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Personal tax

Tax planning up to the general election (Lecture P1292 – 16.50 minutes)

In the approximately 15 months before a General Election, tax practitioners are often asked about what they would advise regarding tax planning.

There are a number of uncertainties which make giving advice in this area particularly challenging:

1. Nobody knows the precise date of the general election. It has to be held by January 2025, but it is likely to be held before then.

2. At this stage, it is not possible to predict the result of the general election.

3. We know very little at this stage about the future tax policies if there is a change of administration.

Tax practitioners should be very wary of becoming amateur psephologists, as even professional pollsters find it difficult to predict general elections themselves. In terms of tax planning, we have been here before. In 1992 large number of owner managed businesses declared substantial dividends and bonuses in advance of the general election as they were fearful that the incoming Labour Party would raise the effective top rate of tax to 60% (including uncapped and extended NICs). In the event that did not happen, and companies had committed and paid large dividends which resulted in bumper tax receipts in that year.

The same actions happened in 2015 and to a lesser extent 2019 with the opinion polls wide of the mark in each case. It is noteworthy that in the last 11 general elections, the Labour Party has only won 3 of them which were all victories by Tony Blair. Tony Blair consistently promised not to raise the rates of Income Tax or VAT as part of his 5 pledges.

Turning to current tax policies; the policies of the opposition party are not yet formed, nor have they been communicated in any detail. We know that they would plan to impose VAT on private school fees and that they would abolish the non-UK domicile tax rules. However, they have hinted that there would be some form of replacement regime.

It is important to note that the Labour Party might have made some significantly different decisions in terms of policies as an alternative to the last two financial statements. Whereas the Conservatives froze or cut allowances but did not generally raise rates of tax, Labour might decide to raise the rates of tax or abolish reliefs, notably Capital Gains Tax breaks.

The Conservatives have also not raised the rate of Inheritance Tax (IHT) nor curbed the many reliefs available, which could again be an area where a Labour Chancellor consider the more radical changes.

Again, the options open to an incoming government may be restricted by tax pledges made in the run up, or during, a General Election campaign. One should remember that when the Conservatives announced the pledge to raise the IHT threshold to £1 million for a couple, Labour responded by allowing transferable allowances, thus saving married couples potentially large sums.

The final element of caution for any practitioner is understanding how far clients will take actions to reduce their liabilities which may impinge on their lifestyles. An obvious example is becoming non-resident; an option considered by many when the top rate of income tax went up to 50% in 2010, but actually carried out by a relatively small number of individuals.

Given that many tax planning measures such as accelerating payments or transfers of wealth are by their nature irrevocable and could lead to additional liabilities, what course of action should a practitioner advise?

At this stage, an information gathering exercise may be worthwhile; reviewing a client's income assets, appetite for risk and how important tax minimisation is to them. If one has that information and has discussed hypothetical options with a client, then it may be possible to move relatively quickly. For example, if a client is looking to sell a business, then the relatively low rate of CGT and the existence of Business Asset Disposal Relief on the first £1 million worth of gains may be a factor in accelerating the sale of a business. Again, commercial, personal and other considerations need to be taken into account.

Secondly, if one has the relevant information, one could put plans into effect in the period between the General Election and the first Budget of a new administration. The possibility that no one party will gain a majority would make the process of agreeing a Budget that much more challenging and the content of the Budget that much more unpredictable. One process that might need to be completed before the Budget is an Excluded Property Trust; holding non-UK assets by someone who is non-UK domiciled at present. Again, appointments into trusts are irrevocable and create permanent changes.

In conclusion, caution is required and the general strategy to take all the necessary information on a client rather than embarking on premature, precipitate, and irreversible actions.

Contributed by Jeremy Mindell

Tips and Gratuities and the Tronc system **(Lecture B1392 – 23.22 minutes)**

What is a tip or gratuity?

A tip, gratuity or service charge "tip" is a payment made by the customer over and above the total of the customer's bill.

This tip may be left at the customers discretion on the table or at the bar, handed directly to the staff member, left in a tip box for distribution later, added as a discretionary service charge or mandatory service charge to the bill by the employer.

Since 1 October 2009, service charges, tips, gratuities and cover charges cannot be used to make up national minimum wage pay.

This means that all eligible workers must receive at least national minimum wage in base pay with any tips they receive being paid on top.

From 1 April 2023 the rates are:

- National Living Wage: £10.42 (aged 23 and over)

- National Minimum Wages:
  - £10.18 for workers aged 21 to 22;
  - £7.49 for a young worker aged 18 to 20 inclusive;
  - £5.28 for workers aged 16 to 17, and over the compulsory school age but under 18;
  - £5.28 for apprentices who are either under 19 or over 19 & in the1st year of apprenticeship.

HMRC's guidance states that where the employer imposes a mandatory service charge to a bill and that is paid out to the employees, national insurance will be due regardless of the arrangements for sharing out the money.

Tips given directly to employee

Where the customer leaves tip on the table or gives directly to the employee, and the employer is not involved, then PAYE does not apply. Tax will be due on the tips but no national insurance. The employee receiving the tip should advise HMRC of the amount by either reporting directly to HMRC or by completing a Self Assessment tax return. Tax would be collected by adjusting the employee's PAYE tax code.

Tips given to employee by the employer

In the situation where the employer passes the tips received to the employees then PAYE and employee's national insurance must be deducted via the payroll. The employer will also pay employers NIC.

Tips paid using the "Tronc System"

The word "Tronc" is believed to come from the French "tronc des pauvres" meaning a wooden box left in a church to collect money for the poor. In modern usage the tronc system is a special pay arrangement under which tips, gratuities and service charges are distributed to employees in the hospitality, leisure and hotel industry.

In these industries often the tips & service charges, NOT paid directly to the employer, are pooled and distributed to the staff by a third party. The employer appoints someone – head waiter or site manager, to independently allocate and pay out the tips and service charges. This system of collecting and paying out tips is known as the tronc. Using the tronc system the employee retains more of the tip than being paid by the employer.

The person responsible for administering the tronc is known as the tronc master. They are usually an employee of the business, often the head waiter, but definitely not the employer. But they can also be an independent third party such as a professional specialising in tronc system.

The tips paid out to employees under the tronc system are treated as earnings. But it is the tronc master, not the employer, who is responsible for deducting tax under PAYE under a

tronc scheme set up with HMRC. This tronc scheme is separate from the employer's own PAYE scheme.

Under the tronc system the payment of tips by the tronc master does not attract national insurance contributions where the:

- tronc master is deciding how to allocate the tips to the employees;
- employer does not pay the tips directly or indirectly to the employees;
- employer has no say in how the tips are allocated to employees.

Under the Income Tax (Pay As You Earn) Regulations 2003 the employer must notify HMRC when a tronc is set up together with the name of the tronc master. HMRC will set up a PAYE scheme in the name of the tronc master. When a payment is made to the employees the tronc master must run the payroll deducting tax but no national insurance from each payment. The payroll information will be reported to HMRC on or before payday under RTI. The tax deducted must then be paid to HMRC by the tronc master by 22nd of the month if paying by BACS or by 19th if paying by cheque.

Employment (Allocation of Tips) Act 2023

The Employment (Allocation of Tips) Act 2023 gained Royal Assent on 2 May 2023. The Act makes it unlawful for employers to withhold tips from staff and it is expected to come into force in 2024. The Act will apply to employees, workers and agency staff.

