Tolley®CPD

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CONTENTS

Personal tax

Director's neglect led to NIC bill (Lecture P1331 – 19.26 minutes)

Summary – HMRC demonstrated that the company's failing to pay NICs was attributable to the taxpayer's neglect. As the sole director during the relevant period, it was appropriate for the full amount payable to be collected through the Personal Liability Notice issued by HMRC.

During 2015 and 2016, David Howick became a director of several companies and by 2018 all of the companies were either in administration or being wound up. SP Surface Finishers Limited was one of these companies. It went into liquidation owing HMRC some £63,000 in National Insurance Contributions. As the sole director at the time, HMRC issued David Howick with a Personal Liability Notice to recover NICs due.

David Howick appealed to the First Tier Tribunal arguing that the company's failures to pay the sums due were due to his past ill health, a car accident and a lack of experience and commercial acumen.

Decision

HMRC needed to prove that:

- David Howick was an officer of the company at the relevant time;
- the NICs were not paid;
- the non-payment was due to David Howick's negligence.

The First Tier Tribunal found that David Howick had become sole director of SP Surface Finishers Limited, following the illness of its other director. It was from this point in time that payments to HMRC ceased. Management reports had made it clear to David Howick that no PAYE or NICs was being paid each month.

The First Tier Tribunal found that:

- his past ill health and a car accident had occurred well before him accepting his directorship;
- he had a history of business failures; and
- lack of funds was not a reason to allow an appeal against a Personal Liability Notice. Despite existing debt factoring facilities being available to help with cash flow issues, he chose not to use them.

The First Tier Tribunal found that David Howick's conduct had not been something that a reasonable and prudent man would do. The failure to pay HMRC was attributable to David Howick's negligence.

The appeal was dismissed.

David Howick v HMRC (TC08531)

Clawback of CJRS payments (Lecture P1331 – 19.26 minutes)

Summary – CJRS claims for two workers were invalid as the employees were added to payroll after the qualifying date.

Carlick Contract Furniture Limited manufactured and supplied contract furniture to major high street pub, bar and restaurant groups.

The first full COVID lockdown was announced on 23 March 2020, with the hospitality sector closing down. The company was severely affected, being forced to close completely for two months, with all staff except the executive management team being furloughed. In order to survive, the company was forced to make 70 redundancies in two phases in June and October 2020.

The company normally runs its payroll on the 26th of each month, with cut-off three working days before that date. In February 2020 this date was Friday 21 February 2020.

Amanda Coleman and Andrew Boales were recruited by employment offer letters dated 18 and 19 February 2020 respectively, with the employment to commence on Monday 24 February 2020. This meant that they could not be included in the February payroll and so were first included on the 26 March 2020 payroll. The real time information submitted to HMRC in respect of this payment was actually included in a return made on 25 March 2020.

The company claimed CJRS for both from its commencement on 1 April 2020 until they were both made redundant on 23 October 2020.

HMRC assessed the company to repay the money as the employees had not been included in an RTI return made on, or before, 19 March 2020, a requirement for the claims to be valid. HMRC referred to a Press Release dated 15 April 2020 stating that the employees must be both be employed by 19 March 2020 and must have also been notified to HMRC through RTI submission by that date.

The company appealed, stating that it had done its best to keep up with rapidly changing guidance and had acted reasonably in the spirit of how the scheme was intended to work.

Decision

The First tier Tribunal was sympathetic to the company's position but had no jurisdiction to make a decision other than within the letter of the law. The Tribunal was bound by the law, with no powers to determine whether an outcome was fair or not

The appeal was dismissed.

Carlick Contract Furniture Limited v HMRC (TC08543)

Applying the tax residence test (Lecture P1331 – 19.26 minutes)

Summary – The taxpayer was UK resident for tax purposes in 2012/2013 as after ceasing full-time work overseas, he retained links to the UK under the pre-statutory residence test rules. As a result, he was UK resident under the statutory residence test in 2014/15.

Ernest Batten argued that he left the UK on 21 March 2010 to live and work in Gibraltar, ceasing to be UK resident as his relocation gave rise to a distinct break in the pattern of his life. He argued that he did not resume UK residence until 2015/16.

HMRC raised income tax and capital gains tax assessments for 2014/2015 on the basis that he was UK resident in that year. Under the statutory residence test (Schedule 45 FA 2013), his residence position for 2014/15 depended upon whether or not he was resident for the preceding three tax years.

It was common ground that he had two ties:

1. A family tie because his wife lived in the UK; and

2. An accommodation tie because he had a home available to him in the UK and he spent at least one night there.

HMRC accepted that Ernest Batten was not UK resident for the tax years 2010/11 and 2011/12 because he was working full-time overseas. Further, HMRC accepted that in 2013/14 Ernest Batten was non-resident because he only spent 87 days in the UK and as a result the number of ties required for UK residence exceeded his two ties. (Under paragraph 18 three ties were required and under paragraph 19 four ties were required.)

The issue to decide was where he was resident for 2012/13. It was agreed that his tax residence in that year depended upon the application of the pre-statutory residence test common law rules.

Decision

The First Tier Tribunal were satisfied that HMRC made the discovery that Ernest Batten was no longer employed full-time overseas. None of Mr Batten's returns had given any indication that his foreign employment had ceased in June 2012. In fact, his tax return for 2012/13 stated that he was still employed full-time overseas.

The First Tier Tribunal found that Ernest Batten made a distinct break from the UK in 2010/11 and as a result became non-UK resident in that year. Although Ernest Batten maintained numerous links to the UK, the First Tier Tribunal considered that the relocation to Gibraltar taken together with the circumstances of his new employment there, looking for opportunities to expand the care home business, gives rise to the necessary degree of change in the pattern of his life in the UK for a cessation of his settled or usual abode in the UK to have taken place.

However, from 2012/13 his employment in Gibraltar ceased and during that year he returned to the UK for 84 days, staying at the UK family home.

The First Tier Tribunal concluded that he was UK tax resident in 2012/13 stating that:

> "When the multifactorial enquiry no longer takes into account full-time employment overseas and account is taken of the available accommodation …, we consider that the result is that Mr Batten was UK tax resident. We consider that the distinct break came to an end in 2012/13."

At this time, he no longer intended to make Gibraltar his home. Although he spent the summer in Gibraltar, he spent the winter months away from Gibraltar. As the years passed, he returned more frequently to the UK and made a number of trips on Eurostar leaving London around 10.30 at night, arriving in Calais at midnight French Time (11:00 in the UK) and then returning to the UK on the train at 1.45 am. The First Tier Tribunal believed that this was to reduce his midnight count in the UK.

Under the rules preceding the statutory residence test, when the distinct break with the UK came to an end, Ernest Batten was UK resident in 2012/13. As a result, he was also resident under the statutory residence test in 2014/15. The income tax and CGT assessments were valid.

Interestingly, the First Tier Tribunal commented that it recognised that the application of the statutory residence test to 2012/13 would have produced a different result. However, the Tribunal went on to state that those rules were not applicable in that year and there was no basis on which the Tribunal could apply the statutory residence test retrospectively.

Ernest Batten v HMRC (TC08524)

Property incorporations (Lecture B1332/ B1333 – 15.42/14.43 minutes)

Interest relief

It is clear that interest rates are increasing and may increase significantly more in the future. This leads to some interesting discussions between property landlords and their advisors. Those conversations may lead to the thoughts, again, of incorporation. Let's consider the potential problem and what the impact might be. Are we panicking too soon?

What is the problem?

Since 6 April 2017, there has been a restriction on the deduction of finance costs from a 'dwelling related loan' on let residential properties. Instead there is a tax reduction for such costs at the basic rate of income tax.

It does not impact commercial property landlords and does not apply to companies with residential letting businesses unless they are acting in a fiduciary or representative capacity. It also does not apply to loans to purchase furnished holiday accommodation. This was phased in over a number of years and is now fully operational.

The basic mechanism is that you do not get a deduction for any interest costs in computing the profits of your property business. Instead, a 'tax reducer' (basically a tax credit) at a rate of 20% of the allowable interest, is applied in the tax computation. There is a further potential restriction since the 20% can only be applied to a maximum of the rental profits for the year, so that if you have losses being utilised to reduce those profits, then the relief is restricted. It can also be restricted to the adjusted total income of the year excluding savings and dividend income. To make this even more complicated, each property rental business (not property, but each business where someone is holding property in a different capacity) is considered separately. Any interest which is not utilised in calculating the reducer is carried forward and can be used in subsequent years but many businesses are carrying forward large amounts due to historical losses.

But what might the impact be of an increase in the interest rate?

Let's consider an individual who has property worth £1m which has £650,000 of borrowing. That property generates £4,000 per month and the other expenses are around £500 per year. The individual has been lucky to obtain a fixed mortgage rate of 2.29% and is paying £1,240.42 per month in interest on the borrowing. This interest amount will remain fixed even if the person is repaying capital also, although funding the capital repayments will be an issue which also has to be considered.

The tax calculation is as follows:

	BR taxpayer	HR taxpayer	AR taxpayer
Income	£48,000	£48,000	£48,000
Expenses	£500	£500	£500
Net profit	£47,500	£47,500	£47,500
Tax on profit	£9,500	£19,000	£21,375
Less tax reducer: (1,240.42 x 12) x 20%	£2,977	£2,977	£2,977
Net tax liability	£6,523	£16,023	£18,398
Net income after interest and tax	£26,092	£16,592	£14,217
Net income if interest deductible	£26,092	£19,569	£17,938

The capital repayments on this loan over, say, 20 years would be an additional £2,137.84 per month, giving a total of £25,654 per year. This would leave a deficit unless you were a basic rate taxpayer, but in reality, the same is true even if you had a deduction for the interest. It is appreciated that many landlords have interest free mortgages.

What if the interest rate increased to 7%? The interest payable each month would then increase to £3,791.67. The table then looks like this:

	BR taxpayer	HR taxpayer	AR taxpayer
Income	£48,000	£48,000	£48,000
Expenses	£500	£500	£500
Net profit	£47,500	£47,500	£47,500
Tax on profit	£9,500	£19,000	£21,375
Less tax reducer (3,792.67 x 12) x 20%	£9,102	£9,102	£9,102
Net tax liability	£398	£9,898	£12,273
Net income after interest and tax	£1,599	(£7,910)	(£10,285)
Net income if interest deductible	£1,599	£1,193	£1,093

Both higher rate and additional rate taxpayers who would not be generating enough income to pay the interest and the tax, it is clear to see that the net income for even a basic rate taxpayer is going to be significantly reduced (although it is important to note that the income for such a landlord would have been significantly diminished even if the 'old' rules had not changed). There would clearly be no capacity for repayment of capital.

Any landlord who is coming up to the end of a fixed rate term, there are still some deals around 2.5% but the standard variable rate is now around 6% on buy-to-let mortgages (at the time of writing). So further increases in the base rate are going to see problems for landlords.

What about incorporating?

Incorporation is a disposal for CGT purposes and a land transaction for stamp tax purposes. Broadly the same provisions apply for SDLT, LBTT and LTT.

Many lenders may use this as an opportunity to charge higher interest rates for the company so it is not necessarily going to become more economically viable simply by incorporating.

It should be noted that the restriction on interest relief cannot be circumvented by putting in place a licence for a company to exploit the property on behalf of the owner. The author has seen schemes where accountants are claiming that such a licence does not give rise to property income and therefore no interest restriction applies. This is not correct.

Capital Gains Tax

All the properties will be transferred to the company at current market value which will create a capital gain in many cases. This gain could be set against the value of the shares if incorporation relief is available under s.162 TCGA 1992.

If the consideration given by the newly incorporated company is not wholly satisfied by the issue of shares, there will be a pro-rata restriction of the s.162 relief. The assumption of bank debt is not regarded as consideration – HMRC accept that bank debts were business liabilities and hence covered by ESC D32.

The 2013 Upper Tribunal decision in Ramsey provides good authority for treating a substantive property letting activity as a business for s.162 purposes. In Ramsey, the Upper Tribunal ruled that activities ordinarily associated with managing an investment property portfolio can be regarded as a business.

In order to be treated as a business undertaking for s.162 purposes the activities must:

- represent a seriously pursued undertaking;
- be conducted on sound and recognised business principles; and
- be of a kind that are commonly made by those that seek to profit from them.

Furthermore, the activities must have a degree of substance with a reasonable amount of time being spent on property related activities. Mr and Mrs Ramsey owned a residential block with 10 flats. They spent about 20 hours a week attending to the building, making sure the rent was paid on time, cleaning communal areas, forwarding post to tenants who had left, and ensuring the property was insured and complied with fire regulations. This level of

activity convinced the Upper Tribunal that Mr and Mrs Ramsey had a property business for the purposes of s.162.

