement is effectively a trust under which the legal owners act as trustees and hold and control the property on behalf of the beneficial owners (beneficiaries).

Where two (or more) people buy property together, under English law they must register their legal co-ownership position as either joint tenants or as tenants in common.

A joint tenancy means that both co-owners are equally entitled to the whole property and one joint tenant cannot force a sale of the whole or part of a property without the consent of the other. On death, the deceased's share of the property will automatically pass by survivorship to his fellow joint tenant. This arrangement is common where the co-owners are spouses.

Alternatively the co-owners may register their co-ownership of the property as tenants in common, which means that each owns a specified share of the property (and is free to deal with this as he/she chooses). On death, the respective shares of the co-owners will pass in accordance with their Will (or under intestacy).

*Declarations of Trust*

Where property is registered jointly, the supposition is that beneficial interests are equal unless there is documentary evidence to the contrary.

Co-owners who wish to separate legal and beneficial ownership or who wish to record their different beneficial interests in a property can do so by a Declaration of Trust (DoT).

This is common in situations when two people (normally non-spouses) buy a property together and contribute unequal shares to the acquisition costs (for example one person may have contributed more savings towards a deposit for a mortgage and may naturally want a higher interest). The owners will want to ensure that their beneficial share of the property reflects their contributions and that income from the property and proceeds of sale are thereafter divided in proportion to those contributions.

If two (or more) co-owners hold a property as tenants in common and thereafter want to change their beneficial interests, the most common way to achieve this is via a Declaration of Trust. This is a specific agreement – most commonly a written document executed as a Deed - which confirms the proportions in which the property will be held going forward.

The DoT sets out the economic interests of each beneficial owner. The DoT can be worded so as to give beneficial owners rights to all economic benefits or just some. For example, a DoT could give the beneficial owners a right to the rental income but not to the capital proceeds on sale.

DoTs are typically drafted by a solicitor and are relatively standard documents. Templates are available on the internet if solicitor costs are prohibitive although care should be exercised when using these.

*How property income is allocated between spouses for tax*

The default position is provided by S.836 ITA 2007 which says that income from property held jointly by spouses who are living together is automatically split equally between them for income tax purposes. This 50:50 rule applies regardless of whether the joint owners are entitled to benefit equally from the property.

Therefore if a married couple (H and W) own a rental property and H is beneficially entitled to 75% of the asset and W to 25%, each would be taxable on 50% of the rental profits. Their actual beneficial interests in the property are ignored for income tax purposes.

This means that if (for example) X owns a rental property outright and wishes for some profits to be allocated to his spouse (Y), X could simply gift a 1% interest in the property to Y. The property would then be jointly owned (and registered as such), so income would be split 50:50. This is a simple and effective solution where X essentially wishes to share the income but retain the asset.

It is important to note that S.836 only applies for the purposes of income tax. The CGT and IHT treatment follow actual beneficial entitlement. Therefore on a disposal of the property, the gain would be split 75:25 between H and W (or 99:1 between X and Y).

Similarly on (say) H's death, his estate would include the value of a 75% interest (in this case being 75% of the whole under the IHT "related property" rules).

*Exceptions*

There are some exceptions to the 50:50 rule most commonly:

- Income from partnerships;
- Income from UK or non-UK furnished holiday lettings (FHLs); and
- Income from jointly held shares in a close company.

*Husband and wife partnerships*

In the case of a jointly owned (non FHL) property portfolio, the 50:50 default position can be circumvented by a husband and wife forming a partnership and allocating their property business profits in accordance with the partnership agreement.

Some care needs to be taken here because, according to HMRC:

> "Joint ownership of property does not, of itself, create a partnership. There can only be a partnership if, exceptionally, the exploitation of the property constitutes the carrying on of a business jointly with a view to profit".

To verify the existence of a partnership, HMRC will often ask to see the partnership agreement and will look to see whether the income from the property has been declared as partnership income under self-assessment. Individuals can be in partnership without having a formal partnership agreement as long as it can be established that they are "carrying on a business in common with a view to profit". This requires the owners to be actively managing the properties on a day-to-day basis (rather than passively collecting rents).

In the absence of any evidence that a husband and wife partnership exists, profits will be split 50:50.

*Furnished holiday lets*

There are no such issues with qualifying furnished holiday lets. Assuming the appropriate letting and availability tests are met, profits are treated as arising from what is effectively a trading business and can be allocated for income tax purposes in whatever proportions the husband and wife so choose.

*Overriding the 50:50 treatment*

There may be reasons why a married couple may wish for the income from their jointly held asset to be taxed in a different way.

For example, one of the spouses may be a higher/additional rate taxpayer while the other may have unused personal allowances or may pay income tax at basic rate only. It may also be useful for the co-owners to reallocate income between them so that both have total income of less than £100,000 (to preserve full entitlement to personal allowances) or to bring income under the £50,000 threshold for clawback of child benefit.

If the couple wishes to be taxed in accordance with their actual beneficial interests in the property (thereby overriding the 50:50 default position), they can do so by making an election under S.837 ITA 2007. In practice this is achieved by making a declaration using HMRC's Form 17 ("Declaration of beneficial interests in joint property and income"). Like pretty much everything nowadays, this can be done online.

A Form 17 election sets aside S.836 and means that from the date of the declaration, each spouse is chargeable to income tax on the income to which they are actually beneficially entitled. So in the case of H (who is beneficially entitled to 75% of their co-owned rental property) and W (who is beneficially entitled to 25%), a Form 17 election would mean that rental profits are thereafter split 75:25, thereby pushing more taxable income into H's hands.

The Form 17 election cannot be used to alter the actual beneficial ownership of the asset and will not therefore permit the income from the asset to be divided in any way which does not align with beneficial entitlement. For example, if H and W own a property 75:25, they cannot use Form 17 to allocate rental income (say) 20:80. If the couple want a 20:80 split of income, they will have to take legal steps to change their actual beneficial entitlement (for example, by means of a Declaration of Trust).

On receiving Form 17, HMRC may ask the spouses to provide evidence that the couple are in fact entitled to a non-equal share in the property. In the event of an enquiry, the onus is on the taxpayer(s) to prove that the beneficial ownership is different from the legal ownership. Such evidence normally takes the form of a written declaration (DoT) or trust deed. Attaching the DoT to the Form 17 is common practice and puts this issue to bed.

Form 17 elections are made on an asset-by-asset basis and must state the asset to which the declaration relates.

The election must be signed by both spouses. The election is effective from the date of the last of the spouses to sign provided it is submitted to HMRC within 60 days of that date. It cannot be backdated.

For example, if a couple wish to make an election in respect of a rental property and wish to make the new arrangement effective from 6 April 2020, they must both sign and date on 6 April 2020 and submit the election to HMRC by 4 June 2020. If the election is submitted after the 60-day time limit has elapsed, it will not take effect and a new one must be submitted. Until the new one is in place, income will continue to be split 50:50. There is no limit on the number of declarations a couple can make in respect of the same asset.

Once in place, the election will apply until either:

- The couple separates;
- One spouse dies; or
- There is a change in the couple’s beneficial interests in the property.

If there is a change in the couple’s beneficial interests in the property, the existing Form 17 election becomes invalid and the default 50:50 position is reinstated until such time as a new declaration is put in place.

One very important thing to note (and one which is often overlooked) is that a Form 17 declaration can only be made if the co-owners hold the property as tenants in common. Most spouses tend to hold property as joint tenants (very often the “joint tenants” box on the Land Registry form is ticked without much thought), so if a Form 17 declaration is being contemplated, the joint tenancy would need to be severed in favour of a tenancy in common.

*CGT issues*

CGT follows beneficial ownership. In other words, it follows the money.

As mentioned above, neither S.836 nor Form 17 have effect for CGT, so on a disposal of the property, the capital proceeds (and as a consequence the resulting capital gains) will be split on the basis of beneficial ownership (as evidence by the DoT). So if no Form 17 election has been made and income is split 50:50, capital gains may still be taxed in a different proportion.

If this is not desired, a DoT to change beneficial rights to capital proceeds can be entered into just before the sale of the property to ensure that gains are taxed in a CGT efficient way (for example, to use annual exempt amounts, 18% bands and brought forward capital losses). This sort of planning is rarely challenged by HMRC (even where the gap between the DoT and the sale are perilously close) because this is simply seen as the couple maximising reliefs entitled to them.

Where spouses enter into a DoT and change their beneficial rights to capital proceeds, this is a disposal by the spouse whose beneficial interest is going down. However this is of limited concern as the transfer will be treated as taking place at no-gain-no-loss.

*Watch out for the "settlements legislation"*

The only real danger lurking at the bottom of this particular pool is the shadow of the settlements legislation which HMRC can (and will) use when one spouse (typically the higher earner) tries to divert income to the other spouse to reduce their overall income tax burden but without accompanying that with a right to capital.

A "settlement" is widely defined and includes any disposition or arrangement which confers "bounty" or has gratuitous intent. A transfer of assets between spouses is therefore a settlement.

Under S.624 ITTOIA 2005, where a spouse ("A") creates a settlement for the benefit of another spouse ("B"), the income of the settlement is taxed on spouse A unless:

- The gift is an outright gift of an asset;
- The gift is unconditional;
- The gift carries a right to the whole of the income; and
- The gifted property is not substantially a right to income.

The settlements legislation will be in play where spouses enter into a DoT to change their beneficial interests in a property, but the DoT deals with income only. If the DoT acts simply to divert a right to rental income from spouse A to spouse B but does change beneficial entitlement to proceeds on disposal, the gift can be construed as being a gift of a right to income. S.624 will then tax spouse A on the income diverted to spouse B, making the planning ineffective.

Therefore where spouses wish to play around with DoTs and Form 17 elections to ensure that income is "in the right place" for income tax purposes, they must ensure that the paperwork is drafted so as to ensure that income and capital rights are aligned. If spouse B is to be allocated (say) 80% of the rental income, spouse B must similarly have a beneficial right to 80% of the proceeds of sale. Otherwise a HMRC attack under the settlements legislation should be expected.

*Main residences*

I know we're talking here primarily about let properties, but we could be dealing with a property which was previously used by one of the co-owners as a home. In which case care needs to be taken when transferring interests between the spouses to ensure that PPR relief is not prejudiced.

Where the property in question was previously the main residence of spouse A, a transfer of beneficial ownership to spouse B may mean that private residence relief is lost accidentally.

S.222(7) TCGA 1992 deals with PPR relief on dwellings transferred between spouses and says that spouse B will only inherit the ownership and occupation history of spouse A where the property is transferred while it is the main residence of both of them. [This was discussed in detail in a previous TSO in December 2017: "Spouses with Houses".]

If the property is not the couple's main residence at the time of the transfer of beneficial ownership, the full PPR relief which spouse A would have been entitled to on sale of the property, will not apply to a disposal by spouse B.

*How income is allocated between joint owners who are not spouses*

The 50:50 rule in S.836 ITA 2007 only applies to spouses living together. It does not apply to jointly held property in any other relationship.

Where S.836 does not apply, income (and indeed gains) are divided between the joint owners in accordance with their actual beneficial ownership.

Neither does the "equal split" rule apply in cases where a husband and wife co-own property with a third (or fourth) party. Per the HMRC Trusts, Settlements and Estates Manual (TSEM9810):

> "Sometimes a married couple or civil partners hold assets jointly with others. The 50/50 rule does not apply in such cases. It applies only to income arising from property held in the names of individuals who are married to, or who are civil partners of, each other, and who live together."

So in cases where parents co-own a rental property with (say) their two adult children, any rental profits will be divided between the four parties in accordance with their actual beneficial ownership. No Form 17 election is necessary.

*Changing beneficial interests by Declaration of Trust*

Where the joint owners are spouses, the DoT itself will not change the income tax position as this is determined by S.836 (which automatically divides income 50:50). The division of income will only be changed if the DoT is followed by a Form 17 declaration. Gains will be split in accordance with the beneficial entitlements specified in the DoT with effect from the date of the DoT (as S.836, and by definition Form 17, has no effect for CGT).