The legislation will make it illegal for employers to withhold tips from workers. It is expected that the change will help around 2 million people working in one of the 190,000 businesses across the hospitality, leisure and services sectors, where tipping is commonplace and can make up a large part of their income. It will also ensure customers know tips are going in full to workers and not businesses.

Particularly since covid, tips are more likely to go directly to the employer as customers use their credit or debit to pay their bill. It is estimated that 80% of all UK tipping now happens by card, rather than cash going straight into the pockets of staff. Currently businesses who receive tips by card have the choice of whether to keep it or pass it on to workers.

The legislation includes:

- All tips received electronically must be allocated to employees in a fair and transparent way;
- Tips must be paid out by the end of the month following the month collected;
- Employer must pass on tips to workers without deduction other than PAYE and NIC;
- Employer must keep written record of how tips are allocated;
- Employer must have a policy setting out how tips will be allocated;
- Workers have a right to make request for information on employer's tipping record;
- Worker has the right to take employer to employment tribunal if rules broken.

To help employers with this new legislation ACAS is drawing up a code of practice for employers, however as yet it has not been released for consultation.

When the measures under the Act come into force next year, if an employer has an existing tronc system in operation for cash tips then the tronc master can continue to run the tronc provided the employer is not involved in the allocation or payment of the tips.

The change in law will affect those businesses where the employer receives the tips directly into the business bank account as customers have paid their bill using credit or debit cards. In the future 100% of tips received by this method must be paid out by the employer in full to the employees. The timescale for paying out the tips is no later than the end of the month following the moth in which the payment was made by the customer.

The total amount of tips received must be allocated fairly to the workers at each place of business. The employer must prepare a written policy on dealing with tips and maintain records showing how the tips have been handled for 3 years. Employees will be able to request specific information on the employer's tip records within the last 3 years.

If an employer fails to comply with their obligations under the Act an employment tribunal can order the employer to revise any allocation of tips or make a payment directly to the employee and pay compensation for financial loss of up to £5,000 per claimant. A claim can be made up to 12 months from when employer failed to comply with the legislation.

Since the employer will be passing the tips on to the employee the payment will pass through payroll with PAYE tax and national insurance deducted. Employers will also pay national insurance contributions. The tips received must be paid out in full, with no deductions other than the tax and NIC.

Points to be consider with clients before changes introduced:

- Does employer have a clear tips policy?
- Are staff and customer aware of the policy?
- Is the tronc set up and operated correctly?
- If no tronc scheme in place, should one be set up to save NIC?
- What is likely effect on cashflow for the business with tips & gratuities going to staff?
- How easy will it be to separate and record tips & gratuities paid by customers to ensure all paid on to staff?

Contributed by Alexandra Durrant

CJRS deadline missed **(Lecture P1391 – 15.39 minutes)**

Summary – With the employee concerned not appearing on an RTI submission by the 19 March 2020 cut-off date, HMRC's assessment to clawback the CJRS grant paid was valid.

Mr Boddice was employed by Sentinel Fire and Security Systems Limited from 25 February 2020.

On 20 April 2020 the company submitted a claim for support payments under the Coronavirus Job Retention Scheme (CJRS) in respect of a number of employees including nearly £18,000 for Mr Boddice for the period March/April 2020 to January 2021.

Following a compliance check, HMRC raised an assessment for the amount claimed to be repaid on the basis that the employee had not appeared on an RTI submission on or before 19 March 2020.

The company paid employees on the last Friday of each month:

- The payroll for February 2020 was processed on or around 24 February 2020, so Mr Boddice did not appear on either the February payroll or the February RTI submission;

- The payroll for March 2020 included Mr Boddice's pay for the last few days of February and all of March, with the relevant RTI submission sent to and received by HMRC on 25 March 2020.

To be eligible for payments under the CJRS, an employee must have appeared on an RTI submission on or before 19 March 2020. Sentinel Fire and Security Systems Limited accepted that this was not the case for Mr Boddice but hoped that, on appeal, the First Tier Tribunal would overturn HMRC's assessment.

Decision

As we have seen in recent months, the First Tier Tribunal can only make decisions based on legislation and has no jurisdiction to decide on matters of fairness.

With the 19 March 2020 deadline missed, the CJRS claims were not valid and the case was dismissed.

Sentinel Fire and Security Systems Limited v HMRC (TC08849)

Invalid expense claims **(Lecture P1391 – 15.39 minutes)**

Summary – The taxpayer's expenses were denied as he could provide no supporting evidence to justify these sums. Penalties were correctly raised by HMRC on the basis of careless behaviour by the taxpayer.

Mr Badjie was within the PAYE system for the tax years 2016/17 to 2019/20 and in his tax returns for these years he claimed expenses, representing between 50% and 60% of his income each year:

Tax year	Travel and subsistence	Other expenses and allowances
2017	£9,341	£3,278
2018	£11,752	£4,124

2019	£13,818	£4,848
2020	£13,291	£4,664

HMRC disallowed all these claims. HMRC issued closure notices and a penalty explanation letter on 5 August 2021 explaining that penalties totalling £1,952.94 were going to be charged on the basis that he had acted carelessly.

Mr Badjie claimed that he had not acted carelessly. He had relied upon his agent and had no knowledge of the expenses claimed on his behalf:

- he had not provided details of any expenses to his agent;
- he did not review his tax returns;
- the first that he knew of these claims was when HMRC told him;

HMRC argued that Mr Badjie was aware of the expense claims. During a telephone call with HMRC, he had informed HMRC that his brother had introduced him to an accountant who could get him a refund. On five occasions between June 2002 and April 2021, he had telephoned HMRC asking why his repayment claim had not been processed. HMRC claim that these calls indicated that he knew his accountant had claimed expenses on his behalf and, as a result, he was expecting a large repayment from HMRC.

Decision

The First Tier Tribunal agreed with HMRC stating that:

> "He clearly knew that as a result of his expenses claims he was due a refund of tax even though he did not have any receipts to support his expenses claim."

Further, he admitted to HMRC on 20 May 2021 that he had "told the accountant what he spent and left it to the accountant to complete the tax returns." He clearly knew what was going on. He gave information to his accountant without any supporting documentation.

The appeal was dismissed and the penalties upheld.

Bakery Badjie v HMRC (TC08840)

Doctor's accommodation costs **(Lecture P1391 – 15.39 minutes)**

Summary – Accommodation costs were incurred to put the taxpayer in a position to be able to perform his duties and were not incurred wholly, exclusively and necessarily in the performance of those duties.

Jayanth Kunjur was a practising dental surgeon who lived in Southampton with his family. In order to qualify as a maxillofacial surgeon, he accepted a training position at St George's Hospital, Tooting, covering from 2012 to 2016.

In addition to his normal working hours, he was required to be on-call two nights a week and one weekend in six. When on-call he needed to be able to get to the hospital within 30 minutes and to have appropriate and reliable telephone connections to deal with on call

telephone queries. Consequently, he rented accommodation near the hospital in Colliers Wood.

This appeal concerned expenditure which Jayanth Kunjur incurred on his living accommodation. He claimed these costs were allowable as they were incurred wholly, exclusively and necessarily in the performance of his duties.

HMRC disallowed the claim, arguing that the dentist's employment contract did not require him to rent premises close to the hospital.

The First Tier Tribunal found that Jayanth Kunjur was entitled to relief for a proportion of the expenditure by reference to the amount of time it considered that he spent at the accommodation performing relevant on-call duties.