It would be reasonable to assume that a property portfolio of one or two properties with minimal management time will not satisfy the test.

On the other hand, if a client has lots of properties and spends in excess of 20 hours a week managing their property business, they should have no problems securing s.162 relief. It should be noted that the key factor is time spent rather than number of properties. I would also argue that the time spent could be undertaken by a property manager but HMRC may take a different view. This latter point has not been tested in the Courts.

SDLT (and LBTT and LTT)

S.53 FA 2003 imposes an SDLT charge on the market value of property where it is transferred to a company and the seller is connected to the company or some or all of the consideration consists of the transfer of shares in a company with which the seller is connected. Although these notes refer to SDLT, equivalent provisions apply for LBTT and LTT purposes.

The connection test in s.1122 CTA 2010 applies for s.53 purposes.

Under s.1122 CTA 2012 the following persons are treated as connected with you:

- your husband, wife or civil partner.
- your brother, sister, ancestor or lineal descendant ("relatives") and their husbands, wives or civil partners. Relatives do not include nephews, nieces, uncles and aunts.
- your husband's wife's or civil partner's relatives and their husband's wives or civil partners.
- if you are in business in a partnership, your partners and their husbands, wives, civil partners and relatives. Business partners will not be connected in relation to acquisitions or disposals of assets of the partnership pursuant to genuine commercial arrangements.
- a company that you control, either by yourself or with any of the persons listed above.
- the trustees of a settlement of which you are a settlor, or which a person who is still alive and who is connected with you is a settlor.

An incorporation of a property portfolio will undoubtedly fall under s.53. However, where the transfer is under the partnership SDLT legislation, HMRC accept that the partnership "sum of lower proportion" rules take precedence over s.53. Depending on the facts this can result in the consideration being regarded as £nil and as a consequence no SDLT is due on incorporation (FA 2003, Schedule 15, Para 18 – 20).

Schedule 15, Para 18(2) will apply where a chargeable interest is transferred from a:

- partnership to a person who is or has been one of the partners, or

- partnership to a person connected with a person who is or has been one of the partners.

Para 18(2) states that the chargeable consideration shall be taken to be equal to:

MV x (100 – SLP)%

SLP (which is an abbreviation of the sum of the lower proportions) is calculated using the following steps.

Step 1: First you need to identify the relevant owner or owners. A person is a relevant owner if immediately after the transaction he is entitled to a proportion of the chargeable interest and immediately before the transaction he was a partner or connected with a partner.

Step 2: For each relevant owner, you need to identify the corresponding partner or partners. A person is a corresponding partner to a relevant owner if immediately before the transaction he was a partner and he was either the relevant owner or was connected with the relevant owner.

Step 3: For each relevant owner, you then need to find the proportion of the chargeable interest to which he is entitled immediately after the transaction and this is apportioned between any one or more of the relevant owner's corresponding partners.

Step 4: The next stage is to find the lower proportion for each person who is a corresponding partner in relation to one or more relevant owner. The lower proportion is the lower of the:

- proportion of the chargeable interest attributable to the partner (i.e. the sum of all interests allocated to him under Step 3) or

- partnership share attributable to the partner (see below).

Step 5: The final stage is to add together the lower proportions of each person who is a corresponding partner in relation to one or more relevant owners. This is the SLP.

It must be remembered that the legislation determines the partnership shares by reference to income shares and not capital shares; so the same formula applies even where the land is held within the partnership by one or more partners in isolation to the others.

What this broadly means is that if your property partnership is family owned, it is likely that no SDLT will arise on incorporation although it is important to remember that nephew/nieces are not connected to aunts/uncles so extended families may not fall within the same provisions. Remember that unmarried couples are not connected.

Examples:

Partnership of husband and wife with the transfer to a company which they jointly own. SLP will be 100 because both of them are connected with the company. It would not matter what proportion they held the partnership or the company shares as there is attribution of rights of associates to determine control.

Partnership of John and Nikki who are not connected (the normal rules which say that partners are connected is disapplied for these purposes). They own the partnership 75:25 and transfer to company which they own in same proportion. The SLP will be 75 and so

SDLT on 25% of MV. This is because Nikki is not connected to company as it is controlled by John.

Partnership?

One very important issue is whether the properties are held in a partnership or simply owned in joint names. To have access to the partnership SDLT rules you must be operating as a partnership and this is a question of fact. Although many advisors have been very relaxed about this point in the past, the case of SC Properties Ltd v Anor [2022] TC08537 confirms that joint ownership is not the same as a partnership. This was not a classic incorporation case but does show that this is not an area for complacency. This case is discussed in detail in the Capital Taxes section of these notes.

Key issues to consider would be as follows:

- Is there a written partnership agreement?
- Have the partners actually been carrying on the business together with a view to profit?
- Has a partnership tax return been submitted to HMRC?
- Is there a partnership bank account?
- Are the partners held out as partners to the outside world?
- Does the partnership enter rental agreements and raise rental invoices in the name of the partnership?
- Have partnership accounts been prepared?
- Do the partners share profits and losses?
- Have the partners contributed capital to the partnership?
- Is business stationery in the partnership name?

If a partnership does not exist then the s.53 FA 2003 market value rules will apply on incorporation so SDLT is payable on the full market value of the properties.

It is also important to be aware of the SDLT general anti-avoidance rules within s.75A FA 2003 where steps have been taken to deliberately use the partnership rules to obtain an SDLT advantage. This might entail moving a property portfolio into an LLP with a view to incorporating within a short period of time. Where a partnership is not currently in existence, it may well be prudent to move a portfolio into an LLP and then sit tight for a while. In reality, if a partnership is formed, it cannot be incorporated for 3 years because of specific anti-avoidance provisions contained within the SDLT partnership rules but if you were to make that move at 3 years and 1 day, HMRC might also be looking at the application of s75A.

Contributed by Ros Martin

Capital taxes

CGT and inter-spouse transfers – FA 2023 (Lecture P1333 – 14.56 minutes)

All references to "spouses" in these notes should also be taken to include civil partners.

All statutory references are to the Taxation of Chargeable Gains Act (TCGA) 1992 unless stated otherwise.

Introduction

Legislation is being introduced to take effect from 6 April 2023 which will tweak the rules concerning the Capital Gains Tax (CGT) treatment of assets transferred between spouses.

These notes will recap the current situation then outline the proposed amendments.

The changes will only apply for CGT. There are no proposals to change the inter-spouse rules for other taxes.

The current regime

Under s.58 TCGA 1992, transfers of chargeable assets between spouses take place at "no-gain, no-loss" for CGT purposes.

This is different to the disposal being 'exempt' from tax. A disposal has taken place. However the consideration which is treated as passing between the spouses is equal to the CGT base cost of the spouse making the transfer, thereby giving a nil result. The effect of s.58 is that the donee spouse inherits the historic CGT base cost of the donor. The treatment is automatic. There is no opt out.

Any actual consideration paid by one spouse to the other for the transfer of the asset is ignored for CGT. [Although it may trigger a liability to Stamp Duty Land Tax if consideration is given for the transfer of UK land or buildings (for example, on the reassignment of a mortgage).]

Note that the donee spouse is NOT treated as acquiring the asset on the same date that the donor acquired it. We are not stepping back in time. The donee's date of acquisition is the date of the inter-spouse transfer.

This could be important in situations where a relief would only be available if the taxpayer held the asset at a certain date (for example, rebasing relief for non-UK residents disposing of UK land and property). Therefore if an individual (H) bought a UK residential property before 2015 and gifted it to his spouse (W) today, a disposal by W in a later non-resident period would not qualify for April 2015 rebasing as she did not own the property at 5 April 2015. Gains would therefore be calculated by reference to H's historic base cost. Any benefits of rebasing would be lost.

There are a couple of occasions where an inter-spouse transfer is not deemed to take place at no-gain / no-loss.

These are relatively rare and include:

- Death-bed transfers between spouses (these are treated as made on death so the transferee spouse will inherit the asset at probate value instead of historic base cost);

- Where the asset transferred formed part of the trading stock of the donor and / or where the asset transferred becomes trading stock for the donee. Such transfers take place at market value.

The effects of separation

S.58 contains the important proviso that the spouses must be "living together" in the tax year in which the transfer take place. This does not have to be taken literally and s.58 can apply in situations where a married couple are physically living in separate homes.

For example, if one spouse is living abroad (perhaps on a short-term work assignment) while the other spouse remains in the UK, no-gain / no-loss treatment still applies to transfers between them.

"Living together" is instead taken to mean that the marriage has not irreversibly broken down. "Separation" will therefore be the event that starts to take couples out of S.58. The date of separation is a question of fact and is commonly pinpointed to be the date on which one of the spouses leaves the matrimonial home in the expectation that the marriage has irretrievably broken down. The date of separation could, in fact, be earlier than this in cases where the spouse continues to live under the same roof but not as a couple. Practitioners will clearly need to show sensitivity and be guided by their clients in this regard.

Once the date of separation has been established, any transfers up until the 5 April following that date will take place at no-gain / no-loss on the basis that the couple had been living together at some point in that tax year. Therefore one can normally be reasonably relaxed about determining the precise date of separation (we just realistically need to place it in the correct tax year).

The practical problem with the s.58 in its current form is that, in the inevitable disruption which accompanies the breakdown of a marital relationship, thoughts seldom turn to how the couple should best time their asset transfers to take advantage of the no-gain / no-loss rule. The "we need to talk" conversation in these instances is rarely about CGT planning.

Ideally CGT liabilities can be avoided by making transfers before the end of the tax year of separation. However, that planning window can be very short indeed and once it has closed, the market value rule takes over.

The market value rule

Inter-spouse transfers after the end of the tax year of separation are deemed to take place at market value. This is by virtue of the legally married couple still being "connected persons" for CGT purposes.

This will mean that:

- If the market value of the asset exceeds the donor's historic base cost, a chargeable gain will arise. Gift relief might then be available, but only if the asset is a 'business asset' within the definitions laid down in s.165 (unlisted trading company shares and furnished holiday lets being the most common). Note that no holdover relief is available under s.260 as the gift is not immediate chargeable to Inheritance Tax. [In fact, IHT exemption for-inter-spouse gifts continues until the date of divorce.]

- If the market value is less than the donor's CGT base cost, a loss will arise. However that loss is restricted by virtue of s.18(3) such that the loss can only be used against gains on disposals to the same connected person (i.e. the separated spouse) in the same or future tax years. Care must therefore be taken to time disposals such that relief for any losses is not wasted.

Inter-spouse transfers after the date of the divorce (decree absolute) are no longer transfers between connected persons as the legal ending of the marriage breaks this connection. However transfers will still be treated as taking place at market value by virtue of s.17 (which deems any transfer not made at 'arms' length' – i.e. with some gratuitous intent - to be made at market value).

Shifting the statutory authority from s.18 to s.17 is usually immaterial where gains arise. However it does mean that the 'clogged losses' rules no longer apply as these sit in s.18(3). Any losses arising on inter-spouse transfers post-divorce can therefore be used against any gains without restriction.

Proposed changes

Representations have long been made to the Government that the CGT rules for separating spouses should be relaxed to keep the planning window open for longer and give couples more time to make financial decisions.

In a CGT Report in May 2021, the Office of Tax Simplification (OTS) commented that "it is unrealistic to expect separating couples to have resolved their affairs by the end of the tax year of their separation".

Finance Bill 2023 therefore proposes to make certain 'tweaks' to the inter-spouse transfer rules which will affect inter-spouse disposals made on or after 6 April 2023.

S.58 will be amended so as to allow no-gain / no loss treatment to continue until the earlier of:

- The 5 April following the third anniversary of the date on which the couple separate; and

- The date on which the couple divorce (or the date on which the marriage or civil partnership is dissolved or annulled).

This means that if a couple separate on (say) 16 August 2022, any inter-spouse transfers made between 16 August 2022 and 5 April 2026 will take place at no-gain / no-loss (assuming there is no divorce in the meantime).

If the couple were to divorce before 5 April 2026, any transfers after the date of the divorce would not be covered by this three year 'extension' and would instead take place at market value as they do currently.

These new rules will apply for disposals on or after 6 April 2023. The separation does not need to take place on or after 6 April 2023 for the new rules to apply.

The new rules will not affect couples who separate in 2022/23. No-gain / no-loss treatment will continue to be available for the whole of 2022/23 under the current s.58. The new rules will apply thereafter.

However, couples who separated before 6 April 2022 and did not transfer their assets before the end of the tax year of their separation, will now need to wait until 6 April 2023 to make any tax-free transfers (as the market value rule will apply in 2022/23). Whether it is practical or desirable for them to wait a further year or so to make any transfers depends on their personal situation. But conversations will need to be had.

According to HMRC, the proposed FA 2023 changes are intended to make the CGT rules fairer in circumstances when spouses are in the process of separating as it will give them more time to transfer assets between them without incurring CGT charges. This logic is irrefutable.