Where the joint owners are non-spouses, the position is more straight-forward. The execution of a DoT to alter beneficial entitlement will drive the tax treatment from that point. Income and gains will thereafter be divided in the proportions specified by the DoT. No Form 17 is required. We simply follow the money.

The income tax position is very simple. Income will be split in whatever proportions the parties have agreed in the DoT. This can be tailored to the tax situations of the co-owners, so (for example) an unmarried couple can agree to divide income from their rental property in any way they choose so as to utilise allowances and tax bands in the most efficient way. This can be varied year-on-year depending on their financial circumstances.

The main issue to consider for unmarried co-owners is CGT. Where beneficial interests in the property itself (not just the rental income) are changed by a DoT, this is a disposal of an interest in a chargeable asset by the co-owner whose interest is decreasing. As this will not be a bargain at arm’s length, the disposal will be treated for CGT as taking place at market value, potentially giving rise to a chargeable gain (depending on the CGT base cost – part disposal rules will apply to determine this).

As most rental properties (FHLs excepted) are not “business assets”, deferral relief will not be available. There may be the option to pay the CGT in instalments under S.281 TCGA 1992, but this merely postpones the inevitable. And the instalments will be interest-bearing.

The solution is to draft the DoT such that it deals with the allocation of income but leaves capital entitlements unchanged. There is then no disposal and no resulting gain.

This will be a “settlement” - being an arrangement which confers bounty in the form of a right to income - but as the settlements rules in S.624 only catch income diverted to spouses, these are of no consequence.

The settlements rules will impact on the arrangement if the DoT allocates a beneficial interest in an asset away from a parent and into the hands of a minor unmarried child. In this case, the income that thereafter arises to the child (assuming it exceeds £100 per annum) will be taxed on the parent settlor under S.629.

“Minor” children are those under the age of 18. Therefore parents can use DoTs to divert rental income into the hands of children over 18 in order to use personal allowances and basic rate bands (which may otherwise be wasted). This could be a useful way of funding (say) college / university costs and is more tax efficient than simply making cash gifts from post-tax income. As a matter of good practice, if income is diverted using a DoT, the income should be paid into the bank account of the beneficiary (not the gifting parent(s)).

*Example*

Fred and Gina own an investment property which is rented out and generates profits of £10,000 per annum. This income is split equally between them. Both are higher rate taxpayers. The net income (being £6,000) is gifted to their daughter Imogen who is 19 and at college. The gifts go towards paying Imogen’s rent and college expenses.

Fred and Gina sever their joint tenancy and enter into a Declaration of Trust under which Imogen is given a beneficial right to 100% of the rental income. The Declaration of Trust gives Imogen no entitlement to proceeds of sale.

For income tax purposes, Imogen has rental income of £10,000 per annum. This is covered by her personal allowances. There is no attribution of income to her parents as Imogen is over 18. Imogen now has £10,000 to spend on rents and college fees. HMRC is now helping fund her education.

*Inheritance Tax*

Any mention of “gifts” makes an IHT practitioner prick up his ears, so if the donor’s estate has diminished as a result of the transfer of income, a PET could arise. However given that this is a gift of income, it is likely that the exemption for normal gifts out of income (S.21 IHTA 1984) would apply and a PET would be avoided.

As IHT also follows beneficial ownership, where a beneficial interest in an asset (and not just a right to income) has been shifted from person A to person B, this will be a PET and IHT will be an issue if the donor dies within 7 years.

Given the nature of the asset, Business Property Relief is unlikely to be available. This is the case even where beneficial interests in furnished holiday lets are being transferred (FHLs might be a trade for income tax and CGT but case law suggests otherwise for IHT).

*Stamp Duty Land Tax*

Stamp Duty Land Tax will always rear its head where arrangements include transfers of property interests, but SDLT is a percentage of consideration and if there is no consideration there is no SDLT.

Remember however that the assumption or transfer of debt is treated as consideration for SDLT so if beneficial interest changes are accompanied by a parallel shift in liability for a mortgage, SDLT could be payable (and at higher rates if the "purchaser" simultaneously has another residential interest which will often be the case).

*The effects of consideration*

Where the joint owners are non-spouses, a DoT to alter beneficial entitlement is more likely to be done in return for consideration.

For example, where two friends co-own an investment property and friend A agrees to reduce his beneficial interest in the property in favour of friend B, it is not unreasonable for friend B to pay consideration to friend A for relinquishing part of his rights to income and proceeds on sale.

The payment of consideration has no effect for income tax. For CGT, the consideration will act as sale proceeds as long as the arrangement has no gratuitous intent. If the transfer does not constitute a bargain at arm's length, market value will stand in place of actual proceeds.

For IHT, as long as the consideration represents fair value for the beneficial interest foregone, there is no fall in value of friend A's estate and no PET. A transfer of value will only arise is friend A is deliberately selling at undervalue.

The consideration will be liable to SDLT being an amount paid by a purchaser to acquire an interest in land. Higher rate duty will be due if friend B already owns a residential property. However be aware that no SDLT will be due if the consideration paid is less than £40,000.

*Other issues*

Finally don't forget that shifting beneficial interests in property using Declarations of Trust has non-tax considerations as well and may impact on things such as:

- Mortgages – in most cases the mortgage lender will need to be informed about (and may need to give consent to) changes in beneficial ownership;

- Wills – these may need to be revisited if estates are substantially changing.

*Contributed by Steve Sanders*

## Settlements rules applied

*Summary – The dividend paid on shares that had been put into trust was not a distribution for the taxpayer. However, the settlements legislation applied so that he was liable to tax on the amount received.*

Mark Dunsby participated in a tax avoidance scheme, which was devised and promoted by De Sales Promotions Limited, and was known as Project Scimitar. The scheme was designed to allow shareholders in trading companies with distributable profits to receive those profits free of income tax. There were three main elements to the scheme:

1. The creation of a new class of share that was issued to a NR individual;

2. The transfer by the NR individual of the share into a trust in which the NR individual retained an interest, but from which the original shareholder could benefit;

3. The declaration of a dividend on the new class of share, where, under the terms of the trust, the original shareholder received almost all of the benefit of the dividend.

The scheme was notified to HMRC under the disclosure of tax avoidance schemes rules.

In this test case, Mark Dunsby took part in this scheme and received £195,400 from the trust. HMRC sought to tax this amount, arguing that under the arrangement he was one of the settlors of the trust and that the settlements provisions applied. Remember, the settlements legislation operates to treat income arising under a “settlement” as income of the “settlor”. Alternatively, they argued that the dividend should be taxed on him under the transfer of assets abroad legislation.

Mark Dunsby argued that under the settlements rules only the NR resident individual, as settlor, could be liable to tax on the dividend.

*Decision*

The First Tier Tribunal concluded that the distribution made was to the trustees, and not Mark Dunsby. However, the Tribunal went on to conclude that he was subject to the settlements rules as a settlor of the trust and the income was therefore taxable on him.

As there was a hope and expectation of future dividends from the share held in the trust, there was an element of bounty in the arrangement.

The Tribunal concluded that both Mark Dunsby and the NR individual could be regarded as having provided the share to the settlement and so it should be apportioned between them on a just and reasonable basis (ITTOIA 2005, s 645(1)(c)). All or substantially all of the value in the share value had been provided by Mark Dunsby and so a just and reasonable apportionment would treat all or substantially all of the property, and related income, in the settlement as being his.

Given that this was a lead case, the Tribunal also gave their view on the alternative argument and concluded that even if he were not a settlor, he would have been taxable under the transfer of assets abroad provisions. For there to be a charge under this regime, the arrangements must involve a relevant transfer of assets whereby income becomes payable to a person abroad either as a result of the transfer or as a result of one or more associated operations or a combination of the transfer and one or more associated operations. The Tribunal concluded that a transfer was made to a person abroad (the NR individual) and, as a result of the transfer and an associated operation (the transfer of the share to the trust), income (the dividend on the share) became payable to a person abroad.

The Tribunal confirmed that both Condition A and Condition B also applied meaning that the anti-avoidance rules applied:

- Condition A: Mark Dunsby had power to enjoy income of a person abroad as a result of a relevant transfer and/or one or more associated operations as he received the dividend income;

- Condition B: The dividend income would be chargeable to income tax if it were his income and received by him in the UK.

*Mark Dunsby v HMRC (TC07755)*

# Capital Taxes

## PPR and the disposal of three properties (Lecture P1211 – 22.13 minutes)

*Summary – Insufficient evidence was provided to show that three properties were owned with the required degree of permanence to qualify for PPR relief.*

Between 2013 and 2015, Aqeela Hashmi bought and sold at least five properties, three of which were the subject of this appeal:

- The first property was bought in March 2013 for £125,000, listed for sale on 10 May 2013 and sold on 18 September 2013 for £165,000 – she lived there for 6 months;

- The second property was bought on 11 November 2013 for £161,000, listed for sale on 14 February 2014 and sold on 6 June 2014 for £249,999 – she lived there for 7 months;

- The third property was bought on 16 September 2014 for £209,000, listed for sale on 3 October 2014 and sold on 10 July 2015 for £315,000 – she lived there for 10 months.

Initially she lived at 132 Shaggy Calf Lane and during the entire period from March 2013 to July 2015 she continued to use 132 Shaggy Calf Lane as her address for various financial matters and remained on the electoral register at this address. Between each sale and purchase she returned to live at this address.

HMRC claimed that throughout the three tax years, 2013/14, 2014/15 and 2015/16, Mrs Hashmi's principal private residence had been 132 Shaggy Calf Lane. HMRC raised assessments in each of the three years to collect capital gains tax due in respect of the three property sales.

*Decision*

Mrs Hashmi failed to produce sufficient evidence to convince the First Tier Tribunal that she intended to live in any of the properties with some degree of permanence.

All three properties were listed for sale within short periods from acquisition, after have undergone improvement works. The Tribunal stated that it was clear to them that she was trading in property.

*Aqeela Hashmi v HMRC (TC07715)*

## IHT and forfeiture disapplied

*Summary - With the forfeiture rules disapplied, Mrs Challen inherited her husband's estate via an inter-spouse transfer with no IHT payable.*

Mrs Challen was convicted of the manslaughter of her husband. Under the forfeiture rule a person cannot inherit under the will of a person who they have killed. As a result, her husband's estate passed to their children and IHT was payable on that estate.

Mrs Challen applied to the court to disapply the forfeiture rule.

*Decision*

The judge reviewed the evidence that Mrs Challen was subject to sustained coercive behaviour from her husband over many decades and agreed that the rule should be disapplied and Mrs Challen should be allowed to inherit. As a result, the estate passed to her via an inter-spouse transfer with no IHT being payable.

*Georgina Sarah Ann Louise Challen [2020] EWHC 1330 (Ch)*

*Adapted from a case summary by Andrew Hubbard*

## No implied trust (Lecture P1211 – 22.13 minutes)

*Summary - The transfer of a property between family members was a disposal as there was no evidence that a trust had been created.*

Asif Bhikhi owned a property. The ground floor was let to a pharmacist and the flats above were let out to residential tenants.

In 2006 Asif Bhikhi was convicted of assisting in illegal immigration and as a result, needed funds to be able to settle a confiscation order. He was not able to obtain a mortgage on the property in his own name and so he transferred the property to a relative's company, with the relative taking out a mortgage to settle the sum due. The plan was that once the business that he ran with his brother was back on its feet, the property would be transferred back.

Although legal title of the property had been transferred, Asif and his brother continued to deal with the property, and collected the rent due from tenants, with the money used to pay the relative's mortgage payments. They paid for any repairs as well as any shortfall in rent to cover the mortgage payments that were due.

In 2016, planning permission was granted for two more flats to be built on top of the property. Asif Bhikhi covered the cost of the new flats and on completion, collected the rent due which was paid into his personal account.