HMRC appealed, saying the First Tier Tribunal had erred in law.

Decision

The Upper Tribunal found that by renting his flat, Jayanth Kunjur was providing himself with somewhere to live during his working week. With his family in Southampton, he chose to pay for accommodation. If his family had lived locally, the claim would never have been made.

The Tribunal accepted that the premises were being used while he performed his duties but that this was not the same as incurring expenditure in the performance of those duties. The costs incurred were 'incidental expenditure' putting the surgeon in a position to be able to do the work he was employed to carry out.

The Upper Tribunal found that the First Tier Tribunal had erred in law by concluding that a deduction was allowable under s 336(1) ITEPA 2003. The costs incurred did not satisfy the 'wholly, exclusively and necessarily' test

HMRC's appeal was allowed.

HMRC v Jayanth Kunjur [2023] UKUT 00154 (TCC)

Class 1NICs on car allowances

Summary – The Upper Tribunal upheld claims by two construction companies for repayment of national insurance contributions previously made in respect of car allowances paid to employees.

The two appeals had been heard separately before the First Tier Tribunal where contrasting decisions had been reached.

Both companies operated similar schemes under which eligible employees could receive a cash allowance as an alternative to a company car. Employees had to demonstrate that they had a valid driving licence and a car available for business use, but the payments were not dependent on business mileage. Instead, the amount depended on the seniority of the employee and many recipients in fact had no business mileage. Employees within the schemes also received business mileage payments.

Decision

The Upper Tribunal held that the car allowances were 'relevant motoring expenditure' (RME) which were treated as earnings for NIC purposes (SI 2001/1004, reg 22A) only to the extent that they exceeded the 'qualifying amounts' in respect of business mileage (i.e. the total of the fixed statutory amounts per mile).

The key issue was whether the allowances were payments 'in respect of the use' by the employees of a vehicle.

The Upper Tribunal held that the allowances were made to ensure that the employee had a suitable vehicle available for business use. 'Use' encompassed expected or anticipated use. The fact that the entitlement depended on the seniority of the employee was only relevant to the quantum of the allowances and not to what they were 'in respect of'.

The Upper Tribunal therefore upheld the companies' claims in principle subject to agreement or further hearings before the FTT to determine the amounts.

Laing O'Rourke Services Limited v HMRC [2023] UKUT 00155 (TCC)

Adapted from the case summary in Tax Journal (21 July 2023)

Payment to EBT

Summary – A payment made by a company to an employee benefit trust (EBT) that was loaned to a director and shareholder of the company was earnings subject to PAYE and Class 1 national insurance contributions (NICs).

M R Currell Limited made a payment of £800,000 to an EBT it had established.

The EBT loaned the £800,000 to a director and shareholder of the company, Mark Currell. The loan was interest-free and repayable on demand after five years, but by the time of the appeal hearing only £50,000 had in fact been repaid.

Mark Currell used the loan to buy shares in the company from his wife, who then lent her proceeds back to the company through her director's loan account, to be withdrawn as and when she wished.

HMRC made determinations charging PAYE and class 1 NICs on the payment by the company to the EBT and the company appealed.

Decision

The First Tier Tribunal found that the company made the payment to the EBT to enable the trust to fulfil the commitment it had already made to Mark Currell to make the loan. The Tribunal rejected the company's argument that it had wished to 'ring fence' surplus funds outside the company to be made available for staff bonuses. The company had a history of paying bonuses, but at the time at which the payment was made, and for at least five years, it would not have been possible for the EBT to pay any bonuses as the entire fund had been paid to Mark Currell. Also, the 'ring fencing' justification was unconvincing. It was inevitable under the arrangements that the money would end up back in the company where it would be just as much at risk as it was before.

The First Tier Tribunal rejected the submission that a genuine loan with real repayment obligations could not comprise a reward or benefit. In this case, the loan clearly conferred a benefit on Mark Currell. His own evidence was that a loan from the EBT was attractive to him. The loan had to be reinvested in the company but could be withdrawn and used as he and his wife wished with no tax consequences. There was a further benefit in the loan being interest free.

Finally, the First Tier Tribunal considered why the loan was made to Mark Currell. The trustees could only make a loan to Mark Currell because he was an employee and not because of any personal qualities or other reason. And on the facts, it was more likely than not that the reason for the loan was because of the work Mark Currell had done over the years in building up the company's business and the loan was a reward for those services.

M R Currell Limited v HMRC (TC08855)

Adapted from the case summary in Tax Journal (28 July 2023)

Domicile of choice and carelessness (Lecture P1391 – 15.39 minutes)

Summary – The taxpayer had an English domicile of origin but during the relevant years had never had a domicile of choice in Connecticut.

Mr Strachan's father was born in Scotland. Aged 21, he moved to England as a qualified doctor, retaining no property in Scotland. His children were born in Oldham. He remained in England until his death, when his probate certificate recorded him as domiciled in England and Wales.

Born in Oldham, Mr Strachan attended secondary school in Edinburgh, and cheered for Scotland, not England, when the two nations competed in rugby. Following a gap year abroad, he studied at Christ's College, Cambridge, followed by a Masters course at Princeton.

Between 1967 and 1985, Mr Strachan was married to an American. By 1971 he had become a US citizen, and subsequently obtained a US passport. During this time, he lived in New York, Texas, Japan and Thailand and Hong Kong. He bought a house in Texas in 1977 that was rented out when he was living abroad between 1975 and 1984. In 1983, having been left money by his aunt, he bought a property in London that he rented out. In 1984, he sold his Texas property and moved to New York, buying a property in Manhattan.

He separated from his wife in 1985 and remarried in 1987. He sold his New York property, but his second wife had a property in Connecticut. By September 1987 he had moved to London to take up a new post, working for Rio Tinto Zinc.

Mr Strachan's paid work came to an end by 2015, when he was 72. Despite this being an obvious point at which they could have returned to Connecticut, the couple remained living in England with "an active and full social and sporting life in London". The couple bought a property in Spain and one in Massachusetts, both of which were used for holidays.

Mr Strachan completed his UK tax returns for 2011/12 to 2015/16 on the basis that he was domiciled in Massachusetts. However, HMRC disagreed believing him to be UK domiciled and issued discovery assessments for the first four years, and an amendment for the fifth totalling some £420,000.

Mr Strachan appealed arguing that from 1987 he had a domicile of choice in the USA.

Decision

The First Tier Tribunal confirmed that although Mr Strachan's father had been born in Scotland, giving him a domicile of origin in Scotland, he had moved to England when he was age 21, retaining no Scottish property and remained in England on retirement. His father's domicile of choice in England, meant that Mr Strachan's domicile of origin was England. Attending university in Scotland and supporting Scotland in Rugby matches did not change this. These were minor factors.

For Mr Strachan to have a domicile of choice in the USA the First tier Tribunal stated that the courts have repeatedly endorsed that a domicile of choice is only established if a person both:

- voluntarily fixes his "sole or chief residence" in a particular place; and
- does so with "an intention of continuing to reside there for an unlimited time".

Although the couple owned a property in Massachusetts, the couple had never lived there permanently, and this was not the place where they were "settled".

Based on the facts, Mr Strachan spent most of the year in England where he had worked. London was the centre of the couple's social life and where they kept their most valuable possessions.

With a UK domicile of origin established, Mr Strachan's appeals against the assessments for 2013/14 to 2015/16 were dismissed.