But whether this does indeed make this "fairer" depends on one's perspective. The changes will certainly be beneficial for the donor as he/she will have more opportunity to transfer assets to their estranged spouse without a CGT charge.

However, the flip-side to this is that the recipient donee will then be picking up assets at the donor's historic CGT base cost as opposed to obtaining a base cost uplift to market value as might have been the case before April 2023. One person's capital gain is another's base cost hike. Donees will therefore be taking on more of the donor's inherent gains than they did before. These gains are not going away. They are just being transferred along with the asset. If you are representing the recipient spouse in this situation, whether or not the donor spouse has a chargeable gain may not necessarily be your concern.

Looking at the bigger picture, the proposals will, as HMRC say, "avoid further depletion of household income or existing accumulated household wealth through dry tax charges". There are plenty of provisions which defer tax charges where no money changes hands. This just adds to the list.

Other proposed changes

a) Transfers on divorce:

- It is proposed that no-gain / no-loss treatment will also apply to assets that separated spouses transfer between themselves as part of a formal divorce agreement.

- Until April 2023, any such transfers outside of the tax year of separation will take place at market value. This change will remove the potential CGT liability for a donor spouse on divorce. In effect, it enables all 'dry' gains made as a result of transfers on divorce eligible for a form of deferral relief (as the donor's inherent gains will be automatically passed to the donee). Previously this only applied to business assets. Again this will be automatic.

b) Private Residence Relief:

- A spouse who retains an interest in the former matrimonial home will be given an option to claim Private Residence Relief (PRR) when that property is sold.

- Currently, when one spouse leaves the matrimonial home, that property ceases to be the departing spouse's main residence for CGT purposes. This will in turn create periods of absence on an eventual sale (with PRR restricted accordingly). The final nine months of ownership will remain eligible for relief but the period between moving out and nine months before disposal will not.

- There is currently scope under s.225B for the departing spouse to continue to treat his/her absence from the property as a period of deemed occupation provided that:

- The property continues to be the only or main residence of the former spouse; and

- The departing spouse does not have another property which qualifies for PRR (which is typically the case where the departing spouse moves in with friends / family or into rented accommodation).

From 6 April 2023, the departing spouse will be able to elect for his/her retained interest in the former matrimonial home to continue to be eligible for private residence relief. This will, of course, mean that if the departing spouse has acquired another property which is simultaneously eligible for relief, that "new" property will not qualify. Practitioners with clients in this position will need to make sure that their PPR is placed where it is most effective.

This does have more than a faint whiff of PRR nominations for second homes, so it will be interesting to see if the new rules enable elections to be changed and varied as they can be now.

c) Deferred consideration on sale of former homes:

- Individuals who have transferred their interest in the former matrimonial home to their ex-spouse and are entitled to receive a percentage of the proceeds when that home is eventually sold, will be able to apply the same tax treatment to those proceeds that applied when they transferred their original interest in the home to their ex-spouse.

Let's unpick this.

Assume A and B are married and living in a matrimonial home. They separate and B moves out. Under the terms of the subsequent divorce, B transfers their interest in the former matrimonial home to A who thereafter remains in occupation with their children. It is contractually agreed that once the children cease full-time education (or if A remarries if sooner), the property will be sold and B will receive a share of the sales proceeds.

At the moment, B's transfer of their interest in the house to A will be a disposal at market value giving rise to a gain (some or all of which will be eligible for PRR). At that point, B no longer has an interest in the former home but instead has a different asset being their right to receive future proceeds of an unknown amount (Marren v Ingles rings bells here).

The base cost of this intangible asset is the value of this right at the date it is created. [Note: Going forward, as transfers on divorce will take place at no-gain / no-loss, the base cost of the intangible asset received on divorce will be nil.]

When A eventually sells the house and B receives a share of the sale money, this triggers a further disposal, this time of B's right to receive proceeds. If the amount received for the disposal of this right exceeds its CGT base cost, a gain will arise. This gain will not be eligible for PRR as the asset being sold is not, in itself, a qualifying residence.

Under new proposals, the gain on the disposal of the right will be eligible for the same PRR as was (or would have been) available when the interest in the property was originally transferred.

Example

Richard and Liz married in June 2016 and moved into a house they had bought jointly for £200,000.

In June 2024 the couple separated and Richard moved into a flat he had owned before the marriage and which had been let in the meantime. He did not elect for the family home to continue to be his only or main residence.

In June 2026 Richard and Liz were divorced and as part of the divorce settlement, Richard transferred his 50% interest in the family home to Liz on the condition that Richard would be entitled to 50% of the eventual proceeds of disposal. The house was worth £400,000 in June 2026 and was sold in June 2028 for £500,000.

CGT implications:

The marital house ceases to be Richard's qualifying residence in June 2024.

Richard's disposal of his 50% interest in the house in June 2026 takes place at no-gain / no-loss (being a transfer on divorce after April 2023). Liz therefore acquires her additional 50% interest at Richard's original base cost giving her a 100% interest in the house with a base cost of £200,000.

In June 2026, Richard acquires a separate asset being the right to receive future consideration. As this is acquired as part of a no-gain / no-loss transaction, the asset has a base cost of nil.

In June 2028, Richard receives future consideration of £500,000 x 50% = £250,000 thereby making a gain of £250,000 on the disposal of the intangible right.

This gain will qualify for the same private residence relief as would have applied at the time of the disposal of the 50% interest in June 2026.

The PRR up to June 2026 is the period of Richard's actual occupation (June 2016 to June 2024 being 8 years), plus the final 9 months (giving 105 months out of a total period of ownership of 120 months).

Richard's chargeable gain in June 2028 will therefore be:

		£
Gain on sale of right		250,000
Less: PRR	£250,000 x 105/120	(218,750)
Chargeable gain		31,250

Note that if Richard had elected for the marital home to continue to be his qualifying residence after the date of separation (which he can from April 2023), PRR would have continued to be available until the date of the disposal of his interest on divorce. The subsequent gain on the disposal of his right in 2028 would therefore be fully covered by PRR and would be nil. However, the flat would not then be eligible for PRR between separation and divorce.

Liz will make a gain of £50,000 (being 50% of the £500,000 sales proceeds, less her CGT base cost of £200,000). This will be fully covered by PRR.

Contributed by Steve Sanders

No partnership, no tax relief **(Lecture P1331 – 19.26 minutes)**

Summary – As no partnership existed, CGT and SDLT reliefs claimed on the disposal of a property being developed were denied.

In 1989, Richard Cooke and his wife bought Marepond Farm for just over half a million pounds.

In 1997 SC Properties Limited was incorporated, primarily as a property development company owned in equal shares by Mr and Mrs Cooke.

In September 2014, planning permission was obtained for the development of a property on the farm called Marepond Copse. Mr Cooke claimed that at that time the couple created a partnership called R & E Cooke Partnership to develop the property, and that the property was appropriated to trading stock of the Partnership.

SC Properties Limited undertook the development of the property using third party contractors. The Cookes granted SC Properties Limited the right to purchase the property for £830,000 by giving notice within 1 year, for consideration of £1.

In January 2016, Richard Cooke and his wife personally claimed Capital Gains Tax relief on the appropriation of the property which had previously been held as an investment to trading stock (s.161(3) TCGA 1992). This was sent in the Cookes' names using their tax references.

In June 2016, SC Properties Limited acquired the property for the agreed £830,000, when it was valued at just under £1.6 million. A joint election was made under s.178 ITTOIA 2005 to defer the profit on the sale of the property by the Cooke's to the company. This profit only crystalised when the company sold the property in March 2017 to a third party for £1,875,000.

Further, the couple claimed Stamp Duty Land Tax relief under the partnership SDLT provisions (Schedule 15 FA 2003). The transfer of the property from the Partnership to SC Properties Limited was free from SDLT because SC Properties Limited was owned by the same individuals who were members of the partnership.

The only issue in this case was whether the partnership actually existed. HMRC inquired into the Self Assessment and SDLT returns claiming that no partnership existed. HMRC argued that the Cookes had not provided evidence to suggest that the Partnership existed. The Partnership did not acquire the property and did not carry on a trade of developing the property. Indeed, HMRC pointed out that the Partnership was not registered with HMRC until February 2019, some time after the property transactions. On that basis, HMRC issued assessments denying the reliefs that had been claimed.

Decision

The First Tier Tribunal found that there was no partnership business. The partnership did not have its own bank account, it raised no invoices and had not registered for VAT. Further, neither the financing nor option agreements made any reference to the existence of a partnership.

The First Tier Tribunal found that the partnership returns that were filed could not be treated as evidence that the partnership existed.

The First Tier Tribunal agreed with HMRC that the evidence suggested that the intention was that any profit derived from the property development should accrue to SC Properties Limited and not to the partnership.

With no partnership, the partnership SDLT provisions did not apply and the CGT elections were invalid:

1. The property was not appropriated to trading stock of the partnership on 14 September 2014 or at any other date.

2. The property was owned personally by Mr and Mrs Cooke when it was sold to SC Properties Limited on 9 June 2016.

3. A chargeable gain arose on that sale, half of which was chargeable on Mr Cooke.

The appeal was dismissed.

SC Properties Limited and Richard Cooke v HMRC (TC08537)

Capital loss allowed (Lecture P1331 – 19.26 minutes)

Summary – Despite no evidence that HMRC had been notified of a capital loss made in 1998, these losses brought forward were allowed as a deduction against gains made in 2014/15. However, the amount of the loss was reduced as it could not be justified by the taxpayer.

On 27 August 1998, Altan Goksu sold a property for £990,000 crystallising a capital loss. He claimed that his accountant assured him that he would declare the loss to the Inland Revenue.

Altan Goksu sold a commercial property in 2014/15 and sought to reduce the gain made by the capital loss made 1998.

HMRC argued that Altan Goksu could not use the loss as he had failed to notify it to HMRC within the time limits required (s.16(2) TCGA 1992).

Altan Goksu appealed on the grounds of reasonable care. Although not notified on his tax return at the time, Altan Goksu recalled that in a telephone call his accountant confirmed that he had had sent a letter notifying the loss to the Inland Revenue, although he could not remember whether he had received a copy. Neither party were able to produce a copy of this letter. However, during HMRC's enquiry, he produced a copy of a handwritten computation of the loss but this was barely legible.

Decision

The First Tier Tribunal heard from the accountant who stated that he remembered submitting the return and believed that the loss claim was made later, by way of amendment, as not all the details were available when the original return was submitted. The accountant described the process that his firm would have used to notify the loss, stating that it was normal practice to send revised computations to HMRC by letter. He had a reliable secretary and so it was very rare that letters went astray. On the balance of probabilities, the First Tier Tribunal found that the loss had been notified to HMRC. The appeals against the assessment and penalty were allowed.

However, as only a handwritten calculation was available, the First Tier Tribunal reduced the loss to a figure calculated by Altan Goksu's current accountants, based on the figures available at this later time.

Altan Goksu v HMRC (TC08536)

Transfers between siblings (Lecture P1334 – 14.56 minutes)

Background

On 7 July 2022, the government published new IHT [inheritance tax] legislation, the Inheritance Tax Act 1984 (Amendment) (Siblings) Bill. This Bill amends IHTA 1984 to make transfers between siblings exempt in certain circumstances.

Current legislation

The IHT exemption for transfers between spouses or civil partners (in IHTA 1984, s 18) is generally well-known among taxpayers and IHT practitioners alike.

The same can probably be said about the transferable nil rate band facility for spouses and civil partners (in IHTA 1984, ss 8A-8C). The legislation in both instances is specifically aimed at spouses and civil partners.

In Holland (executor of Holland, deceased) v IRC [2003] STC (SCD) 350, the taxpayer wasn't married to the deceased, but they had lived together as husband and wife for 31 years, before his death in April 2000. A claim for the spouse exemption was refused by the Revenue. The taxpayer appealed, contending that the spouse exemption wasn't restricted to those who were legally married, but also included those who had lived together as husband and wife. Alternatively, the taxpayer argued that refusal to grant the exemption breached Article 14 of the European Convention on Human Rights, which prohibits discrimination. Unfortunately for the taxpayer, their appeal was unsuccessful on both grounds.

Subsequently, in Burden & Burden v United Kingdom [2008] STC 1305, two unmarried sisters had lived together for many years in a house which they owned jointly. Each had made a will leaving her interest in the property to the other. The sisters applied to the European Court of Human Rights complaining that an IHT liability could arise on the first sister to die, whereas the liability would not arise in the case of a married couple or civil partners due to the spouse or civil partner exemption. The sisters argued that this amounted to a violation of their human rights. However, the court held that the relationship of siblings was fundamentally different from that of marriages or civil partnerships, and it followed that there was no discrimination and no violation of the sisters' convention rights.