In 2018 the property was transferred back to his company, Bhikhi Property Limited at the same price as the original transfer, even though the market value (with the added flats) was significantly higher. Although the property was then registered as owned by Bhikhi Property Limited, he argued that in reality the property was held for 39 members of their family.

HMRC raised an assessment for CGT on the first transfer. Asif appealed on the grounds that he had retained beneficial ownership of the property, and that the relative's company simply held the property on an implied trust.

*Decision*

The First Tier Tribunal found that no trust had existed. There was no reference to a trust in the transfer documents, and Asif Bhikhi had not declared any rental income on his tax returns. Indeed, the recipient company had declared the property on its balance sheet and the rental income had been declared on the company's corporation tax return.

The property transfer was made for consideration, with the company becoming the legal owner. A valid disposal for CGT purposes had taken place.

The appeal was dismissed.

*Asif Bhikhi v HMRC (TC07728)*

## Related property planning (Lecture P1214 – 26.57 minutes)

The related property provisions in S161 IHTA 1984 are there to prevent an individual deliberately fragmenting a shareholding in a private company (or indeed any property which is more valuable as a whole than the sum of its parts) by means of an exempt transfer to a spouse, civil partner, charity or other exempt body. The most important application of this rule arises in connection with the transfer of unquoted shares. This is because of its effect when considered alongside two important factors:

1. the principle that the loss to the donor is the measure of the value transferred; and

2. the fact that the value of different shares in the same company can vary considerably depending on the size of the holding to be valued.

Where a husband and wife each own shares in a company and their combined holdings carry control, the IHT valuation rules ensure that there can be significant benefits in arranging for the spouse with the smaller holding to make the transfer which reduces their combined holdings to below the level of control.

*Illustration*

Jeremy has a 49% shareholding in a family business and his wife owns a 2% shareholding in the same company. There are 100 ordinary shares of £1 each in issue. Prospective share values are as follows:

| | |
|---|---|
| 51% holding | £10,000 per share |
| 49% holding | £5,800 per share |
| 2% holding | £1,200 per share |

If Jeremy and his wife have decided to give away their shares, the position where Jeremy makes the first gift is:

| | | |
|---|---|---|
| | | £ |
| Jeremy | 49 shares @ £10,000 per share | 490,000 |
| Wife | 2 shares @ £1,200 per share | 2,400 |
| | | £492,400 |

On the other hand, if Jeremy's wife makes the first gift, the position is:

| | | |
|---|---|---|
| Wife | 2 shares @ £10,000 per share | 20,000 |
| Jeremy | 49 shares @ £5,800 per share | 284,200 |
| | | £304,200 |

Jeremy's wife should therefore make the first gift. This effect is a standard phenomenon within the context of IHT and should always be borne in mind. However, the position is complicated by the rates of business relief. If the company which Jeremy and his wife control is a trading concern, a 100% relief would be available in either case to cancel out the transfer of value. This planning point is therefore most useful where the transfer involves shares in investment companies or in trading companies with significant excepted assets.

A problem faced by parents holding in excess of 50% of the voting shares of a large family company is that their children are usually unable to afford to purchase their parents' shares in one go. If, instead, the parents make piecemeal gifts or sales of their shares to the children, they may still be vulnerable to a disproportionately large tax charge in connection with the transfer which reduces their related holdings to below the level of control.

*Illustration*

Sam's Business Ltd is a family company with an issued share capital of 10,000 ordinary shares of £1 each. Shareholdings of various sizes are valued as follows:

| | |
|---|---|
| 60% | £170 per share |
| 45% | £80 per share |
| 15% | £25 per share |

Sam owns 4,000 shares, while his wife holds 2,000. A 15% holding can be disposed of by either Sam or his wife in a number of different ways:

First possibility - Sam's wife gives 1,500 shares to their son.

Thus:

| | | |
|---|---|---|
| Before | 2,000 shares @ £170 per share | 340,000 |
| After | 500 shares @ £80 per share | 40,000 |
| | | £300,000 |

Shares worth £37,500 (1,500 shares @ £25 per share) have been passed to the son, but the chargeable value of this gift for IHT purposes (before reliefs) is £300,000. Note that the CGT disposal value is £37,500.

Second possibility - Sam's wife sells 1,500 of her shares to the son for £37,500. It is important to appreciate that this will still be a transfer of value, unless the wife can show that the (see S10 IHTA 1984):

- transaction was not intended to confer any gratuitous benefit on any person;
- disposition was such as might be expected to be made in a transaction at arm's length between persons not connected with each other; and
- deal was done at a price which was freely negotiated at the time of the sale (or at a price such as might be expected to have been freely negotiated at that time).

If the son was threatening to leave the company unless he was allowed to acquire some shares (and where his services were valuable to the business), it is thought that S10 IHTA 1984 would be in point – but otherwise, probably not.

*Contributed by Robert Jamieson*

## Multiple dwellings relief (Lecture P1211 – 22.13 minutes)

*Summary – SDLT Multiple Dwellings Relief did not apply as the basement annex was accessed via the main front door and a common hallway.*

On 24 March 2016 David Merchant and Sarah Gater bought a property for £1,920,000. The property was a terraced house with an annex, with its own kitchen, shower room, living room and bathroom. The owners confirmed that the annex was accessed "through the main dwelling front door and along a common hallway".

Initially, David Merchant and Sarah Gater filed the relevant form and paid the SDLT due to HMRC on the basis that the property was a single residential property.

However, just over a year later, they were advised to apply for Multiple Dwellings Relief. On 20 April 2017 they wrote to HMRC to request an amendment to their return and claimed a refund of nearly £65,000.

HMRC opened an enquiry into the amended return and ultimately rejected the claim. There was a dispute over the date the return was amended. Although the First Tribunal found that it was not when the taxpayers first wrote to amend the return, but rather on receipt of their second letter that included the contract for sale. A valid amendment must be accompanied by the contract, so the later date was the date of amendment. Although this made the claim out of time, HMRC accepted the late claim as a valid claim but disputed the Multiple Dwellings Relief to which the claim related.

David Merchant and Sarah Gater appealed, arguing that they were eligible for the relief. Further, they argued that HMRC's closure notice was not valid as rejection of the claim for Multiple Dwellings Relief was not stated in either their closure notice or the letter referred to in the closure notice.

*Decision*

The First Tier Tribunal concluded that, although the annex had a separate kitchen, shower room, living room and bathroom, it was not suitable for use as a single dwelling as it shared a common front door and hallway.

Further, the First Tier Tribunal found that the closure notice was valid even though it did not state that the claim for Multiple Dwellings Relief was rejected. Adopting the reasoning set out in Archer [2018] STC 38, a notice is not ineffective for want of form where it is substantially in conformity with the legislation and its intended effect is reasonably ascertainable.

*David Merchant and Sarah Gater v HMRC (TC07783)*

## SDLT increased rates for NR transactions (Lecture P1215 – 14.13 minutes)

HMRC have recently published draft legislation, which will increase the rate of Stamp Duty Land Tax (SDLT), which is payable where the transaction involved residential property and the purchaser is a non-resident. This idea has been proposed before but it was announced at the time of the March 2020 Budget that the proposal would be effective from 2021. However, the draft provisions reveal that some current transactions may be caught. Of course, these are draft provisions and so may change before implementation.

The intention is to introduce a 2% SDLT surcharge on purchases of dwellings where the effective date of the transaction is on or after 1 April 2021. This is described as a 'non-resident transaction'. It is important to note that it adds 2% to all transactions, including those, which already attract the 3% 'second property' surcharge or the 15% ATED-linked charge. The maximum SDLT rate therefore becomes 17%.

The legislation is being inserted in FA2003 as Schedule 9A.

*A 'non-resident transaction'*

A transaction is a non-resident transaction if it meets all of the following conditions:

- The purchaser is, or includes, a person who is non-resident (note, as with the current 3% supplement that this is an 'all-or-nothing' charge – if one party to the transaction is caught then the whole transaction is caught);
- The purchase consists of a major interest in a dwelling or dwellings;
- The interest is not a leasehold interest with 21 years or less to run and is not subject to a relevant inferior interest; and
- The chargeable consideration is £40,000 or more.

*What do we mean by "non-resident"?*

Helpfully, the legislation states that an individual is non-resident if they are not UK resident but luckily this is clarified.

The basic rule is that if an individual is present in the UK on at least 183 days during any continuous period of 365 days falling within the relevant period, then they are treated as UK resident. The relevant period starts 364 days before the effective date of the transaction and ends 365 days after the effective date of the transaction. In effect, there is a two-year period with the effective date in the middle and you have to be in the UK for 183 days in any continuous 365-day period within that two years. This seems like quite a complicated test.

Being present in the UK means the same as it does for the statutory residency test i.e. in the UK at midnight at the end of the day. There is an exception for anyone in Crown employment where they are treated as present in the UK at the end of a day where they are present in a country outside the UK for the purpose of performing activities in the course of their Crown employment or they are the spouse or civil partner of such a person (as long as they are living with that person).

There is an alternative way to be treated as UK resident for these purposes. If you are in the UK on at least 183 days during the period that begins with the day that is 364 days before the effective date of the transaction and ends with the effective date, then you are UK resident if you meet any of the following conditions:

- The purchaser is, or includes, a company or a person acting as a trustee of a unit trust scheme;

- The purchaser is, or includes, an individual who is entering into the transaction as a partner in a partnership;

- The purchaser is, or includes, an individual who is acting as a trustee of a settlement as long as no individual is entitled to occupy the property or the income from the property automatically (i.e. an interest in possession settlement).

A company will be not resident for these purposes if it is not UK resident for the purposes of the Corporation Taxes Acts or if it is a close company (whether or not it is UK resident) which is controlled outside the UK and is not an excluded company.

A company meets the non-UK control test if it is a close company, which is under the control of participators who are non-resident (using the definition given in this legislation, not the statutory residency test). In dealing with this test, there are various amendments to the situations where you get attribution of rights of associates. This means you do not attribute the rights of:

- Partners;

- Spouses and civil partners living together where one is UK resident;

- Rights of a company where an individual’s interest is less than 5%;

- Loan creditors.

A company is an excluded company if it is an open-ended investment company, a REIT or a member of a group REIT.

*Spouses or civil partners*

Although the default position is that this is 'all-or-nothing' so that you are caught if one purchaser is not resident, this is not the case where you have spouses or civil partners jointly purchasing. If one is UK resident and one is not, then the surcharge will not apply. The conditions are that they are spouses or civil partners living together where neither is acting as trustee of a settlement.

*Bare trusts*

Normally bare trust arrangements are ignored for SDLT purposes so that the bare trustee is ignored and any transaction is treated as being undertaken by the beneficiaries. The exception is where a lease is granted to a bare trustee. Where this happens, the question of whether the purchaser is non-resident must also consider if the beneficiaries of the bare trust are non-resident.

*Settlements*

If there is a settlement where the beneficiary is entitled to occupy the dwelling for life or have any income earned in respect of the dwelling (so basically an interest in possession trust), any question as to whether this is a non-resident transaction must take account of the residence of the beneficiary.

*Alternative property finance*

If there is an alternative property finance transaction (such as a transaction involving Islamic financing), the question of whether this is a non-resident transaction must also consider if the person who is the ultimate beneficiary of the arrangement is non-resident.

*Substantial performance and then completion*

Although SDLT liability can crystallise on substantial performance rather than on completion, where that happens there is actually another potential charge on completion. Normally there is no additional SDLT to pay. If this happens, the completion will only be a non-resident transaction if the earlier notifiable transaction (i.e. the substantial performance) was also a non-resident transaction.

*Land transaction returns*

If it is necessary to determine if someone is not resident but they have not met the conditions at the filing date to be treated as resident, the return must be completed on the assumption that they will not meet the conditions. The return can be amended if they do subsequently meet the conditions. The time limit for the amendment is two years beginning with the day after the effective date of the transaction.

*What is a dwelling?*

A building or part of a building is a dwelling if it is used or suitable for use as a single dwelling or in the process of being constructed or adapted as such. Land that is occupied or enjoyed with a dwelling is taken to be part of that dwelling but would not be a dwelling if sold separately. This is the same definition as we are familiar with for other SDLT purposes.