The Tribunal moved to consider whether the 2011/12 and 2012/13 discovery assessments were valid. The issue to decide was whether the loss of tax resulting from his incorrect Self Assessment returns had been caused by his carelessness.

The First Tier Tribunal found that he had acted carelessly by not checking advice claimed to have been given to him back in 1987, when he was told that his domicile of choice was Massachusetts. He was wrong to assume he was domiciled in Massachusetts and "given the very significant changes to his position" since that time, "the reasonable taxpayer in his position would have refreshed the advice he had taken over 25 years previously"

However, this did not necessarily mean that had he taken advice before filing these returns, that the advice would necessarily have been different. The Tribunal found HMRC was unable to prove that the loss would have been avoided had the taxpayer taken advice. Consequently, the appeal against the 2011/12 and 2012/13 assessments was allowed. The total amount payable was reduced by close to £100,000.

Ian Charles Strachan v HMRC (TC08858)

Capital taxes

Comparing two holdover relief provisions (Lecture P1393 – 21.06 minutes)

S.165 TCGA 1992 deals with holdover relief for gifts of business assets. The section provides that, on a claim, a gain can be held over and deducted from the asset's acquisition cost in the hands of the donee. This prevents what is often referred to as a 'dry' tax charge. There is no CGT for the donor to pay and the donee will use the reduced base cost when calculating the gain on any future sale of the asset.

The most common assets to benefit from business asset holdover relief are shares or securities. By virtue of s.165(2)(b) TCGA 1992, they must be part of the capital of a trading company or the holding company of a trading group where:

- the shares (or securities) are not listed on a recognised stock exchange; or
- the trading company or holding company is the donor's 'personal company'.

A personal company is one where the individual has at least 5% of the company's votes.

It is important to appreciate that there is a key restriction which can catch shares which are eligible for s.165 TCGA 1992 relief. This applies where there is a gift of shares and the company owns chargeable assets which are not chargeable business assets (Para 7(1) Sch 7 TCGA 1992).

Where a company owns non-business chargeable assets on the date of the gift, the qualifying gain on that gift is subject to the following reduction:

$$\text{Gain} \times \frac{\text{Chargeable business assets (CBA)}}{\text{Total chargeable assets (CA)}}$$

with the chargeable business assets and the total chargeable assets being valued at their market values on the date of the gift.

Example 1

On 1 August 2023, Rachel, a top rate taxpayer, gave her daughter, Samantha, a holding in a personal company (Rachel Real Estate Ltd). These trading company shares had cost Rachel £1,000 when she acquired them in 1995 and their market value was £285,000 on the date of the gift.

The company's balance sheet showed assets with the following values on 1 August 2023:

	£
Goodwill (pre-2002)	60,000
Freehold premises	240,000
Shares held as investments	100,000
Trade debtors and other net assets	82,000

Cash at bank	158,000

The company's chargeable business assets and chargeable assets are:

	CBA	CA
	£	£
Goodwill	60,000	60,000
Freehold premises	240,000	240,000
Shares held as investment	–	100,000
	300,000	400,000

Rachel's gain on the gift of the shares to Samantha is:

	£
Market value as at 1 August 2023	285,000
Less: Cost	1,000
Gain	284,000

The gain which is eligible for holdover relief under s.165 TCGA 1992 is:

$$284{,}000 \times \frac{300{,}000}{400{,}000} = £213{,}000$$

The balance of Rachel's gain of £71,000 (£284,000 – £213,000) is immediately chargeable to CGT. On the assumption that Rachel had already utilised her business asset disposal relief limit of £1,000,000 and her annual CGT exemption for 2023/24 of £6,000, the gift produces a CGT liability of 20% x £71,000 = £14,200.

In this context, a business asset is an asset used for the purposes of the company's trade and a chargeable asset is one which, if sold for a profit, would give rise to a chargeable gain (Para 7(2) Sch 7 TCGA 1992). Note that the values employed for the above calculation are those at the date of the gift rather than cost or book value.

It is worth pointing out that, if the company in the previous example had sold its investments for cash immediately prior to Rachel's gift, there would have been no restriction to the held over gain of £284,000. Cash is not a chargeable asset and so the relevant fraction would then have become:

$$\frac{300{,}000}{300{,}000}$$

with Rachel's entire gain being eligible for deferral.

A critical issue these days is the position of goodwill. In the previous example, the pre-2002 goodwill was a chargeable asset (and therefore a chargeable business asset). However, if the company had created or acquired its goodwill on or after 1 April 2002, it

would have been an intangible fixed asset which is dealt with under Part 8 CTA 2009 and is *not* a chargeable asset.

This can produce some surprising results, given that post-2002 goodwill is therefore omitted from both the numerator and the denominator of the fraction in Para 7(1) Sch 7 TCGA 1992.

One planning point which Rachel could have investigated was to set up an interest in possession trust with a life tenancy for Samantha as an alternative to making her an outright gift. In this case, Rachel's gift would have been an immediately chargeable transfer for IHT purposes and so would have qualified for holdover relief under the s.260 TCGA 1992 facility. Because the shares are relevant business property by virtue of S105(1)(bb) IHTA 1984, they would have attracted 100% business relief. There would have been no IHT to pay on the creation of the interest in possession trust, but, looking at the S260 TCGA 1992 holdover regime, there is *no* restriction of the gain which can be held over where the company has chargeable assets which are not chargeable business assets.

This could have saved Rachel a CGT charge of £14,200.

Contributed by Robert Jamieson

Planning with related settlements **(Lecture P1394 – 20.08 minutes)**

For IHT purposes, S62(1) IHTA 1984 confirms that trusts are treated as 'related settlements' if they:

- are made by the same settlor; and
- commence on the same day.

Note that it does not matter whether the trusts are discretionary or interest in possession settlements.

As an anti-avoidance measure, S66(4)(c) IHTA 1984 prescribes that, when determining the quantum of a 10-year anniversary charge, the initial value of any related settlement must be taken into account. By virtue of S68(5)(b) IHTA 1984, this is also the case when calculating an exit charge prior to a trust's first 10-year anniversary. The purpose of these provisions is to discourage the creation of two or more trusts simultaneously. This problem is easy enough to circumvent during someone's lifetime. However, if a testator establishes in his will a life interest trust for his brother and a discretionary trust for his grandchildren, the two trusts will be treated as related settlements under the IHT legislation.

In this context, the impact of S80 IHTA 1984 should not be overlooked. For example, if one of the two settlements is a life interest trust for the deceased's surviving spouse with remainder on a discretionary trust for their children, that trust is deemed to arise on the *termination* of the spouse's life interest. In other words, the two trusts will not have been created on the same day. However, for 10-year anniversary charge purposes, the surviving spouse's trust will still be deemed to commence on the date when the trust property was first settled (S61(2) IHTA 1984).

It is customarily argued that the deliberate creation of related settlements should, if possible, be avoided, given that the rules involve a 'sharing' of the IHT nil rate band.

Despite this, if the value of the intended trust property is likely to escalate over the next few years, there can be a useful advantage in deliberately creating, say, two or three discretionary trusts rather than just one. This has become of greater interest following the enactment of the anti-pilot trust legislation in 2015 (Ss62A – 62C IHTA 1984).

Example

Mark, whose cumulative IHT total stands at nil, wishes to settle property worth £240,000 on discretionary trusts.

Assume that, in 10 years' time, this property has quadrupled in value to £960,000 and that no distributions of capital (i.e. exit charges) have been made.