OTS report

Over a decade later, in July 2019, the Office of Tax Simplification [OTS] published its second report on IHT simplification. This OTS report observed that from 1996 to 2017 the number of cohabiting couple families had increased from 1.5 million to 3.3 million.

However, the OTS concluded:

'The OTS considers that any change to the definition of spouse to include a cohabiting partner or sibling would be far reaching. This would most naturally form part of a wider response to social change considered across government rather than being driven primarily by Inheritance Tax considerations.'

Siblings exemption

The Inheritance Tax Act 1984 (Amendment) (Siblings) Bill amends IHTA 1984, by introducing a new section 18A (headed 'Transfers between siblings').

This exemption doesn't extend to cohabiting couples.

The legislation states:

> "18ATransfers between siblings
>
> (1) A transfer of value is an exempt transfer to the extent that the value transferred is attributable to property which becomes comprised in the estate of a sibling of the transferor to whom subsection (2) applies or, so far as the value transferred is not so attributable, to the extent that that estate is increased.

(2) This subsection applies to a sibling who has—

(a) ordinarily resided in the same household as the transferor for a continuous period of 7 years ending with the date of the transfer; and

(b) attained the age of 30 before that date.

(3) For the purposes of this section, "sibling" means a brother, sister, half-brother or half-sister of the transferor."

However, the exemption is limited in its application by two conditions, both of which must be satisfied.

The first condition (s 18A(2)(a)) is aimed at benefiting siblings such as the Burden sisters in the case mentioned above. This cohabitation requirement is a high hurdle to jump, which significantly restricts the scope of the exemption.

The reason for the age requirement in the second condition (s 18A(2)(b)) is not immediately apparent. However, it may be aimed at ensuring that the exemption applies to siblings who have made a lifestyle choice to live together, as opposed to (for example) younger siblings who are still living at home with their parents and have not yet acquired a property of their own.

IWhen introduced, the sibling exemption will extend to England and Wales, Scotland and Northern Ireland.

Commencement

The Inheritance Tax Act 1984 (Amendment) (Siblings) Bill was presented to Parliament and published on 7 July 2022. Parliament then went into recess. The Act will eventually come into force at the end of the two-month period beginning with the day on which it is passed. That means the legislation could take effect towards the end of 2022 and will be called the Inheritance Tax (Amendment) (Siblings) Act 2022.

In the meantime, the legislation is subject to possible amendment during its passage through Parliament, so watch this space.

Contributed by Mark McLaughlin

Administration

UK property filing requirements

Taxpayers who dispose of UK residential property must file a CGT UK property return and pay the capital gains tax arising within 60 days. HMRC had advised that this return should be filed before the related Self Assessment tax return.

However, experiencing difficulties with the CGT UK property return system, and so as to meet the Self Assessment filing deadlines, many taxpayers and agents have filed these returns without first having filed the UK property return.

The ICAEW has reported that HMRC has confirmed that the only circumstance in which a UK property return is not required is when the Self Assessment return is filed within 60 days of property completion. In this case, the Self Assessment return is filed before the due date for filing the UK property return and a separate UK property return is not required.

Taxpayers who filed their Self Assessment return but did not to file the property return must go back and file the 60-day return as well in paper format. They should not use the online UK property account. Penalties and interest may be charged.

https://www.icaew.com/insights/tax-news/2022/Jul-2022/HMRC-confirms-that-CGT-property-returns-must-be-filed

What 'Presumption of continuity' means? **(Lecture B1334 – 10.33 minutes)**

Background

In an HMRC enquiry such as into an individual's self-assessment return, the enquiry might extend beyond the tax year of the enquiry and into other tax years. For example, this might happen if the enquiry has revealed understated profits of a self-employed individual.

In addition to assessing additional profits for the tax year of HMRC's enquiry, suppose that the enquiring HMRC officer considers that profits for other years have probably been understated in a similar way, and makes discovery assessments for earlier tax years. The taxpayer's agent should want to know HMRC's justification for reopening earlier tax years. The HMRC officer may well refer the agent to HMRC's practice of 'spreading', or the presumption of continuity.

Presumption of continuity

HMRC uses case law as authority for spreading additions into other years, based on the 'presumption of continuity'.

Probably the most well-known of the above cases is Jonas v Bamford [1973] STC 519, in which Judge Walton J expressed the presumption of continuity as follows:

> "Once the inspector comes to the conclusion that, on the facts which he has discovered, the taxpayer has additional income beyond that which he has so far declared to the inspector, then the usual presumption of continuity will apply. The

> situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer."

Note that Judge Walton was referring to the presumption of continuity applying to later years, not earlier ones.

Subsequent cases

The decision in Jonas v Bamford has been used by HMRC quite extensively in other cases. However, those cases have not all gone HMRC's way. The presumption of continuity does have its limitations.

For example, in Barkham v Revenue and Customs [2012] UKFTT 499 (TC), HMRC opened an enquiry into the taxpayer's tax return for 2004/05. Mr Barkham operated a car sales and maintenance business. Following the enquiry, HMRC raised an assessment increasing Mr Barkham's profits for 2004/05, together with assessments for 2001/02, 2002/03 and 2003/04. HMRC's enquiry into the taxpayer's accounts resulted in an addition to gross profit which represented a 58% increase in gross receipts for the tax year 2004/05. HMRC then applied the same percentage and increased gross receipts for the three earlier tax years, relying on the presumption of continuity to make assessments for those years. The tribunal dismissed the taxpayer's appeal against the 2004/05 assessment. However, on HMRC's assessments for earlier years, the tribunal found the 58% increase in the declared turnover to be "unfair and unreasonable", and "unrealistic" and suggested that the taxpayer and HMRC negotiate any adjustments between themselves. The tribunal judge commented:

> "The presumption of continuity alone does not justify increases in assessments; the initial onus is on HMRC to show evidence in support of the making of the assessments. This would therefore be a limitation of the use of the presumption of continuity where previous year's accounts are sought to be opened."

This was not the first time the tribunal had indicated limitations in the presumption of continuity. For example, in Syed v Revenue and Customs [2011] UKFTT 315 (TC), the tribunal said:

> "In practice it will generally be reasonable and sensible to conclude that if there was a pattern of behaviour this year then the same behaviour will have been followed last year. Sometimes however that will not be a proper inference: there will be occasions when the behaviour related to a one-off situation, perhaps a particular disposal, or particular expenses; in those circumstances continuity is unlikely to be present."

Business economics exercises

If the taxpayer's business records are incomplete, HMRC may seek to assess additional profits by means of a business economics exercise.

For example, in Chapman v Revenue and Customs [2011] UKFTT 756 (TC), HMRC opened an enquiry into the taxpayer's return for 2006/07. Due to the absence of adequate business records, HMRC conducted a 'takings build-up' exercise, which arrived at a shortfall in turnover for 2006/07.

HMRC considered that the retail price index should be applied to calculate a shortfall in declared income for 2004/05 and 2005/06, plus the later year 2007/08, based on the

presumption of continuity. However, the tribunal noted that HMRC's takings build-up turnover figure was "wholly unrealistic", so the omitted sales figure for 2006/07 was reduced.

The tribunal also regarded HMRC's takings build-up calculation for 2007/08 to appear arbitrary and reduced the assessment for that year to nil. In addition, HMRC had not produced a takings build-up for 2004/05 or 2005/06, so the assessments for those tax years were reduced to nil.

On the presumption of continuity and the Jonas v Bamford case, the tribunal in Chapman stated:

> 'The presumption goes on until there is some change. The presumption as expressed in that case looks to the future and not the past. It is difficult to see how one can apply such a presumption based on the enquiry year to the earlier years.'

By contrast, in the subsequent case Allan v Revenue and Customs [2016] UKFTT 504 (TC), the tribunal stated:

> "Once the threshold requirement is satisfied for there to be a 'discovery' of loss of tax, the presumption of continuity applies in the raising of assessments for earlier years".

HMRC might point to the Allan case as authority to extend the scope of the presumption of continuity to earlier years. However, the decision in Allan doesn't set a binding legal precedent. Having said that, the approach in Allan has subsequently been followed in other cases (e.g., Whitlock v Revenue and Customs [2021] UKFTT 167 (TC)).

Isolated inaccuracies

In the case of 'one-off' tax return inaccuracies, HMRC states (at EM3236):

> "If there is only one under-declaration shown in only one year, additional evidence will be required to conclude that other years' figures may also be inaccurate..."

HMRC goes on to say: "Assessments should not normally be raised before HMRC have a case both for the existence of current year assessed liabilities and for the presumption of continuity."

Practical issues

It might be tempting in an enquiry case to agree additions to business profits with HMRC, with a view to bringing the enquiry to an early conclusion. However, profit adjustments for the year of enquiry can result in adjustments for other tax years as well, based on the presumption of continuity. Thus, it is important to avoid agreeing any profit adjustments for the enquiry year without very careful thought.

Even if the presumption of continuity is considered appropriate and HMRC raises assessments to increase profits for earlier tax years, it should not be automatically assumed that the methodology used by HMRC is correct. If the taxpayer (or agent) can provide evidence to indicate that, on a balance of probabilities, HMRC's assessments are excessive, those assessments will need to be adjusted accordingly, or appealed against.

Contributed by Mark McLaughlin

The fundamental principles of PCRT (Lecture B1335 – 22.46 minutes)

The fundamental principle which underpins the document is that the profession has got to display ethical behavior and those who do not behave ethically are negatively impacting the profession as a whole.

The Professional Conduct in Relation to Taxation (PCRT) is a guide to members as to how they behave. If a member of one of the professional bodies does not comply with these rules, then they will be subject to disciplinary processes.

If there is any doubt over the ethical or legal considerations of a particular case, then the person should seek advice from their professional body. These rules are in additional to the responsibilities that anyone within the profession has in relation to the anti-money laundering legislation as the two are separate.

There are five Principles and five Standards to be applied to tax planning. These are underpinned by helpsheets which are designed to give practical advice about the application of the rules but are not mandatory in the way that the Principles and Standards are.

It applies to all members of the profession who practice in tax including:

- employees;
- those dealing with the tax affairs of themselves, family, friends etc. whether or not for payment;
- those working for HMRC or other public sector organisations.

The following are the fundamental principles of the document:

Integrity

To be straightforward and honest in all professional and business relationships.

Objectivity

To not allow bias, conflict of interest or undue influence of others to override professional or business judgements.

Professional competence and due care

To maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.

Confidentiality

To respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the member or third parties.

Professional behaviour

To comply with relevant laws and regulations and avoid any action that discredits the profession.

We can look at these in more detail and will return to these when we look at some examples later on.

Integrity

You have to be honest in all dealings with clients, the tax authorities and other interested parties. The members must do nothing knowingly or carelessly that might mislead either by commission or omission. In reality the main problem here is likely to be omission through carelessness.

Let's take an example of a client who has entered into a joint venture agreement with a business partner who has a separate adviser. That adviser has come up with an idea to mitigate the tax liability for the joint venture and your client has been provided with a copy of the advice. You look up the other adviser on LinkedIn and he seems to be a legitimate adviser. You are short of time and under pressure from the client and so you agree the planning works without really looking at it in detail.

If it turns out the planning is not sustainable, there is an argument to say that you have been dishonest in your dealings with your client through failing to adequately consider the planning. You have not protected them from the potential fall-out from the planning going wrong.

Another example might be where you have an issue where the tax treatment is unclear but the amounts involved are quite small and you are confident that information can be presented such that HMRC will not pick up the issue. This could be called 'tax planning on the basis that HMRC don't notice what you have done'. That again could lead to claims that you have not acted with integrity.

Objectivity

This is an easier one to discuss in many ways as we have evidence of how this has played out in the past. As the guidance states 'relationships which bias or unduly influence the professional judgement of the member must be avoided'. There have been many tax planning businesses in the past who have promoted schemes through accountants who have been given generous commissions for referrals – this happened a lot with EBT type planning. Many (although not all) of those accountants may have been disinclined to study the detail of those schemes when they could see the benefits they were deriving from their clients' involvement.

The PCRT is now explicit that a member must always disclose to their client if they are receiving commission, incentives or other advantages (and the amount of such) relating to any matter upon which they are advising their clients.

Professional competence and due care

This falls into two categories: the member must have the requisite skill to provide the advice that they are giving and the work must not stray beyond the terms of the engagement.

This latter one brings us to the first point at which we have to remind ourselves that part of the PCRT is to protect the advisers themselves. Work outside the scope of an engagement may not be covered by the professional indemnity insurance.

It is the author's view that this is an area where there is a huge issue within the profession. You only need to consider the experience of working on a free tax helpline for one of the insurers (which I have done) to be horrified by the lack of knowledge of people phoning up and who are not prepared to pay to get proper advice for their clients. It is my own personal view that there are too many people within the profession who are advising on areas where they do not have the requisite skill.