*Commencement provisions*

The provisions apply to any transaction where the effective date is on or after 1 April 2021. This means that contracts being entered into now could be potentially caught by this. However, if the contract was entered into before 11 March 2020 it will not be caught unless there is a variation of that contract or it is assigned on or after 11 March 2020 or is actually the exercise of an option or similar pre-emption right on or after 11 March 2020.

*Contributed by Ros Martin*

# Administration

## Failure to operate PAYE (Lecture P1211 – 22.13 minutes)

*Summary - A company failed to keep appropriate employee records and to operate PAYE correctly. Low National Insurance Contributions could not be explained by unpaid work carried out by the company's shareholder-director.*

Planet Double Glazing Limited was a small company that manufactured and fitted double-glazed windows, doors and fittings. The company was incorporated in May 2009 and Mr Singh Johal was the sole shareholder and director.

HMRC opened an enquiry into the company's PAYE records on 6 January 2015 and requested various pieces of information. HMRC established that the company had no employment contracts, paid its employees in cash and did not maintain records of employee costs. There were no underlying records such as work sheets or deductions sheets to show who was employed at what time, the hours worked by employees, or what amounts were paid to employees in the relevant tax years.

The company started to operate a PAYE scheme in March 2013 but failed to operate it correctly. The company did not inform HMRC when employees started work and did not obtain any tax codes to apply to employees' wages. They incorrectly applied the standard code for basic rate tax with a personal allowance when they should have used the OT code with no personal allowance.

There were five full-time employees working for the company in addition to Mr Singh Johal and his wife, each of whom was earning more than £12,000 per annum, above both the income tax personal allowance and the lower earnings threshold for NICs. However, the PAYE summaries produced to show the payments and deductions made for employees in each relevant year did not reflect these employees.

For tax years 2011/2012 to 2014/2015, HMRC imposed assessments and penalties totalling £59,000 on the company for failing to comply with its PAYE and NIC reporting and payment obligations. HMRC made its assessments based on the limited information available and the presumption that, going forward, the business would continue with the same level of turnover and employee numbers.

The company argued that the PAYE and NIC appeared low for the period as Mr Singh Johal devoted a large amount of unpaid time working for the company and that this explained the low payroll costs compared to turnover. HMRC's assessments were too high because they did not take this into account.

*Decision*

The evidence provided did not support Mr Singh Johal's argument that he was doing the bulk of the company's manufacturing on an unpaid basis and so keeping the company's costs down. In fact evidence showed that he had no experience in manufacturing.

Given this, as well as the poor employee records that were kept, and the proven inability to correctly operate the PAYE system, it was reasonable for HMRC to assume the company had employed staff for which the company had not operated PAYE.

The First Tier Tribunal dismissed the appeal and upheld both the assessments and the penalties.

*Planet Double Glazing Limited v HMRC (TC07764)*

## Valid discovery assessment on LLP member

*Summary – The discovery made by HMRC on revisiting an LLP member's tax return following the release of the Upper Tribunal's decision in a related tax arrangement case was valid.*

William Hayes was a member of Ivancroft LLP, an LLP that took part in a tax arrangement referred to as Icebreaker. Under these arrangements, individual members contributed money of their own and a larger amount of borrowed money to the LLPs, in order to provide finance for a range of creative projects. Each LLP claimed to have made a significant trading loss in its first year that the individual members sought to claim as an allowable loss against their income tax liability.

In 2016, the Upper Tribunal heard Acornwood LLP and Ors v HMRC [2016] UKUT 361 (TCC). Agreeing with the First Tier Tribunal, HMRC were correct to deny claims by individual members for interest relief on the loans under s 383 ITA 2007 as the money was not used for trading purposes.

As a result of this decision, HMRC issued William Hayes with discovery assessments.

He accepted that, under the Upper Tribunal decision, he was not entitled to claim relief for the loan interest on the money contributed to the LLP but challenged the discovery assessments, arguing that all relevant information was included in his earlier returns, so there was no discovery or alternatively that the assessment was stale.

HMRC argued that following consideration of the decision in Acornwood, HMRC reviewed William Hayes' tax returns and concluded that the loan interest relief claimed was not allowable and so made a valid discovery.

*Decision*

The First Tier Tribunal referred to Charlton v HMRC where the Upper Tribunal stated that no new information was needed for there to be a discovery; all that was required was that information had newly appeared to an officer.

Following the Acornwood case referred to above, HMRC revisited William Hayes' tax returns, and in view of what was said in Acornwood, it newly appeared to an officer that the interest relief claims made were not allowable and there was an insufficiency of tax assessed. This was a discovery that occurred in August 2014.

The Tribunal went on to consider whether the discovery assessments had become stale.

- The assessment for the year ended 5 April 2011 was raised on 9 March 2015, so just over 6 months after the discovery. During this time, HMRC engaged with William Hayes with a view to settlement;

- The assessment for the year ended 5 April 2012 was raised on 18 February 2016 so just under 18 months after the discovery. During this period HMRC notified William Hayes of his estimated liabilities (in October 2014) and continued to engage with him in relation to his liability, again with a view to settlement.

Neither discovery had become stale and the appeal was dismissed.

*William Hayes v HMRC (TC07750)*

## Employment intermediary returns **(Lecture P1211 – 22.13 minutes)**

*Summary – The Company submitted intermediary returns late to comply with HMRC's request, and not because it knew that there was a legal obligation to do so.*

Fastklean Limited provides cleaners to corporate clients. HMRC believed that the company was an employment intermediary that should have filed intermediary returns.

An employment intermediary is a person who makes arrangements for an individual to work for a third person. Under s716B ITEPA 2003, where PAYE has not been operated, such intermediaries are required to provide HMRC with certain information relating to payments made to those workers. The information to be provided must be included in a return in a form prescribed by HMRC as specified in the PAYE Regulations. The intermediary is required to submit the return no later than the month end date of the relevant tax quarter.

Having sought legal advice, the company was told that the intermediary return provisions did not apply to them due to the manner in which their cleaners provided services: namely that the cleaners were not subject to, or subject to the right of, supervision, direction or control by any person (s44 ITEPA 2003).

Despite Counsel's advice that returns were not needed, in order to comply with HMRC's request to bring their tax affairs in order, on 18 February 2018 the company submitted returns for seven periods from July 2016 to January 2018.

On 5 March 2018, HMRC imposed late filing penalties against the company under s98 TMA 1970. The penalty being charged based on the number of offences: £250 for the first offence, £500 for a second offence and £1,000 for a third and later offences.

Fastklean Limited appealed, arguing that it did not consider the returns were required.

Decision

The First Tier Tribunal stated that, as the company had not provided evidence of the specific working arrangements, it had not met the criteria to disapply the requirement to file returns.

The First Tier Tribunal acknowledged that the company's director had no tax expertise and was reliant his on advisers to comply with what was required by law. It was reasonable for the director to rely on the tax advice given. The Tribunal accepted that the director had submitted the returns to resolve the matter, rather than because the company was obliged to do so.

Fastklean Limited's appeal was allowed.

*Fastklean Limited v HMRC (TC07773)*

# Deadlines

*1 September 2020*

- Corporation tax due for periods to 30 November 2019 for non-instalment companies

*7 September 2020*

- VAT return and electronic payment for 31 July 2020 quarter;

*14 September 2020*

- Quarterly corporation tax instalment payment for large companies;
- Monthly EC sales list (paper return);

*19 September 2020*

- PAYE/NIC/student loan/CIS payments for month to 5 September 2020 if by cheque
- File monthly construction industry scheme return;

*21 September 2020*

- File online monthly EC sales list online;
- Intrastat – submit supplementary declarations for August 2020;

*22 September 2020*

- Online PAYE/NIC/student loan/CIS payments for month to 5 September 2020;

*30 September 2020*

- Accounts to Companies House:
    - private companies with 31 December 2019 year end;
    - public limited companies with 31 March 2020 year end;
- File CTSA returns for companies with an accounting period to 30 September 2019;
- End of CT61 quarterly return period;
- Reclaim EC VAT chargeable in 2019;
- Deadline for reporting the disguised remuneration loan charge;
- 30 June 2020 period must notify HMRC of profits liable to the diverted profit tax

# News

## Finance Bill 2020

The Finance Bill 2019–20 has completed its journey through Parliament and became the Finance Act 2020 when it received Royal Assent on 22 July 2020.

*https://www.legislation.gov.uk/ukpga/2020/14/contents/enacted*

## Self-Employed Income Support Scheme – 2nd grant

Remember, the Self-Employed Income Support Scheme second grant is available to eligible businesses that have been adversely affected by COVID-19 on or after 14 July 2020. The eligibility criteria are the same as for the first grant but the second grant is worth only 70% of average monthly trading profits. Once claimed, this will be paid out in a single instalment covering 3 months' worth of profits, and capped at £6,570 in total.

The scheme is now open for this second and final taxable grant. Taxpayers have been contacted by email. The email gave them a date from when they can make their claim.

The final deadline for making the claim is 19th October 2020.

*https://www.gov.uk/guidance/claim-a-grant-through-the-coronavirus-covid-19-self-employment-income-support-scheme*

## CJRS and the Employment Allowance (Lecture B1211 – 20.56 minutes)

In June and July 2020 we included short articles on how the Coronavirus Job Retention Scheme and Employment Allowance could interact and concluded that we needed HMRC to confirm the position, as the goal posts seemed to be moving.

Initially we reported that a claim for the Employment Allowance could be deferred to later in the year, once the CJRS had ended. This would ensure that the maximum CJRS grant and employment allowance were claimed. At that time, the ICAEW's Tax Faculty supported this treatment but stated that they were waiting for confirmation from HMRC that this was acceptable practice.

In July we reported that HMRC were saying that attempting to get relief for the same NIC costs twice was a fraud and may result in claims being investigated.

But it seems that the position has changed once more, reverting back to our original view. HMRC has now confirmed to the ICAEW's Tax Faculty that employers can defer their Employment Allowance as we had originally suggested.

The ICAEW's Tax Faculty has now received HMRC's guidance on this point. On ICAEW's website dated 17th August 2020 it states:

> "The employer is allowed to wait and claim the EA later in the year. There should be no worry about claiming relief for the same employer's NIC twice, provided that for the time after the date when the EA claim is made there is at least £4,000 of secondary class 1 NIC payable. It is very important to make sure the EA is not set against employer's NIC that has been claimed under the CJRS."

The website also states that:

> "The Tax Faculty understands that where necessary, software developers are modifying their payroll software accordingly."

*https://www.icaew.com/insights/tax-news/2020/aug-2020/employment-allowance-and-the-cjrs*

## HMRC struggling to process P11Ds

Employers are required to have submitted Form P11d for reporting expenses and benefits and Form P11D(b)) covering Class 1A on those reported amounts by 6 July after the end of the tax year. Although there are a number of automated ways to file these returns, employers can still choose to post hard copies to HMRC if they so wish and pay by cheque. The class 1A NIC payable must be settled either electronically by 22 July 2020, or earlier by 19 July 2020 if paying by cheque.

It seems that during the coronavirus pandemic HMRC has been struggling to process these forms with fewer staff have being present in HMRC offices as well as many of those staff being diverted to frontline support work on Covid-19 grant schemes. HMRC's systems have been automatically issuing penalty warning letters to employers who have 'failed' to submit their forms.

Understandably, employers are concerned. How do they know whether their forms are sitting unopened in HMRC offices or have got lost in the post? HMRC has confirmed to the ICAEW Tax Faculty that if these forms were filed by the due date, employers do not need to take any action and should ignore the penalty warning letter. HMRC has stated that they will carry out further checks before deciding whether to issue penalties. However, if P11Ds and P11D(b)s were submitted on time and a late filing penalty is issued, employers (or their agents) should appeal immediately.