Using current lifetime rates, the IHT payable in connection with the first principal charge will be:

If one trust is created the IHT on £960,000 is:

	£
On 325,000 @ 0%	–
On 635,000 @ 20%	127,000
	127,000

This gives rise to an effective IHT rate of 13.229% (127,000 / 960,000 x 100)

The IHT liability on the 10-year anniversary is £38,102 (13.229% x 30% x 960,000).

If two equal trusts are created, the chargeable 10-year anniversary amount in each case will be:

	£
Value of discretionary trust property	480,000
Add: Initial or historic value of related settlement	120,000
	600,000

The IHT on £600,000 is:

	£
On 325,000 @ 0%	–
On 275,000 @ 20%	55,000
	55,000

The effective IHT rate is 9.167% (55,000/600,000 x 100).

The IHT liability for each trust is therefore £13,200 (9.167% x 30% x 480,000).

This makes a total sum payable of £13,200 + £13,200 = £26,400 compared with £38,102.

If three equal trusts are created, the chargeable 10-year anniversary amount in all three cases will be:

	£	£
Value of discretionary trust property		320,000
Add:		
Initial value of first related settlement	80,000	
Initial value of second related settlement	80,000	
		160,000
		480,000

The IHT on £480,000 is:

	£
On 325,000 @ 0%	–
On 155,000 @ 20%	31,000
	31,000

The effective IHT rate will be 6.458% (31,000/480,000 x 100).

The IHT liability for each trust is therefore £6,198 (6.458% x 30% x 320,000).

This makes a total sum payable of £6,198 + £6,198 + £6,198 = £18,594 compared with £26,400.

The key point which makes the multi-trust arrangement work is that IHTA 1984 only requires the (lower) *initial value* of any related settlement to be taken into account rather than the current value of that trust property.

Contributed by Robert Jamieson

Ineffective home loan scheme **(Lecture P1391 – 15.39 minutes)**

Summary – The value of a house that the taxpayer continued to live in having gifted it to an interest in possession trust in return for a promissory note was taxable in her death estate with no deduction for the debt.

This appeal concerned the inheritance tax consequences of transactions implemented by Mrs Elborne in 2003 as part of a "home loan scheme".

In summary this involved Mrs Elbourne:

- disposing of the house that she lived to the trustees of a settlement in which she had an interest in possession in exchange for a promissory note issued by the trustees;

- assigning of the promissory note by way of gift to the trustees of a family settlement in which her children had interests in possession, but which excluded her from benefiting; and

- continuing to live in the house rent-free until her death, more than seven years after the promissory note assignment had taken place.

The appellants argued that the inheritance tax consequences were as follows:

- Mrs Elborne's assignment of the promissory note to the trustees of the Family Settlement was a potentially exempt transfer, but as she survived seven years it never became chargeable; and

- On Mrs Elborne's death, due to her interest in possession in the Life Settlement, the house was deemed to form part of her estate;

- A deduction should be allowed on her death estate for the amount owed to the trustees of the Life Settlement under the promissory note.

The net effect of all of this would be that the value of her house would not be liable to inheritance tax on her death.

HMRC disagreed and raised a notice of determination that included the value of the house but did not deduct of the amount payable under the promissory note.

Decision

Despite various defects in the supporting documentation, including the order in which documents were signed, the First Tier Tribunal concluded that none of these caused the scheme to fail.

The Tribunal agreed that the house formed part of her death estate.

However, the promissory note was not deductible as under s.103 FA 1986, the debt must be abated by the value of the consideration given by Mrs Elborne at the time when the promissory note was issued.

That value was the value of her house when it was put into trust, meaning that the remaining debt available for deduction on death was zero.

The scheme failed and the appeal was dismissed.

The Executors of Mrs Leslie Vivienne Elborne and others (TC08863)

Residential SDLT despite sheep grazing **(Lecture P1391 – 15.39 minutes)**

Summary – A property with two Land Registry titles was found to be liable to SDLT residential rates as sheep grazing in a field was not carried out on a commercial basis. Multiple Dwellings Relief was denied as no claim was made within the statutory time limit.

In January 2019, James Gibson bought a property, Doe Bank Manor, for £1,595,00, which he had been occupying with his family since 27 November 2018.

The property had two Land Registry titles:

1. WK425880: a six-bedroom house, garage with an 'office/studio', self-contained barn, an outbuilding and a 0.5 acre market garden;

2. WK426348: a field/paddock where, for the previous four years, farmers had used the land but for no consideration. With the land used for summer grazing, there were no sheep on the land at the time of purchase.

An SDLT return was filed on the basis that the property transaction was "mixed-use" and the total amount of tax due was calculated at £69,500. No claim for Multiple Dwellings Relief was made in respect of the house and barn.

On 30 November 2020, HMRC issued a closure notice concluding the property purchase was residential and that higher rates of SDLT applied, increasing the SDLT payable by £83,500 to £153,000. Multiple Dwellings Relief was denied as over a year had passed since the original SDLT return had been filed, meaning it was too late to amend return.

Following a statutory review, on 24 January 2022, James Gibson appealed to the First Tier Tribunal.

Decision

The land had not been used for commercial agricultural purposes since 2003. What had once been a working farm had been converted under residential planning permission into a family home with 'far reaching views.'

The First Tier Tribunal found that the property was sold as one lot, with the two parcels of land purchased so as to provide an appealing country residence. The paddock did not convert the property to mixed residential and non-residential use.

The claim for Multiple Dwellings Relief was not made within a land transaction return or in amendment to a return within 12 months after the filing date. Having failed to amend the SDLT return to include a claim for Multiple Dwellings Relief within the statutory limit, the relief was denied.

James George Gibson v HMRC (TC08869)

Residential property for SDLT purposes **(Lecture B1395 – 19.02 minutes)**

The rate at which SDLT is charged on consideration other than rent depends on the amount of the chargeable consideration, and whether the transaction is a residential property transaction or a non-residential property transaction.

The legislation defines what is meant by 'residential property' and then everything else is non-residential. Mixed use property is non-residential.

Therefore, an incentive exists to try and get some of land purchased outside of the definition of residential property.

It is an important distinction for the following reasons:

- The rates are intrinsically higher for residential property;
- Residential property can be subject to the 3% supplement for additional dwellings;
- Residential property can be subject to the 2% supplement for non-resident purchasers; and
- Residential property can be subject to the 15% ATED-linked SDLT rates.

Residential property is defined as follows:

(a) a building that is used or suitable for use as a dwelling, or a building which is in the process of being built or adapted for use as a dwelling; and

(b) land that is or forms part of the garden or grounds of a building falling within (a) above, including any building or structure on such land; or

(c) an interest in or right over land that subsists for the benefit of a building falling within (a) above or for the benefit of land falling within (b) above – for example, access rights across adjacent property.

The definitions of residential property and non-residential property are subject to the rule which provides that where six or more dwellings are acquired as a 'single transaction' then the dwellings are treated as not being residential property. However, it may be more beneficial to claim multiple dwellings relief in this situation and it is possible to do that.

The status of a house or flat as a dwelling is usually obvious. However, there will be other situations where it is not clear as to whether a building is suitable for use as a dwelling, eg when the building is derelict, or where it is used for purposes other than those of a dwelling etc.