The PCRT suggests that when giving a significant opinion on something then a client should consider obtaining a second opinion. Advice should always consider the context in which advice is given.

Of course, larger firms do have an advantage in this respect because they can have review structures to check advice is robust. This is not always as easy in smaller firms.

The PCRT notes that a member is free to choose whether to act for a client either generally or specifically but this does not acknowledge the difficulties in managing client relationships and the pressure to provide services in an increasingly competitive world.

Confidentiality

The duty of confidentiality is, of course, safeguarded in law. It is an express term in most contracts and would be implied if not present. Whilst there maybe circumstances when there is a legal or professional right or duty to disclose this needs to be rigorously monitored and only the minimum amount of information necessary to protect those interests may be disclosed.

This is discussed further below.

Professional behaviour

This is the one which causes, in many ways, the most controversy. It is easy to say that someone has acted 'unprofessionally' but it is difficult to define all of the actions which fall within that category.

The PCRT makes it clear that a member who considers a proposed arrangement to be tax evasion must advise the client not to enter into them. If the client ignores the advice, it is likely the member would not continue to act for that client.

Disagreements with HMRC must be dealt with in an open, constructive and professional manner whilst robustly serving the clients' interests.

This is a really interesting one as many advisers will struggle to maintain professional behaviour in some dealings with HMRC. What do you do if HMRC are being, in your view, completely unreasonable? In a recent case involving an SDLT enquiry, the author was completely flummoxed by the attitude of the HMRC officer who appeared to be seeking 3 lots of SDLT on a single transaction based on a flawed interpretation of the legalities of the deal. His view had been comprehensively repudiated by a reputable barrister but he was still refusing to accept he was wrong. This certainly caused difficulties in maintaining professionalism. It was resolved in the end by writing of an incredibly strongly worded letter suggesting a complaint was going to be made about the behaviour. Unfortunately, this does not always work!

The standards for tax planning

Client Specific

Tax planning must be specific to the particular client's facts and circumstances. Clients must be alerted to the wider risks and the implications of any courses of action.

Lawful

At all times members must act lawfully and with integrity and expect the same from their clients. Tax planning should be based on a realistic assessment of the facts and on a credible view of the law. Members should draw their clients' attention to where the law is materially uncertain, for example because HMRC is known to take a different view of the law. Members should consider taking further advice appropriate to the risks and circumstances of the particular case, for example where litigation is likely.

Disclosure and transparency

Tax advice must not rely for its effectiveness on HMRC having less than the relevant facts. Any disclosure must fairly represent all relevant facts.

Tax planning arrangements

Members must not create, encourage or promote tax planning arrangements or structures that i) set out to achieve results that are contrary to the clear intention of Parliament in enacting relevant legislation and/or ii) are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation.

Professional judgement and appropriate documentation

Applying these requirements to particular client advisory situations requires members to exercise professional judgement on a number of matters. Members should keep notes on a timely basis of the rationale for the judgments exercised in seeking to adhere to these requirements.

Looking at the guidance to get some further pointers in relation to each of these leads the following comments being made but these are explored further below when we look at some examples.

Client specific

Generic advice gives rise to particular risks and should be avoided unless it is clear that it is generic (and would then normally include a disclaimer about this – it covers newsletters and similar). Whilst assumptions can be made when giving advice, these must be reasonable and realistic, and it should be clear when those assumptions impact on the advice so that there is little scope for misunderstandings to arise. Consideration should be given to including the impact of a change in the assumptions or the circumstances where it would be imperative to receive specific advice.

Lawful

Clients must be advised about material uncertainty in the law even if the practical likelihood of HMRC intervention is considered to be low.

Where the view of HMRC is uncertain or not known, this should be included as part of the advice; equally if the advisor disagrees with a stated HMRC view (and this is not, in itself, wrong) then the client should be told this and the risks/costs of adopting a contrary view.

Disclosure and transparency

Disclosure must be made where it is required by law and may be advised where it is appropriate to give a wider context to HMRC although the exact nature of any disclosure will be a matter of professional judgement.

Tax planning arrangements

Where there is genuine uncertainty as to whether particular planning is in breach of the standard, the member must document the reason why they believe the planning is not in breach; include in any advice that there is uncertainty and the risks this creates and include in any advice the relevant disclosures which must be made to HMRC.

Professional judgement and appropriate documentation

Notes and documents must be prepared and retained which support all judgements made and establishing compliance with all principles, sufficient to be utilized after the event if necessary. Again, it is suspected that this is an area where there is some complacency.

Examples

It is always very difficult to make definitive judgements about when the PCRT principles might need to be considered but here are some cases where there are issues to discuss.

A client, whose affairs are always slightly behind and disorganized, is routinely backdating the date at which dividends are to be treated as paid.

This is a fairly common issue.

Let's consider the technical position. A dividend can be authorised in one of two ways:

- It is declared and approved by the directors; this is an 'interim dividend' or
- It is declared or proposed by the directors and approved by the shareholders by written resolution or in a general meeting. This is a final dividend.

An interim dividend is treated as paid when the shareholder receives the money or when the funds are placed at the shareholder's disposal. This might include crediting an amount to a loan account. A final dividend is treated as paid on the date that it is declared as the voting of this creates an immediately enforceable debt. The exception is where the dividend resolution fixes a later date for payment, which is common in quoted companies, so the date of payment is then the later date.

For most OMB type businesses, the dividends paid are interim dividends and not final dividends. It is typically the case that we would be looking to identify the date of payment. In many cases, that payment will be by way of credit to the loan account, rather than physical payment.

Backdating of documents of any kind is fraudulent but probably what we are looking at here is likely crediting to a loan account retrospectively and this is something which is widely undertaken.

This does not fall neatly into any of the categories within the PCRT as many would argue it is not tax planning.

However, one of the criteria of the PCRT is that members must act lawfully. It could be argued that it is not lawful to treat a payment as made when it clearly has not been made. But it is acknowledged this is a difficult issue. As noted above, these cause more problems than the more complex planning where the route is much clearer.

A client is the 100% shareholder in his company and suggests bringing in his spouse as a shareholder as she has no other income.

Another fairly common issue.

In this case, there is no provision which stops a spouse being a shareholder in a company.

However, you would need to consider the application of the Settlements provisions to the scenario, and any advice on this point would need to be client specific and consider the uncertainties about the application of these provisions (which still exist even with cases like *Arctic Systems*).

A husband and wife who have a large property portfolio want to transfer that to a company in order to avoid the restriction on interest relief but avoiding a tax charge on such a transfer would depend on proving that it was a business and arguing that a partnership exists.

This is, in some ways, more interesting in terms of the way in which PCRT impacts on day-to-day tax planning.

There are two technical arguments here, both of which are a matter of fact. Is there a partnership and is there a business? In neither case is it a case of interpretation of the legislation – it is about reviewing the facts to come to a conclusion.

Any conclusion reached should include reference to counter arguments and alternative views which might be put forward by HMRC. The conclusion should, of course, be justifiable by reference to the facts and not swayed by the fact that the client wants a particular outcome.

A more interesting point is that the existence of a partnership is not really a tax law issue and it might be argued that most advisers would not have the technical competency to make a sustainable judgement on that point (although it may be pretty clear that no partnership exist which might be something you would not need to take further advice on!).

If you concluded that this could be done tax effectively you would probably want to make a full disclosure to protect clients.

You sign up a new client who tells you that he jointly owns his rental properties with his wife and that she is allocated 90% of the rental income from those properties as she has no other income. At the Land Registry the property is shown as being held solely by the client.

This is an area where there are significant compliance issues.

Many married owners of jointly-owned rented properties assume that so long as they declare the profit on one of their individual tax returns then that is their legal liability done. But this is not necessarily correct, particularly if there is an uneven split of income and the taxpayers may need to complete a Form 17. In this scenario, it is unclear that the property is even jointly-owned.

It might be that there has been a trust deed put in place which does transfer a beneficial ownership of the property to the spouse, but this would need to be evidenced by a copy of the deed. However, this is not sufficient on its own.

By default, tax law (s.836 ITA 2007) holds that rental profit from property jointly owned by spouses/civil partners is taxed 50:50, irrespective of the underlying respective proportion of actual ownership; this does not apply, however, to property held within a business partnership proper. Again, it is a misconception that all that has to be done is to submit a Form 17 to HMRC and the profit is taxed at a different split to the default 50:50.

If it would be more efficient for income tax purposes to split the profit differently, then the profit may be divided according to that beneficial ownership. Such unequal ownership is achieved only as tenants in common and it is then that a Form 17 is relevant. Form 17 must be signed jointly: if one spouse/civil partner does not sign then both must accept the standard 50:50 default split. The form is also only appropriate between two married/civil partners living together.

Once HMRC have been notified, the new proportions remain in force until the couple's beneficial interests in the property change or one spouse/civil partner dies, or they stop living together as a married couple/civil partners. The form must be submitted within 60 days of the date of the declaration and cannot be backdated, the time limit being strictly enforced with no power of extension.

So, you need a trust deed to show beneficial ownership and then a Form 17 to notify HMRC. If those are not available, an assumption needs to be made that the ownership of the property resides with the husband and that there have been incorrect returns submitted in the past. The client would have to rectify those returns or the adviser would have to reconsider whether they wanted to act for the client.

A client, who you have acted for over many years, tells you that they have moved into a property which you know has been let for two years to the same tenant. The property is sold shortly afterwards and the client tells you that the gain does not need to be declared as the gain will be covered by principle private residence relief. They tell you that they also lived in the property before it was let.

This is a case where the PCRT requires you to exercise some skepticism in your dealings with the client. This is clearly an area where there is scope for tax to be avoided if the contentions made by the client are incorrect.

It would be important to make sure that there is evidence that the client did qualify for private residence relief so that there was evidence both that the client did live at the property and that the occupation had the necessary degree of permanence and expectation of continuity for it to qualify for the relief.

In a case which went before the FTT in 2016 (*Mitesh Kothari v HMRC* TC04915) a wide range of factors were considered in determining that private residence relief was not available.

Evidence that the property had become K's permanent home was provided in the form of an electricity bill and a TV licence, issued to K and his wife at the Park Lane address and a Council Tax bill for the property, though sent to his previous address. K stated that his intention to reside in the property was changed after an agent told him in February 2009 that a good price would be possible; he put it on the market and an offer was made in March.

HMRC's position was supported by the short length of actual occupancy; the statement that K wished to be close to his office in Mayfair, even though the office was not rented until February 2009; the fact that the flat had only two bedrooms despite K's family including a wife and three young children; and K's inability to afford living in Park Lane Place, given his accumulated rental losses which would be lost. He had indicated in conversation that the move to Park Lane Place was provisional until it was clear that the family enjoyed living there; he had not moved any of his furniture, but simply bought the last tenant's furniture; and he had not changed the schooling arrangements for his eldest child.

It would be expected any adviser would be reviewing all of the information and acting accordingly if they felt their client was not being honest about the true facts.

A client ran a pub which ceased trading and since the cessation he has been trying to get planning permission on the building to enable it to be converted into flats. He has always intended to sell the site with planning permission rather than undertaking the development himself. You realise that you are approaching the point where it is 3 years since cessation so that it is unlikely that there will be a third-party sale within that period. The relevance is that he cannot claim BADR on a sale after 3 years, and his tax rate will be 20% rather than 10%. You suggest that he appropriates the property into trading stock, notifying HMRC that he has commenced a property development business, even though he is still intending to sell as soon as planning permission is obtained but this crystallises the capital gain.

The question is whether this is acceptable tax planning? The question of whether he has commenced a trade would be governed by considering the badges of trade but it is a matter of fact whether you are trading. You would be well advised to make a full analysis of the strength of any argument for and against trading.

Would it be a better option in some ways to actually transfer the property into a new company which was registered as trading? This would incur an SDLT cost and many would consider that protection against the risk of challenge from HMRC but that is a debatable point.

Contributed by Ros Martin

First Tier Tribunal hearings **(P1332 – 16.41 minutes)**

Introduction

A consultancy client of ours appealed some VAT assessments and the matter ended up (finally) at a First Tier Tribunal hearing in June 2022. This was held by video, but I thought it might be useful to practitioners and those who work in corporates to understand how the Tribunal case progresses.

Before the hearing

A formal appeal to the First Tier Tribunal must be made within the time limits prescribed (although the Tribunal has discretion to hear an appeal if made late). If the agent is submitting the appeal they need the authority of the client which is given by the client completing and signing Form T239.

The appeal must set out the reasons why the taxpayer believes that the assessment is excessive or incorrect (in brief).