## Online marketplace fees and DST

From 1 September 2020 Amazon UK is increasing its fees for UK sellers to cover the new digital services tax that was introduced last April. They stated:

> "Now that the legislation has passed, we want to inform you that we will be increasing Referral fees, Fulfilment by Amazon (FBA) fees, monthly FBA storage fees and Multichannel Fulfilment (MCF) fees by 2% in the UK to reflect this additional cost. We will not apply the increased charges retroactively, but starting 1 September 2020, the fee types listed above will increase."

On 10th August, EBay UK, also affected by the new 2% digital services tax, confirmed to its sellers that they would not be increasing their fees:

> "eBay is one of the marketplaces which will have to pay the new tax – and a lot of you have asked whether we at eBay will be passing on this tax to our sellers in the form of new fees.
>
> We wanted to reassure you that we won't do that, so you will not be charged additional new fees as a result of this tax."

*https://sellercentral-europe.amazon.com/forums/t/upcoming-fee-changes-in-the-uk-following-introduction-of-digital-services-tax/322163*

*https://community.ebay.co.uk/t5/Announcements/Protecting-your-business-from-Digital-Services-Tax-costs/ba-p/6701162*

# Business Taxation

## LLP member: employee or self-employed? (Lecture B1211 – 20.56 minutes)

*Summary – Payments made by an LLP to the taxpayer were made to him as a member and not an employee, so he was liable to pay Class 4 NICs.*

Peter Wilson qualified as a Chartered Accountant in Australia and later as a Chartered Accountant in the UK. He was a partner of Arthur Young Australia and over the years worked as a tax adviser for accounting firms in Australia, the US and UK.

He joined Haines Watts and at that time Haines Watts did not have a separate international tax department. It was agreed that Haines Watts would take over the relationships with his old accounting clients and provide all administrative assistance, staff, furniture, services etc. while Peter Wilson concentrated on building the international tax business.

It was agreed that he would receive "first charge drawings of £15,000 per month based on a minimum requirement of 1000 recoverable hours at £400 per hour as well as a number of other benefits. Specialist tax staff would be recruited to support the growth of the international tax work and he would receive 25% of the profits from that work (after his first charge and the cost of his other benefits). He enjoyed substantial voting rights as a member of the LLP although he was not entitled to vote on certain matters, including the admission of new members.

The LLP Agreement clearly identified three different categories of Member. The Managing Member, the Management Members and the Client Members. Peter Wilson fell into this last category. He claimed that payments from the LLP were made to him as an employee rather than under the partnership profit sharing arrangement as member.

*Decision*

The First Tier Tribunal stated that for Peter Wilson's appeal to succeed, he needed to show that he could be an employee of the LLP for tax purposes despite being a member of the LLP, and that the payments made to him were in relation to employment by Haines Watts and not in relation to his membership of Haines Watts.

The Tribunal considered the documents signed by him when he joined the firm. These clearly showed that the intention was to appoint him as an LLP member and the Tribunal concluded that the payments were made to him as partner.

Further, the Tribunal noted that he had submitted tax returns in 2011/12 and 2012/13 on the basis of receiving income/profit from his interest in the partnership. The Tribunal concluded that, as a highly qualified tax adviser, this action undermined his claim that he was an employee.

*Peter Wilson v HMRC (TC07716)*

## Yard repair or replacement **(Lecture B1211 – 20.56 minutes)**

*Summary – Expenditure incurred on resurfacing a yard was revenue rather than capital in nature, even though it included a new drainage channel.*

Steadfast Manufacturing & Storage Limited leased a factory and yard. The yard had not been resurfaced since before the site was acquired, and the surface was in poor condition. Some areas were unstable and unsuitable for use by forklift trucks, although they were used when necessary to turn the trailers for articulated lorries. As these areas were used less often than other areas of the yard, weeds grew through the surface area such that in overhead photographs the areas appear green rather than paved.

Historically, the yard was repaired twice a year by patching with gravel. The forklift trucks in particular would quickly dig into this material with their tyres. As this patching was becoming less effective it gave rise to health and safety concerns and the company decided that the yard should be resurfaced.

The work was undertaken as a single project and, as well as resurfacing, a drainage channel was added between the factory and the re-surfaced area to stop water from running across the yard, and to allow an expansion joint for the concrete. The cost of this channel was only £740. Overall, there was no increase in size of the useable area and no increase in the loadbearing capacity of the yard. The total cost of the works was approximately £74,000.

The issue was whether the expenditure amounted to a replacement (capital expenditure and disallowed) or a repair (revenue expenditure and so allowable).

*Decision*

The First Tier Tribunal concluded that there was no improvement in the yard compared to its original condition, and that the works only returned the yard to its previous standard. There was no increase in the useable area compared to the original. There also was no evidence of any increase in the load bearing capacity of the yard.

HMRC argued that the expenditure was capital because after the repairs had been done, there would be no need for further repairs for up to 20 years. The Tribunal dismissed this argument stating that prevention of the need for future repairs simply meant that the job had been done well in the first place. If HMRC were correct, most repairs would be treated as capital, which is clearly not the case. The work restored the yard to its original state and did not bring something new into existence. The additional drainage channel did not alter this. It was a minor addition to the works and there was no evidence that it made a substantial difference to the yard or the factory.

The expenditure incurred on restoring the yard should be treated as a revenue expense.

*Steadfast Manufacturing & Storage Limited v HMRC (TC07770)*

## Unincorporated businesses' losses (Lectures B1212/ 1213 – 15.11/10.51 minutes)

With the economy hit hard by COVID-19, many unincorporated businesses will make losses this year, perhaps for the first time. A sole trader has great flexibility in how losses can be used (see below) and these rules also extend to members of partnerships and LLPs, subject to restrictions for non-active partners and limited partners (not covered in this article).

*The default position*

S.83 ITA 2007 allows a trading loss not used in any other way to be automatically carried forward to set against the first available profits of the same trade. As this only gives potential relief against one source of income in the future, rather than any immediate tax saving, it is usually the option of last resort. Of course, some businesses currently will be wondering if they will ever make profits again.

*Terminal loss relief*

Some business owners will not want to risk further capital by continuing to trade in the post COVID-19 world. If the trade ceases, terminal loss relief (s.89 ITA 2007) allows the loss incurred in the final twelve months of trade to be set against trading profits of the three tax years before the tax year of cessation, on a LIFO basis. This may generate large tax repayments if the trade has previously made significant profits.

*Example - Vince*

Vince ceased trading on 30 June 2020 after being in business for many years.

His adjusted results in recent years are as follows:

| | £ |
|---|---|
| Y/e 31.12.17 | 12,000 |
| Y/e 31.12.18 | 1,800 |
| Y/e 31.12.19 | 8,000 |
| 6m to 30.6.20 | (13,000) |

He has rental income of £5,000 p.a. The overlap profits on commencement were £2,000.

*Analysis of final 12 months*

[NB This is, in practice, done on a strict day-count basis, but here calculations are done to the nearest month for ease of explanation]

| | £ |
|---|---|
| 2020/21 (3m: 6.4.20 – 30.6.20) | |
| Unrelieved trading loss = (3/6) x (13,000) | (6,500) |
| Overlap relief | (2,000) |
| 2019/20 (9m: 1.7.19 – 5.4.20) | |
| [(6/12) x 8,000] + [(3/6) x (13,000)] | ( 2,500) |
| Terminal loss | (11,000) |

If a claim is made, this would be used against trading profits, as follows:

| | £ |
|---|---|
| Terminal loss | 11,000 |
| 2019/20 | (8,000) |
| | 3,000 |
| 2018/19 | (1,800) |
| | 1,200 |
| 2017/18 | (1,200) |
| | Nil |

Much of this loss claim will not save tax, due to the level of his income in years other than 2017/18.

Note that the time limit for a s.89 relief claim is 4 years from the end of the tax year in which the trade ceased (e.g. 5 April 2025 for a cessation in 2020/21).

*Early year losses*

Where a loss is incurred in any of the first four tax years of trade, s.72 ITA 2007 allows that loss to be carried back and used in the three tax years before the year of the loss, on a FIFO basis. Key technical points of such claims are:

The available loss for each tax year is established using the same rules as for profits (i.e. normal opening year rules).

If periods overlap, the loss is given only in the earlier tax year (i.e. there is no double counting of losses, in contrast to what happens with profitable basis periods).

The loss is set against total income, before deducting the personal allowance.

You must relieve all three previous years if there is enough loss (i.e. you cannot choose one particular year in which to set the loss off).

The maximum possible loss must be set off in each year (i.e. the claim cannot be restricted to preserve the personal allowance).

This claim is particularly useful where someone has given up a high-paying job to start their own business, as it may generate tax repayments at the higher or top rates of tax.

*Losses made by continuing businesses*

Once outside the first four tax years of trade, any loss relief against other income ("sideways loss relief") is given under s.64 ITA 2007. This relief is available against total income (before personal allowance) of the tax year:

- in which the loss-making basis period ends, and/or
- immediately preceding that year.

The loss can be used in either year first, with a separate claim made for the other year if appropriate. Neither claim may be restricted to preserve the personal allowance.

S.71 ITA 2007 and s261B and s261C TCGA 1992 allow a s.64 claim to be extended to gains of either year (once income for that year has been extinguished). In practice, this option will rarely be used, but may be useful if significant gains are made, perhaps from disposal of business assets, in the year of cessation.

After the financial crisis a decade ago, there was a temporary increase in the s.64 carry back option to three years. It will be interesting to see if Rishi Sunak does something similar over forthcoming months.

*Time limit for a claim*

The time limit for a claim under either s.72 or s.64 is 12 months from 31 January following the year in which the loss is made (e.g. for a 2020/21 loss, 31 January 2023).

*Loss cap*

Note that any sideways loss relief claim, under both s.72 and s.64, is restricted to the greater of:

- 25% of the individual's adjusted total income (i.e. total income less pension contributions) for the tax year; and

- £50,000.

Other losses to which the cap applies include qualifying loan interest and claims under s.131 ITA 2007 (capital losses on unquoted trading companies used against income). However, there is no cap on a s.131 claim where the shares qualify for EIS or Seed EIS relief.

*Disclaiming capital allowances*

Capital allowances increase trading losses. Clients should consider disclaiming plant and machinery capital allowances if the increased loss generated would be wasted due to the level of income being relieved.

*Contributed by Kevin Read*

## Property development partnership and deductibility of interest

*Summary – Interest on loans made to two Isle of Man companies, as partners in a partnership, was not deductible from the partnership profits. The loans were taken out by the partners as investors rather than the partnership and the interest paid was not wholly and exclusively for the partnership trade.*

Ian Shiner and David Sheinman were business partners and directors of a UK property development group, Mark Oliver Homes. As is common in the property development world, the partners place each property development into a separate entity, with each entity then contracting with the Mark Oliver Homes group to carry out construction. In that way, any trading difficulties arising out of a particular development are ring-fenced and the failure of one development will not bring down the group as a whole.

Following advice from PriceWaterhouseCoopers, Ian Shiner and David Sheinman were running the development in this case through an Isle of Man partnership structure. They had set up trusts through two Isle of Man companies (Armourdale Limited and Parleybrook Limited). The trusts entered into a partnership, known as the Redwood Partnership, also in the Isle of Man. Prior to this appeal it had been established in the Courts that Ian Shiner and David Sheinman were taxable on the partnership profits.

The trade was funded by a number of loans from an employee benefit trust within the UK group to the two Isle of Man partner companies, with the money used to finance land to be developed by the Redwood Partnership.

Ian Shiner and David Sheinman claimed that the loans made to Armourdale Limited and Parleybrook Limited as partners should be treated as loans to the Redwood partnership, since Isle of Man partnerships do not have legal personality. As partnership loans, interest which was paid by the partners was effectively interest paid by the partnership and so deductible in arriving at partnership profits.

HMRC disagreed and argued that the loans had been made solely to the partner companies and not to the partnership. The partners had then made capital contributions of the amounts borrowed on to the Redwood partnership. As a result, the interest was paid by the partners and not by the Redwood partnership and so could not properly be shown as a deduction in the partnership accounts.