Starting with the first part of the definition, a transaction will be a residential property transaction if it comprises the acquisition of a building which is used or suitable for use as a dwelling, or the acquisition of a building which is in the process of being built or adapted for use as a dwelling. The term 'dwelling' is not defined in the legislation and must therefore take its everyday meaning, being 'a building, or a part of a building that affords those who use it the facilities required for day-to-day private domestic existence and a significant degree of permanence'. It also includes buildings under construction where there is evidence to show that it is being built or adapted for use as a dwelling. However, planning permission to convert to a dwelling is not sufficient if the work has not commenced.

HMRC have confirmed that it is not necessary for the sellers or previous occupants of the building to be in residence on the 'effective date' of transaction for the property to be considered 'in use' as a dwelling. If it is not in use, then HMRC will typically consider the last use.

One argument that is sometimes made is that whilst a property has been a dwelling in the past, it is no longer habitable as such due to dereliction. However, HMRC make a clear distinction between a derelict property and a dwelling which is essentially habitable, but which is in need of modernisation, renovation or repair, which can be carried out without materially changing the structural nature of the property.

This has been confirmed in recent case law which treated a property as residential even though it was acknowledged that some (quite significant) work was needed before the purchasers could actually live in it (*Amarjeet Mudan and Tajinder Mudan v HMRC* [2023] TC08777). The judge was also clearly influenced by the fact the house had previously been occupied as a dwelling.

Another interesting case is that of *Fish Homes Ltd v HMRC* [2020] UKFTT180 where the taxpayer company acquired a two-bedroom flat in Greenwich but subsequently found that the flat was in a block which was covered with cladding similar to that used on the Grenfell tower block. The taxpayer company argued that the acquisition of the flat was not a residential property transaction because the danger created by the cladding meant that the flat was not suitable for use as a dwelling. However, their argument was slightly hampered by the fact that the shareholder's daughter and one of her friends did, in fact, occupy the flat after the purchase. Whilst it could not be rented to a third party it was found that the flat was a dwelling.

If a building falls to be treated as residential property, then any land that is or forms part of the garden or grounds of such a building (including any building or structure on such land) will also be residential property.

If any land acquired along with the building is not 'garden or grounds' of the building, and there is no building on that land that is used or suitable for use as a dwelling, or is in the process of being constructed or adapted for such use, the land will not be residential property, the transaction will, therefore, not consist entirely of the acquisition of residential property, and the lower non-residential property SDLT rates will apply to the transaction.

For the purposes of SDLT there is no statutory concept that land can only be the garden or grounds of a dwelling if the land is required for the 'reasonable enjoyment' of the property, nor does the legislation stipulate a size limit that determines what is meant by the 'garden or grounds' of a dwelling.

This point has been confirmed by a number of recent tax cases.

The purchaser's future intentions as to the use of the land are irrelevant in determining whether, at the 'effective date' of the transaction, the land is, or is part of, the grounds of the building.

As a consequence, the same piece of land may constitute garden or grounds of a building in one transaction but not in a subsequent transaction. At SDLTM00450 HMRC give the following example:

> 'For instance, a purchaser (Person A) may acquire the garden of a dwelling (whether or not fenced / walled off at that time from the rest of the vendor's property) separately from the dwelling, with the intention to use it for commercial purposes. If at the time of the purchase the garden was enjoyed as a garden by the residents of the dwelling (ie the vendor) then the purchase will be of residential property regardless of the fact that the land is being purchased and the dwelling is not. However, if the same land is subsequently sold on by Person A then it may be the case that by the time of that subsequent sale it is no longer used as the garden of a dwelling and has therefore become non-residential land.'

A number of factors may need to be taken into account in coming to a view as to whether land is the garden or grounds of a building and it is unlikely that any one factor will be determinative.

Some of the major factors to be considered in determining whether land is 'garden or grounds' are as follows:

- *The use to which the land is put is likely to be the most important factor*

  If, at the 'effective date' of the transaction, the land in question is put to a commercial use, then that would be a strong indicator that the land is not garden or grounds of the relevant building. However, at SDLTM00460, HMRC state that 'It would be expected that the land had been actively and substantively exploited on a regular basis [for the purposes of that commercial use] for this to be the case.' HMRC point out that a large number of activities, such as beekeeping, grazing and equestrian activities could be purely a leisure activity or could be carried out on a commercial basis. Whilst livestock may graze on the land, if that activity is not carried out on a commercial basis, and the land "…primarily provides an appealing setting for a dwelling…" then the land is likely to be 'garden or grounds' of the dwelling. Conversely, if the land is grazed under a genuine commercial arrangement, then it should not be 'garden or grounds' of the dwelling. HMRC also state:

  'The grazed land might also have a value as part of a "treasured view" from the dwelling. In this case the relative uses of the land would have to be weighed up in deciding whether it formed part of the 'garden or grounds' of the dwelling.'

  Where a lease has been granted to a third party for the exclusive occupation of the land, this may indicate that the land should not be 'garden or grounds' of the dwelling. Unhelpfully HMRC then qualify this conclusion when they state that:

  'However occasionally allowing third parties to occupy or exploit the land is unlikely to mean the land ceases to be "garden or grounds". Where a lease or a licence is in place, the true nature (including commencement and duration) of the agreement will need to be established (SDLTM00460).'

  This qualification seems to be a reference to the decision of the FTT in *Brandbros Limited v HMRC* [2021] UKFTT 157. The case involved the purchase by Brandbros Limited of a three-bedroomed end of terrace property with features including a garage to the rear. The purchase of the property completed on 27 July 2018. Later that same day Brandbros Limited entered into a lease of the garage with SFEP Limited. The lease was for a term of 25 years, at an initial rent of £2,000 per year, and permitted the tenant to use the garage inter alia for storage.

  The FTT held that the garage was a building or structure in the grounds of the property acquired and therefore the use to which it was put was irrelevant in determining the nature of the transaction for the purposes of SDLT. The house acquired was clearly residential property. Residential property extends to any garden or grounds of the house including any buildings or structures on such 'garden or grounds'. Thus, the garage is deemed to be residential property irrespective of its actual use.

The FTT went on to say that even if they had concluded that the use of the garage should be taken into account in determining the nature of the transaction, they were still satisfied that the grant of the lease did not alter the classification of the transaction as the acquisition of residential property. This was on the basis that the lease over the garage was not granted until after the 'completion' of the transaction, and therefore what was acquired was residential property. The fact that the lease was granted on the same day, but after 'completion' of the acquisition of the property, had no effect on the SDLT treatment of the purchase of the property.

- *Layout of land and outbuildings (SDLTM00465)*

  The presence of the following may indicate that the land is 'garden or grounds':

  - domestic outbuildings;
  - areas laid out for leisure use or carrying out hobbies;
  - small orchards; or
  - stables and paddocks suitable for leisure use.

  The presence of the following may indicate that the land is non-residential:

  - commercial farming/horticulture;
  - commercial woodland;
  - commercial equestrian use; or
  - some other commercial use.

- *Extent of the land*

  The extent/size of the land in question will also be a factor to be considered. At SDLTM00470, HMRC indicate that a small country cottage is unlikely to have dozens of acres of 'garden or grounds' whereas a stately home may well have 'garden or grounds' which extend to that sort of acreage. Large tracts of fells/moorland are unlikely to be 'garden or grounds'.