Usually, the tax in dispute has to be paid before the appeal is heard, but the taxpayer can make a hardship application to the Tribunal to permit the case to proceed without payment being made (which is what happened in our client's case) which then informs HMRC. If HMRC does not believe that payment of the tax would cause undue hardship to the taxpayer, the Tribunal can either support this view or take a contrary decision and allow the appeal to proceed. The Tribunal's decision on this is final.

Our client's case was designated as 'complex' – one implication of this is that, generally, the loser pays the winner's costs unless the taxpayer opts out of the regime and decides it will bear its own costs irrespective of the outcome.

The other implication is that HMRC then has 60 days to send the taxpayer and the Tribunal its statement of case (in simple cases, it is 30 days). The taxpayer then has 42 days from receiving HMRC's statement of case to provide a list of documents to HMRC and the Tribunal. These documents will include the taxpayer's statement of case.

These deadlines can be extended by either party with the permission of the Tribunal. Normally, the party wanting an extension sends a letter to the other explaining the reasons why and asking if the other party is agreeable.

If HMRC has an acceptable reason for the extension it is usually best to agree to it, otherwise it might appear that the taxpayer is using the strict deadlines to stop HMRC being able to properly present its case. In our case, the effects of Covid-19 meant that HMRC was struggling to access physical documents stored in one of its offices.

The first party then notifies the Tribunal that it has asked the other party and that it has agreed (if this is the case) and the Tribunal then responds to both parties.

The taxpayer can choose to represent themselves (not recommended!), ask their usual tax advisor to represent them, or appoint a barrister to advocate for them. Our client chose to appoint a barrister on my recommendation (and I would advise all my clients to do the same – a court case, even by video, can be daunting for many people and barristers have the experience and knowledge to react to developments as they arise).

Bear in mind that the advisor contracts the barrister and the barrister will invoice the advisor not the client so always ensure your client is willing and able to reimburse you when you invoice them for these fees.

The hearing

There is the Judge and a panel member. HMRC will be represented by a barrister. The relevant inspector will be present as a witness and, in our case, representatives from HMRC's solicitors and a lot of other observers.

For our client, the barrister, the client and I were 'present'.

Although it was a video hearing, we were advised to dress smartly (shirt and tie) and you must be in a room alone.

The hearing starts at 10am each day and ends around 4 – 4.30pm. We had a short break in the morning and afternoon and one hour for a lunch break.

HMRC, as the respondent, appears first. Their barrister asks the inspector if the witness statement in the Exhibits is theirs and to confirm that it is their signature and is true to the best of their belief.

The client's barrister then cross-examines the HMRC inspector. HMRC's barrister can then ask the inspector clarifying questions afterwards.

The Judge or the panel member can ask questions at any stage during this time, usually to clarify a point the barrister or inspector has made.

After this, the client is called and their barrister asks them the same questions about their witness statement. HMRC's barrister then cross-examines the client and again the Judge and panel member can ask questions at any stage.

The client's barrister then has the chance to ask them clarifying questions and that concludes the client's time as a witness.

In our case, the examination of the inspector and the client lasted more than one day. During this time (including breaks), they are not allowed to speak to anyone about the case (including their spouse, partners etc. but definitely not their barristers or advisors).

While the inspector was being questioned, the client, barrister and I used a WhatsApp group to communicate with each other. When our client was being questioned, the barrister and I communicated with each other by WhatsApp.

At the end of the hearing, both barristers are given time to sum up their respective client's cases.

Our case lasted four complete days. It can be very draining listening to all the questions, responses and looking up all the exhibits referred to by both barristers, but the advisor must stay alert at all times to pick up on things the inspector or HMRC barrister say which is not, in our opinion, correct and to advise our barrister accordingly. In addition, when our client is being questioned, listening to the responses and advising our barrister to ask clarifying questions when it is their turn.

After the hearing

In our case, the Judge asked for written submissions by both barristers with a timeline of events, which I understand is not the norm.

It is then a waiting game until the Judge issues their decision. As of the end of August, we are still waiting for the decision, over two months since the case was heard.

The Judge issues their decision to the advisor (not the client nor the barrister).

Contributed by Malcolm Greenbaum

Dealing with the opening enquiry letter (P1335 – 21.13 minutes)

This article will provide advice on dealing with an opening enquiry letter from HMRC, whether in relation to an individual, a partnership or a company.

The basics

Whenever you are dealing with an enquiry, it is important to consider the basics. The first of these is to determine the status of the letter received from HMRC. A formal enquiry notice must be in writing, and the letter should state that it is an enquiry. With HMRC's increased usage of nudge letters (for which see the separate session) and other intervention methods, it is important to establish whether HMRC have started a formal enquiry.

It is also important to determine the type of enquiry that is being started by HMRC. An enquiry into an individual's tax return is permitted under s 9A, TMA 1970, a partnership under S12AC TMA1970, and that into a company under Para 24, Schedule 18, FA 1998. This session is aimed at dealing with those types of enquiries. If HMRC are starting an investigation using Code of Practice 8 or Code of Practice 9, different considerations apply, and reference should be made to the sessions on those topics. Similarly, the position is different in relation to a criminal investigation.

Content of the enquiry letter

If you have established that the letter is a formal enquiry notice, the next step is to determine whether the notice is valid. There is a statutory framework governing the enquiry process, and HMRC must adhere to those rules. A common issue is where the enquiry notice has been issued late. HMRC have 12 months from the submission of a tax return to start an enquiry (when that return is filed on time). The notice must be received by the taxpayer before the time limit. HMRC should allow sufficient time for the enquiry notice to be received, although the date of delivery should be checked with the client. Failure to issue the enquiry notice in sufficient time renders the notice invalid. Although HMRC typically issue letters by second class post, at times they may use an alternative method.

If the enquiry notice is invalid, the adviser should establish whether HMRC have started an aspect enquiry or full enquiry. The former considers one or more specific aspect of a tax return, whereas the latter encompasses all parts of the return. This session will focus on dealing with a full enquiry, although the general principles discussed will also apply to an aspect enquiry.

The opening letter will, typically, include a request for information and documents, usually on an informal basis, although, exceptionally, the officer may issue a formal information notice. The adviser should consider what is being requested, and whether they are statutory records, other records, or information, as different appeal rights apply in the event that HMRC issue a formal notice.

The officer should provide a deadline for the submission of the information or documents requested, unless they are seeking to inspect the documents, etc at, for example, the client's business premises. HMRC guidance (at EM1580) states that, usually, 30 days, as a minimum, should be given. The officer is expected to show flexibility in this matter and has specific instructions to allow a longer time if their request is issued in December or January.

The officer may include a request for a meeting with the client, which could be at HMRC offices, or the client's home or business premises. Any such requests must be given careful consideration, and further comment is made later in the session.

Liaison with the client

When an enquiry notice is received, it is important to liaise with the client, firstly to check if, and when, they received the document. It is prudent to explain the enquiry process to the client, including case selection by HMRC. Although HMRC conduct certain enquiries at random, they make up a very small percentage of the enquiries undertaken, and, in the vast majority of cases, the enquiry will have started following a HMRC risk assessment. The penalty regime should also be explained to the client, so they understand the benefit of co-operating with HMRC if additional liabilities are established. From the dialogue with the client, it is important to establish if there are any irregularities to be addressed.

After liaising with the client, ideally at a meeting, the adviser should consider what further work, if any, is necessary before responding to HMRC.

Preparing your response

The adviser needs to consider whether the information requested by HMRC will be provided to the officer. I have covered how to deal with information requests in another session, but, in summary, items requested by HMRC should be "reasonably required" for the purpose of checking the taxpayer's tax position. This needs to be determined on a case-by-case basis, as it what is reasonable for one taxpayer may not be so for another. Advisers should note that the position can change during the course of an enquiry as to what is reasonable.

The same considerations apply to documents as for information. If the officer has asked for documents to be produced at, say, the client's business premises, the adviser needs to consider whether this is likely to be beneficial for the client. In most cases, the answer to that question will be "no", and the adviser should make alternative arrangements for the provision of documents to the enquiry officer.

The adviser should consider any requests for a meeting with the client. In most circumstances, it will be far better, if a meeting is considered necessary, for the adviser to attend a meeting with the enquiry officer without the client present. The adviser should, if necessary, remind the officer that he does not have a legal right to meet with the taxpayer.

In the event that the client has indicated to the adviser that there is a disclosure to be made, it will, generally, be better for the adviser to take a pro-active approach in the matter, rather than submitting information or documents for the officer to review. The subject of voluntary disclosures has been covered in a separate session.

Practical considerations

Advisers should be prepared to challenge HMRC, as necessary, in relation to enquiry letters, including if the notice is invalid because it has been issued late.

When dealing with information requests, my view is that if the information or document is something that the officer is entitled to, that item should be provided in response to an informal request, rather than the officer proceeding down a formal route. Where HMRC have requested documents not previously seen by the adviser, they should be reviewed before being sent to the officer.

There will, inevitably, be contentious areas. Typically, these can include the provision of personal information or documents, or items relating to a director in the context of a company enquiry. A request for personal bank statements is a common source of contention. In other cases, an officer may seek information or documents for a period beyond that covered by the tax return under enquiry. In such circumstances, the officer should be asked to justify their request, rather than the adviser handing over whatever is requested by the officer.

The adviser should consider whether he will be able to comply with the deadline from the officer for the provision of information. If necessary, a realistic extension should be sought, and adhered to. It is important to avoid delay, by the adviser and client, as any unreasonable delays are likely to impact on the penalty charged, if additional liabilities are established and they arise from careless or deliberate behaviour.

As a final point, it is always worth considering getting input from a specialist, even if the case is considered to be low-risk.

Contributed by Phil Berwick, Director at Berwick Tax

Deadlines

1 September 2022

- Corporation tax for periods to 30 November 2021 if not liable to pay by instalments

7 September 2022

- Due date for VAT return and payment for 31 July 2022 quarter (electronic payment)

14 September 2022

- Quarterly corporation tax instalment payment for large companies
- Paper monthly EC sales list –Northern Ireland businesses selling goods

19 September 2022

- PAYE/NIC/student loan/CIS payments for month to 5 September 2022 if by cheque
- File monthly CIS return

21 September 2022

- Online monthly EC sales list –Northern Ireland businesses selling goods
- Supplementary intrastat declarations for August 2022
  - arrivals only for a GB business arrivals
  - despatch for a business in Northern Ireland

22 September 2022

- PAYE/NIC/student loan/CIS payments for month to 5 September 2022 paid online

30 September 2022

- Accounts for Companies House
  - private companies with 31 December 2021 year end
  - public limited companies with 31 March 2022 year end
- Corporation tax returns for companies with period ended 30 September 2021
- Small business rate relief claims for 2021/22 should be made to local authority

News

Draft legislation for Finance Bill 2023

On Wednesday, 20 June, the Treasury published the draft legislation which should form the basis of Finance Bill 2023.

With the disruption caused by the Tory leadership challenge, the timetable is potentially subject to change and the final contents of the bill will eventually be decided by the chancellor at the next Budget. The new areas of interest are:

- Dormant assets scheme – which will be extended to include assets from other financial services sectors, ensuring they can be transferred without tax implications.

- Double taxation relief restriction – to ensure that no extended time limit claim for double tax relief may be made for a credit calculated by reference to a foreign nominal rate of tax.

- Lump sum exit scheme – where payments to individuals leaving or retiring from farming will be treated as capital rather than income.

- Qualifying asset holding companies regime – with amendments designed to enable a greater number of diversely held fund structures to be eligible.

- Transfers between separating spouses/civil partners will be given up to three years to make no gain/no loss transfers of assets for capital gains tax purposes (see Capital Taxes section of the notes for more deatil)

Previous announcements include:

- Pensions tax relief – to implement a system to make top-up payments directly to lower earners who are saving in pension schemes using a net pay arrangement.

- BEPS Pillar 2 actions – for implementation in the UK.

- Research and development (R&D) qualifying expenditure – with relief focused towards R&D activity in the UK.

- Relief on disposals of joint interests in land – to ensure roll-over relief and only or main residence relief are available to members of limited liability partnerships and Scottish partnerships.

- Transfer pricing documentation – to be in accordance with the Organisation for Economic Co-operation and Development's transfer pricing guidelines.

- Homes for Ukraine scheme – with temporary reliefs from stamp duty land tax and annual tax on enveloped dwellings introduced for companies that make property available.

Adapted from the summary in Taxation (28 July 2022)

Another rise in HMRC interest rates

Following the news that the Bank of England was increasing the base rate to 1.75%, HMRC have announced that their interest rates on late paid tax will increase by 0.5%. This means that:

- from 15 August 2022, the rate for late paid corporation tax quarterly instalment payments rises to 2.75%, while the rate paid on overpaid quarterly instalment payments and on early payments of corporation tax not due by instalments increases to 1.5%;

- from 23 August 2022, their late payment interest rate will increase to 4.25%, and increase of 0.5%.