*Decision*

The First tier Tribunal agreed with HMRC.

The loans were made to the partner companies as trustees who had then advanced the money received to the partnership as a capital contribution. No interest deduction was allowed. It did not matter that the contribution was made so that the partnership could use the proceeds wholly and exclusively for the purposes of its trade.

The appeal was dismissed

*Ian Shiner and David Sheinman (TC07779)*

## Partners and limited partnerships – complex issues

*In this case, the First Tier Tribunal considered a number of complex appeals relating to the tax treatment of transactions involving a limited partnership and its partners.*

BlueCrest Capital Management LP (BCM LP) was a limited partnership operating as an investment manager. By 2007, it had one general partner and 51 limited partners. Three of the limited partners wished to sell a proportion of their interest in the partnership, amounting to 19% of the total equity. A complex structure was established in the Cayman Islands to enable the interests in the partnership to be purchased by an entity within BlueCrest. A Cayman Islands company (BCMCL) was established and, in part using funds borrowed from a bank, it purchased the interest in BCM LP. It then contributed its interest as capital to a Cayman Islands limited partnership (C LP), in which it became the general partner.

The main issue arising from these transactions was whether BCMCL was liable to corporation tax on all of the profit allocations of BCM LP in respect of the 19% interest. The First Tier Tribunal held that it was. The interest in BCM LP was originally held by the company in its own right and was now held by it in its capacity of general partner in C LP. But it did not follow that the other partners in C LP became partners in BCM LP. Only BCMCL was a partner in BCM LP and it alone was liable to corporation tax on the profit allocations. The First Tier Tribunal then decided that the interest payments made by BCMCL in respect of the borrowed funds were not allowable deductions in computing its taxable profits.

The remaining appeals related to a 'partner incentivisation plan' (PIP) set up by BCM LP. Under the plan, a corporate partner was introduced and was awarded a portion of the LP's profits on a discretionary basis. It then reinvested those profits into the LP as a capital contribution (so-called 'special capital') and shares in that capital were awarded to other partners according to their performance in the business.

HMRC contended that the awards of special capital to individual partners represented an allocation of the profits of BCM LP, but the First Tier Tribunal held that they were not. Instead, the partners received capital transferred by the corporate partner. It was the corporate partner that received an allocation of profits, which was correctly chargeable to corporation tax. The First Tier Tribunal went on to conclude, however, that the amounts received by the other partners were taxable; they were analogous to a taxable bonus and so to be regarded as income. As they were neither employment income nor an allocation of partnership profits, they were taxable as miscellaneous income under ITTOIA 2005 s 687(1).

*BCM Cayman LP and others v HMRC (TC07782)*

*Case summary in Tax Journal (31 July 2020)*

## Incorporation: Goodwill overvaluations (Lecture B1214 – 12.48 minutes)

*Background*

When a sole trader or partnership incorporates so that the business operates through a company, there are several different ways the incorporation could be undertaken.

For example, the proprietor(s) might:

- Sell the business for shares in the company; or
- Gift the business assets to the company; or
- Sell the business for cash (with the proceeds often being left outstanding on a director’s loan account, for the proprietor(s) to withdraw from the company as they wish if funds allow).

*Market value*

A disposal of chargeable assets on incorporation is normally a transfer between connected persons. For this purpose, a company is connected to another person if that person has control of it or if that person and persons connected with him together have control of it (TCGA 1992, s 286(6)).

Where the transactions are between connected persons, the rules of TCGA 1992, s 18 prevail; in particular, the transaction is to be treated as a bargain not made at arm's length. This, in turn, brings TCGA 1992, s 17 into play to the extent that the consideration for the business proprietor(s) disposal of the assets is to be treated as their market value for CGT purposes.

*Goodwill valuation*

The chargeable assets of the business could include goodwill. It needs to be goodwill that is capable of being transferred to the company, as opposed to personal goodwill, which is considered incapable of being transferred.

The valuation of assets such as goodwill is a highly specialised area. Even if goodwill has been valued by a professional valuer, it does not necessarily follow that HMRC's Shares and Assets Valuation division will agree with the professional valuer's valuation. In fact, there could be potentially major differences in valuations of the same asset by HMRC and the valuations expert.

*Tax treatment of overvaluations*

What if the goodwill is overvalued by the client or his professional adviser?

In April 2005, HMRC published a Tax Bulletin (Issue 76), which indicated that the excess consideration in such a scenario could fall to be treated in alternative ways; either as employment income, or as a distribution similar to a dividend.

HMRC stated that if goodwill was '… deliberately overvalued when it was sold to the company' the excess payment by the company would be taxable as employment income and taxed accordingly. The excess payment would be liable to Class 1 National Insurance contributions.

Alternatively, the goodwill will often be transferred before the company has commenced trading. HMRC stated that, in the majority of cases where goodwill is transferred, any excess value would be received in the capacity of a shareholder, rather than an employee or director. A payment of excess value would therefore be treated by HMRC like a dividend (by reason of the distribution provisions in CTA 2010, ss 1000 and 1020).

HMRC's analysis of the tax treatment of payments for goodwill in Tax Bulletin 76 is based on the premise that the goodwill has been deliberately overvalued. HMRC appear to accept in Tax Bulletin 76 that goodwill valuations are not an exact science and consider that distributions (within CTA 2010, s 1020) can be 'inadvertent'. HMRC may therefore allow the transaction to be 'unwound' in those circumstances.

However, there are conditions for this unwinding treatment to apply; firstly, 'reasonable efforts' must have been made to carry out the transaction at market value using a professional valuation (or, as HMRC puts it, an 'independent and suitably qualified valuer on an appropriate basis'); secondly, there can be no unwinding of intentional overvaluations; and thirdly, there must be no tax avoidance motive. If a distribution is unwound, the shareholder must repay the excess value to the company.

*Partial DLA repayment*

What if the distribution is not unwound, but the company is terminated before all the sale proceeds for the goodwill can be paid to the shareholder? Is the distribution element the original proceeds less the agreed goodwill valuation, or the amount withdrawn by the director shareholder in excess of the agreed goodwill valuation?

In Pickles v Revenue and Customs [2020] UKFTT 195 (TC), a husband and wife in business as a partnership business sold all its assets to a related company (HFPL) in May 2011. HFPL was established for the purpose of incorporating the partnership, and the incorporation was driven by commercial considerations.

The value attributed to goodwill sold on the incorporation, which was credited to the directors' loan account, was £1,199,043. This figure was based on a calculation by the appellants' former agents.

HMRC assessed the difference between the originally attributed goodwill figure of £1,199,043 and the agreed value for goodwill of £450,000 to income tax as a distribution; so the distribution by HMRC's reckoning was £749,043. The taxpayers appealed. In July 2014, HFPL was placed into administration, before being dissolved in October 2015. None of the balance owing on the directors' loan account at the date of the administration (i.e. £427,180) was repaid.

HMRC and the taxpayers initially agreed that the goodwill transferred should be valued at £450,000. However, at the First-tier Tribunal, HMRC's expert witness recommended a goodwill valuation of £270,200. The tribunal accepted this figure and determined the market value of the goodwill to be £270,200.

The tribunal also noted that following the business sale, the appellants received cash of £771,863 from HFPL for the sale of the goodwill. This exceeded the market value of £270,200 by £501,663.

The tribunal decided that a 'distribution' had been made to the taxpayers. The amount of the distribution in the tribunal's view was the benefit received in excess of the value of the consideration given for the asset transfer (i.e. £501,663). The tribunal disagreed with HMRC's argument that simply by crediting a director's loan account with £1,199,043 the company made a distribution for tax purposes (CTA 2010, ss 1000 and 1020).

The tribunal therefore decided to the extent that the cash of £771,863 received from the company in partial repayment of the directors' loan exceeded the value of the goodwill amounting to £270,200, the difference of £501,663 was a benefit received by the taxpayers and a distribution for income tax purposes. However, the balance of the £427,180 debt that remained outstanding could not also be regarded as a distribution. The taxpayers' appeal was therefore partly allowed (by the tribunal Judge's casting vote, the other tribunal member dissenting).

*More to follow?*

The tribunal in Pickles noted that there appeared to be no authorities on the meaning of 'distribution' that might be of assistance in this context, and it was not possible to agree on the interpretation of the relevant law. There was an important point of widespread significance; the tribunal therefore gave HMRC permission to appeal to the Upper Tribunal to provide definitive guidance and encouraged HMRC to do so.

Whether or not HMRC appeal to the Upper Tribunal remains to be seen, but in view of the First-tier Tribunal judge's comments, an appeal by HMRC seems highly likely.

*Contributed by Mark McLaughlin*

## Failed R&D relief claim (Lecture B1211 – 20.56 minutes)

*Summary – A company failed to provide sufficient evidence to support its claim for R&D relief.*

AHK Recruitment Limited provided human resources services and systems. In its Corporation Tax Returns for the periods ending 31 December 2014 and 31 December 2015, the company claimed R&D relief under to s1044 CTA 2009 and, on the basis of that relief, R&D tax credits under s1055 CTA 2009. The claim related to a project that sought to develop a technological system capable of predicting applicant suitability for a job. The system looked to build an Artificial Intelligence system that could make recruitment related decisions to a human standard.

HMRC refused the claim arguing that evidence to support the claim provided by the company was inadequate. Even if any R&D activity was conducted, the company had not proved the quantum of the claim; evidence relating to sub-contractor costs was inadequate as it did not prove that the work undertaken by the sub-contractor related to the project.

*Decision*

The First Tier Tribunal confirmed that AHK Recruitment Limited needed to prove it had undertaken a project to achieve an advance in science or technology and, as part of that project, it had undertaken activities to resolve a scientific or technological uncertainty. The Tribunal concluded that AHK Recruitment Limited had failed to prove that it undertook such qualifying R&D.

Even if the company did carry out qualifying R&D it had failed to prove that the costs included in its R&D claim related to R&D activities.

The First Tier Tribunal concluded that that the company had neither provided sufficient documentary evidence nor supported its claim with satisfactory evidence from a competent professional who was contemporaneously involved in the project at the time.

*AHK Recruitment Limited v HMRC (TC07718)*

## Oil royalties

*Summary – The bank's appeal against discovery assessments charging its receipt of oil royalties to corporation tax was dismissed. Assigned oil royalties are taxed under UK ring-fence rules, and the taxpayer was careless not to include them on returns to HMRC.*

Royal Bank of Canada had lent money (from its Canadian operations, not from its UK permanent establishment) to an oil exploration company to fund exploration in the UK continental shelf.

Following the sale of the oil exploration business and the insolvency of the borrower, the rights of the borrower to receive oil royalties were assigned to Royal Bank of Canada.

Royal Bank of Canada had treated them as income of its banking business in Canada. HMRC argued that it should have treated the income as part of a ring-fence activity carried on through a deemed UK permanent establishment.

*Decision*

The First Tier Tribunal dismissed Royal Bank of Canada’s appeal, deciding that:

- the royalty payments, as originally created between the borrower and the purchaser of its operations, were 'payments as consideration for the right to work mineral deposits' and the fact they had been assigned to Royal Bank of Canada did not alter their classification;

- the UK/Canada double tax treaty confers taxing rights on the UK in respect of the royalty payments;

- under UK law, the royalty payments were taxable in full as ring fence profits of a deemed permanent establishment of Royal Bank of Canada; and

- HMRC had validly raised discovery assessments for each year.

The Tribunal found the discovery was not stale. In particular the fact that much of the information that formed part of the 'ultimate jigsaw' had been available to HMRC for many years before the years under assessment, did not preclude the officer in question from making a discovery.

The First Tier Tribunal also found that the list of information on the desk of the hypothetical officer is an exhaustive list and 'any attempt to include other information, however ingeniously the argument is repackaged, must be rejected, based on the principles in Langham v Veltema [2004] EWCA Civ 93.