- *Proximity to the dwelling*

  If the land is physically close to the dwelling and easily accessible from it or separated by a feature which is easily crossed such as a small road or river, or even land owned by third parties, this would indicate that the land is 'ground or gardens'. Fencing off the land would not, in itself, cause the land to cease to be 'garden or grounds'. However, the more difficult it is to get to the land from the dwelling and the greater the degree of separation between the dwelling and the land, the less likely it is that the land will be 'garden or grounds'.

- *Legal factors and constraints*

  If the land is subject to any legal constraints as to use, for example, there may be planning permission in place which permits the land to be used for commercial

purposes, then this may indicate that the land is not 'garden or grounds'. However, in HMRC's view planning law by itself is not determinative and actual use will normally be given greater weight. They give two examples as follows:

- Where planning regulations prohibit commercial use, but these are being breached by longstanding commercial use (particularly if the actual use is unlikely to be challenged by the planning authority), then this would indicate the land is not likely to be 'garden or grounds'; or

- alternatively, where commercial use is permitted but the land is actually being used for residential purposes, then this would be an indicator that the land is 'garden or grounds'.

The terms of any contracts, leases, restrictive covenants or easements will be relevant factors. However, whether the land is registered under one land registry title, or more than one land registry title, will rarely be relevant.

If the owner of the dwelling has no rights to access the land, then this is likely to indicate it is not 'garden or grounds', particularly if the land is physically separate from the dwelling. In contrast, if physically separated land can be accessed via an easement, this could mean that it is garden or grounds.

Rights of way over the land for walkers, or rights of access by utility companies to the land, will not normally prevent the land from being 'garden or grounds'.

The receipt of 'Basic Payment Scheme' payments (scheme under which rural grants and payments are made to the farming industry) for the land would be an indicator that the land is not 'garden or grounds' but, in HMRC's view, it does not, by itself, mean that the land is non-residential in nature.

HMRC indicate at SDLTM00475 that the following factors are likely to indicate non-residential land:

- a non-domestic rateable value for the land has been assessed;

- non-domestic rates are collected for the land; or

- the land has been classified as agricultural land and buildings for the purposes of exemption from business rates.

HMRC have been challenging a number of claims that the non-residential rates of SDLT apply to the purchase of a dwelling with land, where the taxpayer was claiming that the land acquired was not part of the 'garden or grounds' of the dwelling. Unfortunately, from the perspective of establishing sound precedent case law, none of the cases had particularly strong fact patterns from the purchaser's perspective, and HMRC has been very successful in arguing these cases.

Doctor David Hyman and another v HMRC [2019] UK FTT 469 (TC)

The facts were that Doctor Hyman and his wife acquired a farmhouse together with approximately 3.5 acres of land. In the first instance they paid SDLT at the higher residential SDLT rates but then made a repayment claim when they received advice that the lower non-residential SDLT rates should have applied.

The land acquired included a meadow, bridleway and derelict barn (which had been classified as non-residential by the local council). However, even though the land was physically separated by hedges/fences from the farmhouse, and the public had a right of way over the bridleway, the First-tier Tribunal held that the land was the garden or grounds of the farmhouse and therefore that the higher residential rates of SDLT applied, and no repayment was due. The decision of the First-tier Tribunal was appealed to the Upper Tribunal which gave its decision on 18 March 2021 dismissing the appeal. The decision of the Upper Tribunal was then appealed to the Court of Appeal which gave its judgment on 17 February 2022, dismissing the appeal.

C Goodfellow and another v HMRC [2019] UK FTT 750 (TC)

The facts were that Mr and Mrs Goodfellow purchased a property with approximately 4.5 acres of land. As well as a dwelling there was a detached garage, which was used as an office, together with a stable yard and a paddock for horses. As in *Hyman,* the taxpayer initially paid SDLT at the higher residential rates of SDLT but then made a repayment claim on receiving advice that the lower non-residential property rates of SDLT should have applied. The arguments for non-residential property treatment were largely that some paddocks were let to a neighbour, to allow them to graze horses, for a nominal rent of £12 per annum, and that the office space in the garage was non-residential property. These arguments were rejected by the First-tier Tribunal. The tribunal took the view that the office in the garage was no different from a 'home office' and was therefore residential property. As regards the paddocks, the tribunal found that the property was sold as an 'equestrian property' and the equestrian facilities were therefore a necessary part of the property and there was no commercial activity taking place on the land. As such the land constituted the 'garden and grounds' of the dwelling, the property was residential property, and therefore no repayment of SDLT was due. The decision of the First-tier Tribunal was appealed to the Upper Tribunal which gave its decision on 18 March 2021 dismissing the appeal. The decision of the Upper Tribunal was then appealed to the Court of Appeal which gave its judgment on 17 February 2022, dismissing the appeal.

Pensfold v HMRC [2020] UK FTT 0116 (TC)

A Cayman Islands company acquired a farm with 27 acres of land and proposed to develop the site as an eco/agritourism venture. The SDLT land transaction return was filed on the basis that the lower non-residential rates applied to the purchase. The basis for treating the property as non-residential was that the land was subject to a grazing agreement with a third party, who had been grazing the land for some years, every year, from April to October. This third party also maintained the land in the intervening winter. No formal agreement was in place to permit the grazing which took place under a traditional gentleman's agreement. However, at the 'effective date' of the transaction, the land was not being grazed. The marketing brochure advertising the farm for sale made no mention of the sale being subject to grazing rights, and likewise the contract to purchase the property made no mention of the grazing rights. The First-tier Tribunal pointed out that, had the entire 27 acres of land been subject to grazing rights, that would have made the plans to develop an eco/agritourism venture rather difficult to implement. The tribunal therefore concluded that, at the 'effective date' of the transaction, the property was entirely residential and, therefore the higher residential rates of SDLT applied. The decision of the First-tier Tribunal was appealed to the Upper Tribunal which gave its decision on 18 March 2021 dismissing the appeal. See below for further commentary on the appeal.

Lynda Helen Myles-Till v HMRC [2020] UK FTT 0127 (TC)

The facts were that the taxpayer acquired a property with around three acres of land and the property comprised a three-bedroom house (Shepherds Cottage), a detached double garage, a garden to the rear of the house and a grass-covered field known as the "paddock". The estate agent's marketing literature mentioned the paddock a few times; for example, it stated that: 'The garden looks back on to a paddock enclosed by mature hedging and post and rail fencing.' In 1983, the paddock had been part of a neighbouring farm. For many years the paddock had been covered in grass and therefore potentially usable for grazing animals. This potential use of the paddock for grazing caused an agricultural and rural planning consultant to refer to the paddock, in his report, as agricultural land.

The arguments for treating the land as non-residential property were largely that the land had historically been used as agricultural land as part of the neighbouring farm, at the 'effective date' of the transaction the paddock was overgrown agricultural land that had not been adapted for any other use, and the size of the paddock was far larger than would usually come with a dwelling of the size and character of Shepherds Cottage. In coming to its decision, the tribunal stated that:

> 'One must, in addition, look at the use or function of the adjoining land to decide if its character answers to the statutory wording in s 116(1) – in particular, is the land grounds "of" a building whose defining characteristic is its "use" as a dwelling? The emphasised words indicate that the use or function of adjoining land itself must support the use of the building concerned as a dwelling. For the commonly owned adjoining land to be "grounds", it must be, functionally, an appendage to the dwelling, rather than having a self-standing function.'

In the tribunal's view it came down to whether '… the paddock had a self-standing function as opposed to being a functional appendage of Shepherds Cottage.' The tribunal concluded that as there was no evidence of actual use of the paddock for grazing since it was last part of a farm in 1983, that at the 'effective date' of the transaction the paddock was the 'grounds' of Shepherds Cottage, and therefore the property was wholly residential.