The repayment interest rate applied to overpayments of tax also increases, by 0.25%, to 0.75%.

Note that the official rate of interest applied to beneficial employment-related loans remains unchanged at 2%.

https://www.gov.uk/government/publications/rates-and-allowances-hmrc-interest-rates-for-late-and-early-payments/rates-and-allowances-hmrc-interest-rates

Petition to increase approved mileage allowance payment rates

A petition has been set up to ask the Treasury to increase the approved mileage allowance payment (AMAP) rates due to increasing fuel prices.

Currently, the advisory rate is 45p per mile for the first 10,000 miles and 25p thereafter and it applies to employees and volunteer drivers who use a private car for business mileage. The rate applies across all fuel types.

There are concerns that existing rates do not cover driving costs, which is impacting charities' ability to attract volunteer drivers.

The petition states:

> "Since 2011, inflation has gone up by over 25%; fuel has increased by over 20% over the last 5 years. Volunteer car drivers who did so much during Covid, and still do, to get people to healthcare settings, e.g. hospitals, vaccination centres, and to deliver shopping and prescriptions, are not being compensated fairly for the use of their cars. Consequently charities are struggling to recruit new volunteer drivers. These drivers help free up hospital beds and keep people independent and in their own homes."

In response to the petition, the Treasury said:

"The AMAP rate is advisory. Organisations can choose to reimburse more than the advisory rate, without the recipient being liable for a tax charge, provided that evidence of (actual) expenditure is provided."

https://petition.parliament.uk/petitions/600966

Electric cars guidance conflicts with the law

The ICAEW's Tax Faculty considers that HMRC's guidance at EIM23900 and online tool for the tax treatment of the reimbursement of electricity costs for charging company provided wholly electric cars conflicts with the law.

Both state that employer reimbursements to employees for the cost of electricity used to charge company-owned, wholly electric cars, available for private use, are subject to tax and National Insurance.

The Tax Faculty's interpretation of s.239(2) ITEPA 2003, in conjunction with s.149(4), is that such reimbursements are included within the car benefit charge.

The Tax Faculty and other professional bodies are in discussions with HMRC, with a view to HMRC correcting its guidance and tools.

Adapted from article in Taxation (18 August 2022)

Business Taxation

Unexplained payments (Lecture B1331 – 23.36 minutes)

Summary – Unexplained payments made to shareholders were taxable as self-employment income and not a loan.

Martyn Arthur ran a business providing advice and representation for taxpayers appealing to Tax Tribunals in respect of decisions made by HMRC. The business had run through two companies, Martin F Arthur Limited and Martyn Arthur Forensic Accountant Limited, which he had controlled and partially owned. His wife was a shareholder in both companies and had previously been a director. The companies ran into difficulties and were closed down.

In May 2020, Martyn Arthur was convicted of cheating the public revenue over the period up to 2012/13. This appeal was concerned with establishing what, if any, undeclared tax liabilities of his arose in respect of the tax years up to 2015/16. HMRC argued that the couple had underdeclared their income from the companies, which resulted in them issuing a number of assessments and penalties for deliberate inaccuracies in their returns in respect of the tax which they said had been underdeclared.

According to the tribunal:

> "The confusion arose as a result of the chaotic state of the affairs and records of the Companies and the numerous transfers of money that had taken place involving the Companies and both the Appellants."

Comparing the couple's bank statements to the companies' bank statements, HMRC created a list of untaxed money received by the couple from the companies, which HMRC regarded as being taxable as being profits from self-employment.

The couple argued that the money movements between the bank accounts should be treated as loan account debits and credits. Any net balance owing to the companies should be subject to tax under s.455.

Decision

The First Tier Tribunal found that Martyn Arthur treated both companies' money as the couple's asset, with no need to accurately record amounts paid and received or indeed, any requirement to repay the net sums received. The companies' loan balances were not an accurate reflection of the monies owed by the couple and further, when the companies were dissolved, there appeared to be no attempt to repay any outstanding amounts due. They were therefore amounts taxable as self-employment income and not a loan.

Moving to the penalties, the tribunal did not accept that Martyn Arthur's mental health issues and alcohol dependency made his actions careless rather than deliberate. His penalties were therefore upheld.

The tribunal stated that by 2015/16, his wife was aware of HMRC's criminal investigation into her husband's affairs, but she continued to allow him to submit her own returns, without checking. This was deliberate behaviour. However, before this time, it could not be shown that she was aware of her husband's criminal investigation, and consequently her penalties for her 2014/15 inaccuracies were recalculated on the basis that they were careless and not deliberate.

Martyn and Denise Arthur v HMRC (TC08539)

'Ceased to own' and capital allowances

Summary - The taxpayers were entitled to capital allowances even though these had been created by an artificial series of transactions with no business purpose, reversing the First-Tier Tribunal's decision that the arrangements were defeated by a Ramsay analysis.

The taxpayers (known as Cape and Wiseman at the First Tier Tribunal stage) had entered into arrangements that were designed to 'step up' the capital allowances to which they were entitled on assets that they already owned.

In simplified terms, the taxpayers sold the assets to a bank, the bank leased the assets back to the taxpayers for three or four weeks, and then the bank sold the assets back to the taxpayers. Under an anomaly in the legislation (that was subsequently corrected by FA 2011), the taxpayers contended that they did not have to bring a disposal value into account for capital allowances purposes on the initial disposal but were entitled to claim allowances on the cost of the subsequent reacquisition. The taxpayers' analysis of the legislation relied on them having 'ceased to own' the assets when they sold them to the bank.

HMRC argued on *Ramsay* grounds the condition had not been met. The First Tier Tribunal concluded HMRC's argument succeeded on the basis of its factual findings, including that the:

- transactions had no commercial purpose;
- taxpayers lost ownership of the assets for only a few weeks; and
- reacquisition was preordained.

Decision

The Upper Tribunal said that there could be no objection to the First Tier Tribunal's findings of fact, but that these did not support a conclusion that the taxpayers had not 'ceased to own' the assets.

The Upper Tribunal applied its own construction of the legislation (read purposively, as required by the Ramsay authorities) and decided that the First Tier Tribunal 's findings did not justify this conclusion.

The phrase 'ceased to own' was to be applied at a particular snapshot in time, and it did not matter if it was possible, likely or pre-ordained that a person would become the owner of the asset again in the future. It also did not matter why the person had ceased to own the asset.

Altrad Services Limited and Robert Wiseman and Sons Ltd v HMRC [2022] UKUT 00185 (TCC)

Adapted from the case summary in Tax Journal (22 July 2022)

LLPs and salaried members legislation (Lecture B1331 – 23.36 minutes)

Summary – For the salaried members legislation to be avoided, a member must have significant influence over just part of the LLP's affairs rather than the LLP's affairs as a whole.

Bluecrest Capital Management (UK) LLP managed investment funds as well as provided support services to other group entities. Certain members ran the investment portfolios with capital allocated for them to invest at their discretion. Other members had no such allocations. The members' remuneration included variable bonuses that were determined by reference to their performance as well as the performance of the business as a whole.

Under the salaried members rules, where certain conditions are breached, members are deemed to be taxable as employees liable to PAYE and NIC, rather than as self-employed. The legislation is designed to ensure that LLP members who are effectively providing services on terms similar to employment are treated as employees for tax purposes.

For the rules to apply, an individual must satisfy three conditions. It was common ground in this appeal that Condition C applied but that Conditions A and Condition B were disputed.

- Condition A - Were the bonuses variable without reference to the profits of the LLP?
- Condition B - Did the members not have significant influence over the LLP's affairs?

HMRC believed that these conditions were met and issued the LLP with PAYE and NIC determinations covering five years.

Bluecrest Capital Management (UK) LLP appealed.

Decision

The First Tier Tribunal considered the variable bonus remuneration. Condition A is met if it is reasonable to expect that at least 80% of the amount paid by an LLP to an individual member is disguised salary. This includes amounts which are variable but vary without reference to the overall amount of the profits or losses of the LLP, or are not, in practice, affected by the overall amount of those profits and losses. The Tribunal found that the LLP had not established a satisfactory link between the LLP's profits and the variable remuneration paid. It was not good enough that 'if there were fewer profits available for distribution, an individual member would receive a lesser amount'. This condition had been met.

However, LLPs could still fall outside of the salaried members legislation if they had significant influence over the affairs of LLP's affairs.

The First Tier Tribunal found that this influence did not have to be over the LLP's affairs as a whole; the influence could be over one or more areas of the LLP activities and this included financial influence. Members who were LLP heads of departments as well as those who managed portfolios of at least $100m were found to have the required influence. However, other members did not, meaning that their bonuses did not vary enough with profit and should be treated as disguised salary.

The appeal was allowed in part.

Bluecrest Capital Management (UK) LLP v HMRC (TC08529)

Goodwill amortisation

Summary – Individuals had beneficial interest in goodwill but did not own it. Consequently, goodwill was not created after 2002, nor was it acquired from an unrelated or related party

In 1999, Mr Beadnall and Mr Copley signed a partnership agreement to run an estate agency which had been in existence since 1991. Mr Copley retired in 2010, ending the partnership. Mr Beadnall continued the business as a sole trader, incorporating the trade in 2013.

In 2011, they signed a deed of retirement which confirmed the termination of the partnership and transferred the partnership property, described as 50% of the market value of the business to Mr Beadnall in return for a payment of £450,000. Partnership property included 'goodwill and all the assets'.

The business recognised £900,000 of goodwill in the first set of accounts, 50% of which was treated as pre-2002 goodwill not eligible for amortisation. The business claimed the remaining 50% as a corporation tax deduction, calling it an acquisition of Mr Copley's share of goodwill.

HMRC disallowed the deduction.

The taxpayer appealed.

Decision

The First Tier Tribunal said it had to establish, as a matter of law, who owned the goodwill that was an asset of the partnership.

It was clear that the individuals did not own the goodwill before the termination of the partnership. They both had a beneficial interest in it but did not own in whole or in part. Further, when Mr Copley retired and the partnership was dissolved, the ownership of the goodwill did not vest in the individual partners. Mr Copley's interest remained a beneficial interest in his share of the partnership property. Mr Beadnall did not, therefore, acquire goodwill from Mr Copley. The goodwill was not created after 2002, nor was it acquired from an unrelated or related party.

The appeal was dismissed.

Beadnall Copley Limited v HMRC (TC08508)

Adapted from the case summary in Taxation (14 July 2022)

Care home 'transferable goodwill'? **(Lecture B1331 – 23.36 minutes)**

Summary - the Court of Appeal allowed HMRC's appeal against the Upper Tribunal's decision on the valuation of leasehold interest in two nursing homes granted to two companies on the incorporation of the taxpayer's business.

Dr Denning owned the freeholds of two nursing homes running both as a sole trader.

In 2010, she incorporated a group of three companies, two as wholly owned subsidiaries of a parent in which she was the sole shareholder.

She then transferred the businesses to the two subsidiaries. The transfers included the grant of five-year leases of the properties, one to each company, with no premium. The sale agreement also included deeds assigning the goodwill of the businesses to the companies for a total of £1.8m.

HMRC challenged the figures for goodwill, arguing that the consideration was in reality part of the open market value of the leases. The issue for the court was therefore what was the amount of that open market value.

Both parties called expert evidence and the experts agreed that the care homes were trade related profits so that the leasehold interests had to be valued on the profits method of valuation. Applying the guidance given by the Royal Institution of Chartered Surveyors in VGPA 4, the experts agreed capital values.

HMRC argued that those values represented the open market values reflecting trading potential, but Dr Denning's argument was that the values included both the value of the leasehold interests and also transferable or business goodwill. Since the value of the leasehold interest was simply the market rent, the agreed capital value related solely to the goodwill.

The Upper Tribunal had agreed with Dr Denning.

Decision

However, the Court of Appeal held that VPGA 4 was aimed at the valuation of property interests. That they were valued by reference to trading potential did not mean that two separate assets were being valued. There was only one asset, the leasehold interests, and the profits method of valuation was no more than a method of arriving at the value of the property. The fact that the leases were at a market rent was concerned only with the transaction between the landlord and tenant. It did not mean that an assignee of the lease would pay nothing for it.

HMRC v Denning and others [2022] EWCA Civ 909

Adapted from the case summary in Tax Journal (15 July 2022)

Repayment of participator loan **(Lecture B1331 – 23.36 minutes)**

Summary – The GAAR Advisory Panel found that arrangements involving the repayment of participator loans through transactions involving group companies were reasonable. Unlike some of the previous referrals to the Panel in this area, there was no marketed pre-packaged scheme with unusual and apparently non-commercial steps involved.

M was the majority shareholder of Z, the parent of an active group of companies; for the period ended 31 May 2014, it recorded a post-tax profit of over £60m.