For two of the years, HMRC also had to rely on the longer time limit for discovery assessments that are available where the loss of tax had been brought about carelessly by the company. RBC argued that, given the complexity of the issues involved, including correspondence involving HMRC, there were reasonable grounds for concluding that the royalty payments were not taxable and therefore that it was reasonable not to include them on a tax return.

However, the First Tier agreed with HMRC that Royal Bank of Canada had been careless. The decisive fact was a 1991 letter from BP (who had been paying the royalties at that time) to Royal Bank of Canada that stated that BP had spoken to HMRC (the Inland Revenue, as it then was) and they (i.e. BP and HMRC) had concluded that Royal Bank of Canada should have contacted HMRC to determine Royal Bank of Canada’s tax liability. Royal Bank of Canada produced no evidence that it had contacted HMRC or external advisers. The First Tier Tribunal concluded that Royal Bank of Canada had simply ignored the letter, left the royalties out of its tax returns and made no explanation to HMRC; and that this was not the approach of a reasonably diligent taxpayer.

*Royal Bank of Canada v HMRC (TC07751)*

*Adapted from the case summary in Tax journal (17 July 2020)*

## Arguing deliberate non-disclosure

This is an immensely complex procedural decision about the way in which HMRC'S case against a large international group should be argued. The background is HMRC's attempt to rescind a settlement reached with the group relating to the anti-arbitrage rules in F (no 2) A 2005, on the basis that the group had not provided adequate disclosure. The judgement does not consider whether or not the rules apply: that will be for a later hearing. What was in point is whether HMRC would be allowed to run the argument that the company had deliberately failed to disclose the full picture when reaching the settlement. After much legal wrangling, the judge gave HMRC that permission. It is important to note that this is not a finding that there was deliberately non-disclosure: merely that HMRC would be permitted to make that argument. The case is certainly worth following because the substantive hearing is likely to give important judicial guidance on what has to be established before HMRC can rescind agreements with taxpayers.

*IGE USA Investments Limited and others [2020] EWHC 2121 (Ch)*

*Taken from Andrew Hubbard's weekly case overview*

# VAT

## Input tax claim disallowed (Lecture B1211 – 20.56 minutes)

*Summary – An input tax claim, where a property had been opted to tax, was denied. The taxpayers were not letting the property as the occupants had no obligation to pay rent.*

In 2008 Colin And Susan Slaymark bought an industrial unit/warehouse in Eastbourne, on which they opted to tax.

During ownership, four companies occupied the property: Fender Limited, Adkat Distributions Limited, Hotel Leisure Limited and South East Refurbs Limited. None of these companies paid any rent.

Some seven years later, the property was sold for £1.5 million plus VAT of £300,000. The couple's final VAT return included the £300,000 of output VAT less input tax of £68,541.

HMRC disallowed most of the input tax, allowing only the amount relating to the solicitors and estate agent's fees on the sale of the property.

The couple appealed.

*Decision*

The First Tier Tribunal considered whether the corporate tenants were required to pay rent, and, if not, whether Colin and Susan Slaymark expected them to pay rent. The Tribunal found that there was no obligation for any of the four companies to pay rent, nor did the couple expect that rent would be paid. They were not carrying on the economic activity of letting the property.

As for the expenses, the Tribunal agreed with HMRC. The fees relating to the property sale were allowed (legal and estate agent fees). However, the majority of the fees were disallowed as some of the expenses were unrelated to the property, while other expenses could not be proven.

The First Tier Tribunal dismissed the appeal.

*Colin And Susan Slaymark v HMRC (TC07709)*

## Child seats rented with a car

*Summary – The supply of a child's car seat as part of a car rental agreement was found to be a separate supply with VAT chargeable at 5%.*

Europcar hires cars to customers and, as an optional 'Extra', a customer can hire a child's car seat at the same time as renting the car. Throughout the booking process, and on customer invoices hire of the car and hire of the car seat are separately itemised and priced; customers need to know what they were being charged for and expected to see both car and car seat charges on the invoice.

The daily rate for car hire was about £18; the daily rate for hire of a car seat was about £11, up to maximum of about £110. Of those customers who were traveling with children needing a car seat, a large majority (about 75%) did not hire a car seat, preferring to use their own.

Car rental is a standard rated supply while the rental of a child's car seat is taxable at the reduced 5% rate. HMRC refused "voluntary disclosure claims" seeking repayment of overpaid output tax during the period 1 October 2008 to 31 December 2015 totalling some £630,000.

The issue to decide was when a car is rented out with a car seat, was this a single supply of a car or separate supplies of a car and a seat?

*Decision*

The First Tier Tribunal stated that clearly, the supplies of car and car seat were linked. Customers wanted to hire a car and, because they were travelling with small children, they needed a car seat to legally transport their child. The question was whether they were so closely linked as to be a single economic supply.

The Tribunal regarded the two supplies as economically distinct. Car seat customers go through a booking process that clearly indicates that hiring a car seat is an optional extra for which an additional, not insignificant, fee had to be paid. At each stage, the costs of car hire and car seat hire were separately set out, supporting a finding of independent supplies.

Car seat customers also had a genuine choice as to whether to hire a car seat or not, as they had a practical and realistic alternative of supplying their own car seat. When hiring a car seat, customers made an economic decision to pay for the convenience of not having to travel to the car-hire location with their own car seat.

The supplies should be regarded as distinct and independent because the car hire and car seat hire were, from the customers' perspective, not so closely linked that they formed a single, indivisible economic supply that it would be artificial to split.

*Europcar Group UK v HMRC (TC07733)*

## Essay writing services (Lecture B1211 – 20.56 minutes)

*Summary – The Company was supplying essay writing services to customers as principal, rather than acting as the agent of the writers.*

All Answers Limited operates an internet-based business where customers order academic work such as essays, dissertations or pieces of coursework in return for a fee. The company uses, but does not employ, writers and shares the fee paid by the customer with the writer, with All Answers Limited typically retaining two thirds of that fee. The writers are teachers, lecturers and PhD students. At no point is the writer's identity made available to the customer or vice versa.

HMRC argued that All Answers Limited had made a single standard-rated supply of the academic work to a customer and so should account for VAT on the full fee paid by the customer. The amount paid to the writer was a separate supply.

All Answers Limited argued that it was acting as the writer's agent in relation to the supply of the academic work. Output VAT was accountable on the two thirds of the fee that belonged to them for their commission element. The supply of the academic work was made by the writer to the customer and so the company was not obliged to account for VAT in respect of that supply.

The First Tier Tribunal disliked the company's business, describing it as thriving "upon providing essays, dissertations and coursework to cheats". The Tribunal found in HMRC's favour stating that when they stood back and considered the commercial and economic picture there was only one supply to the client and that that supply was made by All Answers Limited.

The company appealed to the Upper Tribunal.

*Decision*

The Upper Tribunal concluded that there was a legal relationship between All Answers Limited and a customer under which All Answers Limited, and only All Answers Limited, assumed liability for the obligation to provide academic papers. In return for All Answers Limited assuming such liability, a customer paid All Answers Limited a sum of money. The terms of that legal relationship were consistent with the commercial and economic reality of what happened. The supply of the academic work was made by All Answers Limited to a customer and so VAT was accountable on the full fee paid. It followed that, when All Answers Limited paid over the writer's share of that fee, All Answers Limited was paying consideration to the writer for a separate supply made by the writer to All Answers Limited, consisting of the service of preparing that academic work.

The appeal was dismissed.

*All Answers Limited v HMRC [2020] UKUT 0236 (TCC)*

## Career coaching for international students (Lecture B1211 – 20.56 minutes)

*Summary - Career coaching services provided to Chinese students studying in the UK were consulting services rather than educational supplies. The supplies were standard rated until July 2016, from which date they became outside the scope of VAT.*

Mandarin Consulting Limited provides career coaching to help Chinese students gain job and internship opportunities in major international organisations. Prior to July 2016, Mandarin Consulting Limited had contracted with the students but from that date, the company began contracting with their parents.

There were two key issues to decide in this case.

1. Were the supplies being made consultancy services or should they be treated as educational activities?

2. If the services were consultancy services, where was the place of supply as this determined the VAT treatment?

Mandarin Consulting Limited argued that their supplies were consultancy services and that those supplies were outside the scope of UK VAT as the recipients of the supplies did not have their usual residence in the UK. Their principal argument was that the supplies were made to the student's parents on the basis that they paid for the services and so were the "economic" purchaser of the services. If it was found that the supplies were made to the student candidates, the company argued that these too were usually resident outside the UK; the candidates were in the UK only for the temporary purpose of education. Thus, regardless of whether the recipients of the services were the candidates or the parents, Mandarin Consulting Limited argued that the supplies were outside the scope of VAT.

HMRC raised two VAT assessments for the under-declaration of output tax of £800,000 between the VAT periods of 03/16 to 06/17 and of just over £600,000 in the VAT periods 12/13 to 12/15. The company appealed

*Decision*

The candidates (or from July 2016, their parents) sought specialist advice from the company on job applications and interviews. These were not educational activities but rather they were consulting services. There was no set curriculum or course of study and no institutional framework within which the company's coaching was supplied. Instead, the coaching supplied to each candidate was tailor-made to suit the requirements of the individual candidate. The Tribunal concluded that the company supplied consulting services and not educational activities.

For consulting services, the place of supply is where the customer belongs. The Tribunal stated that the contractual arrangements, although not conclusive, should be the starting point and would be conclusive in deciding the place of supply unless the contractual arrangements were inconsistent with the underlying economic and commercial realities of the arrangements.

From July 2016, the company entered into contracts with the parents to coach their children. The Tribunal stated that from this time, the parents had a direct contractual right to require the company to deliver what was promised under these contracts. There was no doubt that the parents were outside the UK, and so the services provided to them were outside the scope of VAT.

Prior to July 2016, the services were supplied to the candidates through a contract with the candidates but the cost was usually borne by their parents. The Tribunal concluded that the company supplied its services directly to the candidates and not to the parents. The Tribunal stated that usual residence does not include temporary residence for a specific and definite period of time, such as attendance at a university degree course. Of far more relevance was where was a person's occupational and personal ties. Although there could have been an argument that the candidate's usual place of residence was outside the UK, the Tribunal observed that the company had no system for checking or verifying their usual place of residence. In fact the company was unaware of the importance of asking for that information in the first place. The First Tier Tribunal found that Mandarin Consulting Limited had failed to obtain sufficient evidence to show that the candidates' usual place of residence was outside the UK. The place of supply for services provided prior to July 2016 was therefore the UK, making them standard-rated up to this date.

*Mandarin Consulting Limited v HMRC (TC07714)*

## No need to register (Lecture B1211 – 20.56 minutes)

*Summary – Based on new evidence and extrapolating figures in a more logical way, the taxpayer proved that she had not exceeded the VAT registration threshold.*

Mrs Nguyen runs a nail bar. Following a number of unannounced visits by HMRC and a period of self-invigilation for a week in which Mrs Nguyen was asked to record the takings from each customer, HMRC concluded that her takings had been suppressed by 50%. HMRC issued an assessment for £90,979 in respect of the period 2012/13 to 2016/17. They stated that they believed that her business should have been registered since January 2013.

Mrs Nguyen appealed, disputing HMRC's takings figures and argued that she was below the VAT registration threshold. At the hearing, she produced new evidence, including CCTV recordings taken since the start of 2019, showing the number of clients and how long each treatment typically took. Further, there were letters from clients supporting treatment times and cost as well as banking records and till summaries since April 2018. The hearing was postponed so that HMRC could review the new evidence.

*Decision*

As the business was still being run on the same basis, the First Tier Tribunal accepted the new evidence, despite the fact that it related to a period falling outside the assessment period.

The First Tier Tribunal concluded that on average there were ten customers a day over a six-day week and that each customer spent about £25. In total that gave projected takings of around £76,500. In 2013, the VAT registration threshold was £77,000, (higher in later years) The First Tier Tribunal concluded that the nail bar business had always traded below the registration threshold and the appeal was allowed.

*Ly Nguyen v HMRC (TC07705)*

## Release of option to buy land

*Summary –Item 1 Group 1 Schedule 9 VATA 1994 applied to equitable interests in land and covered both the creation and surrender of an option to buy land making both exempt.*

On 20th March 2015, Landlinx Estates Limited was granted an option to buy Loxwood Nurseries in West Sussex within a two-year period, provided planning permission was granted. As the seller had never opted to tax the property, the land was exempt from VAT.

A few months after planning permission was granted, the parties agreed to cancel the obligations between them and on 22 December 2016, Landlinx Estates Limited received £1,425,000 from the landowner, releasing the landowner from the option.

In early 2017, when Landlinx Estates Limited submitted its VAT return for the VAT period to 12/16, the company did not include the £1.425,000. HMRC's published guidance (VAT Notice 742 and at VATLP20000) states that the grant, assignment or surrender of an interest in, right over or licence to occupy land is normally exempt from VAT. Section 7.4 of Notice 742 confirms that an option to purchase or sell an interest in land amounts to a supply of an interest in land for these purposes. Following this guidance, Landlinx Estates Limited considered the surrender of the option to be an exempt supply of an equitable interest in land and so did not include it on the VAT Return.

HMRC enquired into the company's Return and later issued an assessment for £237,500 on the basis that the company had made a taxable supply of £1,425,000. HMRC argued their guidance was wrong and that the money related to taxable income.

HMRC argued that Article 135(1)(j) of the VAT Directive applied to goods only. The grant of an option under English land law gives rise to an equitable interest in land, but did not give the option holder the right to dispose of the goods (property) as owner. That right lay with the owner of the land, the seller.

Landlinx Estates Limited appealed.

*Decision*

The First Tier Tribunal disagreed with HMRC, deciding that the exemption under Article 135(1)(j) of the VAT Directive was not limited to the supply of goods. Article 135(1)(j) applies equally to the supply of the major interest in land as well as the rights given by options over such land and buildings.

The Tribunal confirmed that Group 1, Schedule 9, VATA 1994, that implements Article 135(1)(j) of the VAT Directive, exempts the supply of land and buildings. The Tribunal confirmed that UK law exempts "the grant of any interest in or right over land" with the notes stating that grant includes an assignment or surrender.

The First Tier Tribunal held that the surrender of an option over land was, an exempt supply and the appeal was allowed.

*Landlinx Estates Limited v HMRC (TC07706)*

## Houseboat – building or boat? (Lecture B1211 – 20.56 minutes)

*Summary – Prohibition in the planning permission meant that the construction of a houseboat was not the 'construction of a building designed as a dwelling' and the DIY refund scheme did not apply.*

On 30 May 1990, Edward Burrell obtained planning permission and then built his houseboat on a piece of land by creating a steel structure on rails. A concrete foundation was laid onto the steel structure for stability and a crane used to lift the structure before placing it on water, where it remained.

On completion, Edward Burrell submitted a claim for a VAT refund under the DIY Housebuilders Scheme. He argued that the houseboat was designed as a dwelling and was not being used, and could not be used for any other purpose. His home was never a vessel and at no stage could it have been used as a vessel. It had always looked like a dwelling. It consisted of self-contained living accommodation. Note 16, Group 5 of Schedule 8 did not apply as the works did not include the conversion, reconstruction or alteration of an existing building, or the enlargement of or extension to an existing building, or the construction of an annexe. In summary, it was a home with a concrete foundation base.

HMRC disagreed arguing that the construction of the houseboat was not the construction of a building as required under s.35(1A) (a) VATA 1994. Further, the planning consent that was granted related to the creation of a mooring and an email from the planning officer confirmed that no permanent structures or buildings on the land were permitted.

Edward Burrell appealed

Decision

The Tribunal found that the planning permission could not be interpreted to mean planning permission to construct a building. The permission made reference to the construction of a boat but also stated that 'No permanent structures or buildings placed on the land are permitted.'

The final nail in the coffin for Edward Burrell came in the Post-Construction Inspection Report when the marine surveyor used the words 'vessel' and 'awaiting launch' to describe the structure as follows:

> *A purpose built static houseboat with steel hull and timber superstructure.*
>
> *For stability purposes the vessel has been ballasted with 6.5 tons mass poured concrete.*
>
> *The vessel was build [sic] ashore on a slip way and is now awaiting launch"*

These words did not imply a permanent structure such as a building.

The construction of a houseboat did not meet the 'construction of a building designed as a dwelling' test and so did not qualify for the DIY Housebuilders scheme.

The appeal was dismissed.

*Edward Burrell v HMRC TC07766*

## COVID-19: VAT challenges for retailers (Lecture B1215 – 15.39 minutes)

*Background*

There is no doubt that drastic measures will be carried out by many High Street retailers faced with unenviable trading challenges following the coronavirus crisis. Small-scale changes will probably not be enough. This session therefore considers some VAT issues that could be relevant in the future retail world.

*Shop-in-shop arrangements*

Imagine a clothes shop where the owner has decided to sublet some space to another business, what is known as a shop-in-shop arrangement. This could be quite common in the future, with retailers seeking regular rental income to help with their own fixed costs, including repayments on emergency bank loans taken out during the lockdown period.

There are two VAT challenges with these arrangements:

1. The liability of the rental income;

2. The way that the output tax will be declared on the sales of the second business, the concessionaire.

*Is there a land supply?*

For the rental income, the key issue is whether the space used by the concessionaire will be a clearly defined area of land in the shop that will be used exclusively for its own purposes. There will be a formal rental agreement in place. If the answer is 'yes', as would seem likely, the rent will be exempt from VAT as a licence to occupy land (HMRC Notice 742, para 2.6). If the space is allocated on an ad-hoc basis, with no fixed area, the supply will be standard rated on the basis that the main retailer is giving the concessionaire the 'right to trade' from the shop.

*Partial exemption*

The proposed shop-in-shop arrangement means that retailers receiving rent will be partially exempt. They will need to carry out calculations each VAT quarter and restrict their tax. This outcome could be avoided if the retailer opts to tax the building with HMRC and charges VAT on the future rental income received i.e. no exempt income. But is this wise?

*Option to tax*

A landlord or property owner should only ever opt to tax their interest in a building if there is a big input tax incentive for doing so. In other words, a landlord is buying a commercial property to rent out, and will either be charged a big amount of VAT when he buys the building, or if he carries out major improvement or repair works. This input tax would be blocked in the absence of an option to tax election because the costs will directly relate to exempt rental supplies. In a shop-in-shop situation, there is no major input tax incentive for opting to tax; the retailer's reason for opting would be to avoid the headaches given by partial exemption; that is not usually a strong enough argument.

There are two other possible reasons why retailers should not opt to tax their buildings:

1. 20-year rule - once made, an election with HMRC remains in place for 20 years before it can be revoked, and it applies to all income earned from a building, including the future sale. Future buyers or tenants might be running a VAT exempt business that cannot claim input tax e.g. an insurance broker, dentist or financial adviser;

2. De minimis limits – there is a good chance that many retailers will be de minimis as far as partial exemption is concerned and still be able to claim input tax on all of their costs. VAT Notice 706, section 11.

*Shop-in-shop takings*

In many cases, the main trading business in a shop-in-shop arrangement will deal with the sales and takings of the concessionaire. This means that the concessionaire does not need a till and cashier on the premises, which might not be practical.

The priority is to be clear whether the concessionaire is making sales of goods to the final customers or whether the commercial reality is that they are selling goods to the main retailer, and the retailer claims input tax and accounts for output tax on the sales. The concessionaire might give the retailer a discount on the selling price as a reward for collecting the cash.

Helpful and well-written guidance on this dilemma is given in HMRC's retailer manual - see HMRC's policy on shop-in-shop arrangements. In reality, officers are unlikely to get too excited about which accounting method is adopted because they are still getting output tax on the sales.

*HMRC's policy on shop-in-shop arrangements: Extract from Retailer Manual: VRS8150*

After examining various contracts, HMRC now accepts that some agreements are constructed so that the host store is the principal as far as the retail sale is concerned. In such cases, the host store will be accountable for the output tax due on the retail supply to shoppers, and the concessionaire will effectively be making wholesale supplies to the host store. Such supplies cannot be accounted for within the concessionaire's retail scheme.

*Online trading to increase*

A question that is likely to be very common with many retailers post Covid-19 is as follows:

> "I expect my shop turnover to fall by 20% but I intend to replace this business with online sales. What VAT issues does this create? I'm going to use a computer specialist in India to deal with my website."

The Internet has made the world smaller – it is likely that some goods will be sold to customers outside the UK. Here is a summary of five important VAT issues:

- Advance payments – it is likely that customers will pay for online orders in advance of the goods being delivered – this creates a tax point for VAT purposes;

- Zero-rated sales – retailers will need to ensure that zero-rated sales are properly identified, so that no output tax is paid on these sales e.g. children's clothes for a clothes retailer, exports outside the EU;

- Returned goods and refunds – retailers must ensure that output tax is reduced for any goods returned by customers where the customer gets a refund. This requires strong accounting controls and clear policies;

- Audit trail – it would make sense for retailers to record a separate daily gross takings (DGT) figure for the online sales, separate to the till used in their trading shops. Retailers do need to issue tax invoices to their customers unless they request one. VAT Notice 700, para 16.2.1;

- Making Tax Digital – retailers might end up with more than one DGT figure for each day's trading. The two totals must form part of their digital accounting records but there is no need for each individual sale to be part of the record. VAT Notice 700/22, para 4.5.

*Reverse charge*

Imagine if retailers use the services of an overseas website designer to help with their online sales e.g. an Indian supplier. This outcome means that retailers are buying VATable services from abroad and will need to do a reverse charge calculation on each VAT return. However, this will not produce any extra VAT bill: the output tax declared in Box 1 (based on payments made) will equal the input tax claimed in Box 4 because the expense wholly relates to taxable sales.

*Residential dwelling* - Example

A ground floor clothes shop owned by Rita consists of a separate first floor area that is used to store stock. Due to modern just-in-time buying policies and increased online sales, the first floor is surplus to requirements and Rita has decided to seek planning permission to convert it into an apartment that she will either sell or rent out. There are potential VAT wins with both options:

Zero-rated sale – if she sells the apartment on either a freehold basis or with a lease exceeding 21 years (20 years in Scotland), the sale will be zero-rated for VAT purposes. This would still be the case even if she opted to tax the building because an option is overridden in the case of residential property. The zero-rating would apply on the basis that it is a residential conversion. VAT Notice 708, section 5. She can therefore claim input tax on all of the project costs because they will relate to an intended taxable sale. The apartment must meet all of the conditions of a dwelling as per para 14.2 of the same notice.

Exempt rental income – if her plan is to rent out the apartment, input tax will be blocked under partial exemption. However, potential good news is that the services of builders converting a non-residential building into a dwelling will be subject to 5% VAT. This reduced rate also applies to materials supplied by builders as part of their work. But the services of professionals are always standard rated, e.g. architects, surveyors, and estate agents.

*Payback and clawback rules*

A potential pitfall is that if Rita changes her mind about the use of the apartment when completed, the input tax previously claimed or not claimed will be subject to the payback and clawback rules. For example, if she planned to sell the apartment but then encountered a post Covid-19 property downturn, she would need to repay all of the input tax claimed in the previous six years if she decided to rent it out instead. However, if the rental intention is temporary, there is an important input tax concession that was first introduced during the financial crisis back in 2009. The concession looks at a property over a ten-year life, so an intention to rent for, say, two years and then sell means that 20% of the input tax relates to exempt supplies rather than 100%. In many cases, the property owner will be de minimis again for partial exemption purposes, a perfect outcome. See VAT Notice 706, para 13.12.

*Conclusion*

The session has considered the VAT consequences of some radical measures that might be carried out by retailers in the post COVID-19 trading world. The challenge is to consider the output tax and input tax issues of each separate measure to hopefully arrive at the correct VAT outcome.

*Contributed by Neil Warren*