At 1 June 2015 M's Director's Loan Account with Z was in credit to the amount of £188,415.49. However, during the next 12 months there were various debits which resulted in a balance on the DLA of £9,994,451.97 being owed by M to Z at 31 May 2016.

If this balance were to be outstanding at 28 February 2017, that would result in a tax charge equivalent to Corporation tax on Z on the amount of the loan under s.455 CTA 2010.

Further loans were made by another group company, Y, to M. The Advisers accepted that these transactions in February 2017 were made to allow M to repay the Z loans, so preventing the s.455 charge.

HMRC argued that this created a tax advantage for the company. However, the advisors argued that the Y loans were not 'abusive' as they were made charging a commercial rate of interest. They believed that it made no difference as to whether M borrowed money from a third party or from another group company.

Decision

The Panel stated that it was aware that HMRC regularly challenges cases that seek to eliminate a liability to tax under the Loans to Participators legislation.

Here, it was common ground that there were arrangements to avoid a s.455 tax charge and that under the GAAR legislation, the Panel was required to assume they were 'tax arrangements.

However, the cases that they had previously seen involved 'artificial means of creating repayments or value passing out of the company'. The Panel concluded that this was not the case here but was the omission in the legislation regarding loans made by groups and group companies to clear other loans something to which the GAAR should apply?

The GAAR Advisory Panel accepted the Advisers' point that M's loans from Y were made at a commercial rate of interest and concluded that this did not involve contrived or abnormal steps. The Panel did not see that there had been an extraction of value that meant tax would be avoided.

The Panel concluded that the arrangements did not involve contrived or abnormal steps and that entering into them was a reasonable course of action.

https://www.gov.uk/government/publications/gaar-advisory-panel-opinion-of-26-april-2022-repayment-of-a-participator-loan-through-transactions-involving-group-companies

Transfer pricing and unallowable purpose

Summary – The company's non-trading loan relationship debits under the transfer pricing rules were disallowed. Further, had those rules not applied to disallow the debits, they would have been disallowed under the loan relationship's unallowable purpose rule.

BlackRock Holdco 5 LLC was a Delaware-incorporated but UK resident company formed as part of the structure for the acquisition by its parent company of the Barclays Global Investor business in 2009.

The company issued several tranches of loan notes to its immediate parent company and claimed non-trading loan relationship debits for the interest paid on the loans over a period of six years.

HMRC disallowed the debits on two grounds:

1. The loans differed from those that would have been made between independent enterprises (the transfer pricing issue); and

2. Securing a tax advantage for BlackRock Holdco 5 LLC (or another person) was a main purpose, BlackRock Holdco 5 LLC being a party to the loan relationship and the debits were attributable to that purpose (the unallowable purpose issue).

The First Tier Tribunal had allowed the company's appeal on both grounds.

- On the transfer pricing issue, it had held that an independent lender would have entered into loans of the same amount and on the same terms subject to certain third-party covenants, which would have been obtained;

- On the unallowable purpose issue, the First Tier Tribunal found that the company had two main purposes, a commercial purpose and one of securing a tax advantage. It had then apportioned the debits entirely to the commercial purpose, so that no part of them should be disallowed.

Decision

The Upper Tribunal considered the transfer pricing issue first. It held that the First Tier Tribunal had erred in law in allowing the covenants to be taken into account in considering whether an independent lender would have made the loans. Third-party covenants that were not part of the actual transaction could not be considered to be part of the hypothetical arm's length transaction because to do so would be materially to change the 'surrounding circumstances and ... economically relevant characteristics of the transactions'. Having decided that an independent lender would not have made the loans without the covenants, it should have determined that there was no comparable arm's length transaction and that the loans would not have been made between independent entities.

Although that decision was sufficient to determine the appeal, the Upper Tribunal went on to consider the unallowable purpose issue. It did so in three stages.

1. It rejected HMRC's argument that there was no commercial purpose to the loans. The First Tier Tribunal had reached a factual conclusion that there was a main commercial purpose, and HMRC had not been able to satisfy the high threshold required to set it aside;

2. It rejected the company's argument that there was no main tax advantage purpose. There was ample evidence that there was such a purpose; the First Tier Tribunal's findings demonstrated that the company was only included in the structure and so entered into the loans to take the UK tax benefits.

3. It reversed the First Tier Tribunal's apportionment of the debits. The commercial purpose was a by-product of the tax-driven decision to place the company in the structure, which meant it received a commercial benefit. All of the debits should be apportioned to the tax advantage main purpose and the debits disallowed.

HMRC v BlackRock Holdco 5 LLC [2022] UKUT 00199 (TCC)

Adapted from the case summary in Tax Journal (29 July 2022)

VAT and indirect taxes

Football pitch hire (Lecture B1331 – 23.36 minutes)

Summary - The supply of football pitches and league management services was a single composite exempt supply of the right to occupy land.

Netbusters (UK) Limited organised 5-a-side football and netball league matches. To do this, the company:

- managed all aspects of league administration;
- hired pitches from third parties and made them available to the teams to play their league matches.

The pitches were also hired out separately to members of the public.

Netbusters (UK) Limited sought to reclaim output VAT totalling £414,622 on the basis that its supplies were:

- 87.5% exempt as the supply of the pitch or court which should be treated as the hire of a sporting facility (Schedule 9 Group 1 VATA 1994);
- 12.5% taxable as the supply of league administration services of organising fixtures and providing referees and bibs for the matches.

HMRC disagreed and refused the claim, arguing that the company's supplies were standard rated supply of the 'organisation of football and netball leagues' and so was competitive league sports management services.

The First Tier Tribunal found in the taxpayer's favour, finding that the services represented a single composite supply of the right to occupy land which did fall under Schedule 9. Group 1. The supply was exempt.

HMRC appealed to the Upper Tribunal, arguing the lower tribunal had erred in law and had failed to consider and apply the "passivity principle" of the letting of land or the objective character or economic reality of the company's supplies. HMRC considered the supply not to be the grant of a licence to occupy land nor the hiring out of pitches but rather the supply of league administration services.

Decision

The Upper Tribunal found that the First Tier Tribunal had applied the correct tests. Letting of immoveable property could be a low value, passive activity. However, in this case, the First Tier Tribunal had considered all of the relevant case law and had correctly identified two supplies (pitch hire and league administration). They acknowledged that both enhanced the other but the character of the supply was predominantly the hire of land, and the administrative services were viewed as ancillary. As a result, the First Tier Tribunal had not erred in law and had reached a reasonable conclusion.

The Upper Tribunal confirmed that the supplies made were a single composite supply, exempt from VAT.

The appeal was dismissed.

HMRC v Netbusters (UK) Limited [2022] UKUT 00175 (TCC)

Goods to Ireland standard rated

Summary – The taxpayer did not obtain or retain valid commercial evidence of export to Ireland to support zero-rating of the relevant transactions.

Maron Plant Limited sold 29 items of plant and machinery – mainly JCB excavators – to two linked customers based in Ireland. As the customers were supposedly VAT registered in Ireland, and the goods were shipped to Ireland, they were treated as zero-rated sales.

HMRC challenged the zero rating on the basis that Maron Plant Limited had not provided adequate proof that the goods had been shipped to Ireland. There were no bills of lading or evidence of the route taken to ship the JCBs to Ireland. There were several invoicing discrepancies and some of the goods appeared to have been resold in Northern Ireland at a future date, so had never left the UK.

HMRC's published guidance makes it clear that exporters must take extra caution if a customer 'is not previously known to you'.

Decision

The First Tier Tribunal agreed that it was Maron Plant Limited's obligation to show that zero rating was correct.

The tribunal had problems with the evidence given by the company's sole director. The tribunal also noted that neither customer had been known before the first collection of goods.

The tribunal concluded that HMRC's assessment was correct – the sales of the goods were treated as standard rated on the basis that they had never left the UK.

The appeal was dismissed.

Maron Plant Limited v HMRC (T08523) (TC8523)

Adapted from the case summary in Taxation (21 July 2022)

Invalid invoices

Summary - A VAT representative group member could not recover input VAT on transactions connected to fraud as the company did not hold valid VAT invoices.

Tower Bridge GP Limited is the representative member of the Cantor Fitzgerald Group VAT group.

In March 2009, a group member began trading in carbon credit transactions. Between 18 May 2009 and 3 June 2009, carbon credits were bought and used by the group for its own taxable transactions in carbon credits. The invoices issued in respect of 17 transactions included VAT totalling £5,605,119.74, which was paid. Tower Bridge GP Limited claimed this amount as input tax in its VAT return for the period 06/09.

However, these invoices were not valid VAT invoices as they did not show a VAT registration number for the supplier and did not name the group member as the customer. Although the supplier was a taxable person, it transpired that it was not registered for VAT; hence no VAT number on the invoice.

HMRC denied the input tax claim and also refused to exercise their discretion to allow recovery of the input tax on the basis that:

- the supplier was not registered for VAT;
- the transactions were connected to fraud;
- the group member failed to conduct reasonable due diligence in relation to the transactions.

Tower Bridge GP Limited appealed and were unsuccessful at both the First Tier and Upper Tribunals.

The company appealed to the Court of Appeal.

Decision

The Court of Appeal confirmed that HMRC's refusal to exercise its discretion was valid.

HMRC's discretion is intended to allow defective invoices to be corrected by supplying subsequent information which ought to have been included on the invoices in the first place.

In this case, the customer's name could be supplied, but the supplier's VAT registration number could not, as it did not exist. Allowing the input tax recovery would have resulted in a loss to HMRC as no corresponding output tax would have been recoverable.

The appeal was dismissed.

Tower Bridge GP Limited v HMRC [2022] EWCA Civ 998

Construction of house **(Lecture B1331 – 23.36 minutes)**

Summary – As the house was not demolished, the building work was not zero-rated. However, the work qualified for 5% VAT as the house had not been lived in during the two-year period prior to the work starting.

Under Schedule 8 Group 5 note 18(b) VATA 1994, building work on the construction of a house can be treated as zero-rated where the previous property is demolished. The legislation permits such zero-rating where a single façade is retained, but this retention must form part of the planning consent or other statutory requirement.

In this case, Northchurch Homes Limited claimed zero-rating, with only a single façade being retained.

However, in reality, other parts of the original property were retained including part of the roof as well as the ground floor bay, the gable and other sections of walls. HMRC refused the claim

Northchurch Homes Limited appealed and also included a second argument, should zero-rating not apply. The company argued that Schedule 7A group 7 VATA 1994 applied as the house had not been lived in during the two-year period prior to work starting. As a result, the work qualified for the reduced 5% VAT rate.

Decision

Not surprisingly, the First Tier Tribunal found that the works did not amount to the "construction of a building" because the original building did not cease to be an existing building. "What was retained was, as a matter of fact, and for several reasons, more than 'a single facade'". The supply was not zero-rated.

However, the First Tier Tribunal accepted that the house had been empty for more than two years before the work started, meaning that the supply should have been at the reduced 5% rate. The judge stated:

> "I am entitled to consider the correct rating if there is sufficient evidence before me to permit me to determine the issue. I am not bound to find that, if the rating was not zero rating, then it should be standard rating. In this case, there is sufficient evidence before me."

Northchurch Homes Limited v HMRC (TC08526)

Paid for and free crash tests **(Lecture B1331 – 23.36 minutes)**

Summary – The free crash tests carried out by the charity did not represent a non-business activity meaning that recovery of general overheads was not restricted.

The Towards Zero Foundation was a charity whose primary objective was to achieve zero road traffic fatalities.

The charity initially bought new cars by way of a "mystery shopping" exercise and then undertook crash testing.

Where test results were substandard or unsatisfactory, the charity published and influenced customer buying behaviour. This drove manufacturers to improve their safety features. Having improved safety in this way the manufactures proactively seek and pay for further testing and so gain improved ratings in the market.

HMRC enquired into whether the charity was appropriately restricting input tax attributable to non-business activities.

Both parties agreed that the testing undertaken and paid for by the manufacturers was a business activity involving the making of taxable supplies giving rise to input tax recovery.

However, HMRC considered that the initial free testing funded by the charity represented a non-business activity and so no input tax could be claimed on the charity's expenses and overheads for this activity. HMRC raised assessments by reference to the information available on the basis that there should be a 40% restriction on general overhead input tax recovery.

The charity appealed the assessments, arguing that it did not undertake any non-business activity as the free testing was not a separate activity in its own right. It was initial work that led to the subsequent charged testing work.

Decision

The First Tier Tribunal agreed with the charity.

The free testing was an “inherent and integral part” of the charity’s business activity. It was not part of the organisation's charitable aims as laid out in its Articles of Association.

The appeal was allowed.

The Towards Zero Foundation v HMRC (TC08547)