Gary Withers v HMRC [2022] UK FTT 00433 (TC)

This case is notable as it is the first case which HMRC have lost at the First Tier Tribunal on the issue of mixed use property.

Mr Withers and his wife bought a dwelling with an annexe and around 39 acres of land including gardens, fields and woodland. They submitted the return on the basis this was mixed use as some of the land was used for sheep grazing and cutting hay as well as an area being part of a Woodland Trust rewilding scheme. HMRC considered that the land was wholly residential.

Further relevant factors were the use of the grazing land by a local farmer for 20 years under a formal agreement with evidence of feeding stations and water troughs being put in place to support these activities. The rewilding land was subject to strict conditions regarding access and use.

The First Tier Tribunal found that the land had a function other than as garden or grounds. The volume and organisation of the sheep grazing was sufficient to make this part of the land commercial. The rewilding agreement was sufficient to take this area of land outside of the definition of 'garden or grounds'. The following comments were made:

> 'There were, importantly, grazing and Woodland Trust agreements in place at the time of the purchase and the Tribunal consider that the relevant areas of land were used for a separate purpose and self standing functions and failed to meet the tests of residential property. Their use or function does not support the use of the dwelling/building concerned as a dwelling.'

The appeal was therefore allowed.

Whilst it is interesting to see this success, it is probably not going to change the view of HMRC in challenging such cases.

Daniel Ridgway v HMRC [2022] UK FTT 00412(TC)

There is a further case which has added to the question of whether property is residential or non-residential by considering firstly whether legal impediment to use as a dwelling is sufficient to change the nature of a property and secondly whether the anti-avoidance provisions at FA 2003, s75A are relevant.

Mr Ridgway was acquiring two properties. The first was a semidetached house and the other was a studio which had previously been converted from a garage. The two properties had separate titles and land registrations.

Mr Ridgway was looking for ways to reduce his SDLT liability and was told if the studio was in commercial use at completion then the transaction would be mixed use and so attract non-residential rates of SDLT. He granted a 9-month commercial lease to a photographic studio which contained a prohibition on using the property as a dwelling.

HMRC denied the claim on the basis that the studio was still 'suitable for use as a dwelling' even though there was a lease contained a restriction on use in this way.

The First Tier Tribunal found that the terms of the commercial lease were sufficient to mean that the property was not suitable for use as a dwelling. However, they considered that the provisions at s75A meant that the arrangement did not work in mitigating the SDLT. This legislation applies where transactions are inserted into an arrangement which reduces the overall SDLT liability and the Tribunal found that Mr Ridgway had entered into the lease with the intention to reduce his SDLT liability. Having fallen foul of s75A, the lease was ignored and this was the purchase of residential property.

James Faiers v HMRC [2023] UK FTT 00297 (TC)

Mr Faiers purchased a property in Kent which included land on which there was a commercial electricity distribution network subject to a wayleave in favour of the electricity distributor EPN. The network consisted of a pole supporting two 11KV electricity cables criss-crossing parts of the property with a total of 10% of the land within a 'safety zone'. However, this area was not physically separated from the rest of the property. A repayment was sought on the basis that this was mixed-use as the part used for commercial purposes could not form part of the garden or grounds of the dwelling.

The appeal was dismissed for the following reasons:

- the whole of the land adjoined and surrounded the dwelling with no part physically separated;
- although the power network was part of a third party's commercial operation, this was not in this case determinative;
- the level of physical intrusion was not extensive; and
- The safety issue did not prevent the landowner from doing anything at all.

The *Withers* case discussed above was considered but there was felt to be a clear difference between the use and intrusion in each case. It is useful to note that, although not binding, the Tribunal judge did state that the presence of an electricity sub-station on the land would probably be sufficient to render it mixed-use.

The conclusion to be drawn from this is that it is difficult to convince HMRC and the Courts that land is mixed use unless there is clear commercial use of the land. HMRC did launch a consultation in 2021 in which they proposed a change in the legislative definition, but this has not yet been implemented.

Contributed by Ros Martin

Administration

‘Naming and shaming’ of tax advisers (Lecture B1394 – 11.15 minutes)

Background

For some years now, HMRC has been taking an increasing interest in the behaviour of tax advisers. This is perhaps understandable, bearing in mind it has been estimated that around 65% of individuals and firms who undertake tax work aren’t members of any professional body.

Publishing information about taxpayers and advisers

HMRC has a statutory obligation of confidentiality under the Commissioners for Revenue and Customs Act 2005, s 18(1), which states that HMRC officials may not disclose information held by HMRC in connection with a function of HMRC. HMRC’s statutory duty of confidentiality is enforceable by criminal prosecution and carries a maximum penalty of two years imprisonment (CRCA 2005, s 19).

However, an important exception to HMRC’s duty of confidentiality relates to public interest disclosures. Permitted public interest disclosures include those made to a regulated professional body, where it relates to misconduct on the part of a member of the profession, broadly where the misconduct relates to a function of HMRC (CRCA 2005, s 20(3)).

With regard to the publication of information about tax advisers, there was already a statutory exception from the confidentiality obligation for disclosures made for the purposes of a function of HMRC if it did not contravene any restrictions imposed by the Commissioners for Revenue and Customs (CRCA 2005, s 18(2)). However, this confidentiality obligation is subject to any other enactment permitting disclosure (CRCA 2005, s 18(3)).

For example, HMRC can publish information in respect of the disclosure of tax avoidance schemes (DOTAS) legislation. A statutory provision (in FA 2004, s 316C) allows HMRC to publish information about any proposals or arrangements which have been allocated a DOTAS scheme reference number. This includes information about any person who is a promoter in relation to those proposals or arrangements and any person who is a supplier of services in relation to them, where a scheme reference is allocated in certain circumstances (in FA 2004, s 311(3)).

In addition, under the regime for enablers of defeated tax avoidance, HMRC can publish details of an enabler if certain conditions are satisfied (F(No. 2)A 2017, Sch 16, Pt 10, para 46).

However, HMRC seemingly didn’t consider these statutory powers to be adequate either.

‘Promoters, enablers and suppliers’

HMRC’s powers to publish information were therefore extended (in FA 2022, s 86). This provision allows HMRC to publish any information or documents considered appropriate “…to inform taxpayers about the risks associated with a tax avoidance scheme, and/or to protect the public revenue”.

HMRC may publish information and documents identifying or concerning any person who is, or is suspected of being, a promoter in respect of a tax avoidance scheme 'relevant proposal' or 'relevant arrangement', or is a 'connected person', or a member of a 'promotion structure', or is a person suspected of having been involved in making the relevant proposal or arrangement available for implementation.

The definitions of 'relevant proposal' and 'relevant arrangement' are based on the legislation on promoters of tax avoidance schemes (POTAS), which also includes powers to publish information about a person subject to a stop notice, or a monitored promoter (FA 2014, ss 236H, 248):

- 'Relevant proposal' is defined as a proposal for arrangements which (if entered into) would be relevant arrangements;

- 'Relevant arrangements' are those which enable, or might be expected to enable, any person to obtain a tax advantage, where a main benefit that might be expected to arise from the arrangements is the obtaining of that advantage.

Furthermore, the identity of a 'connected person' depends on the type of scheme or arrangement. For example, if the proposal or arrangement involves a trust, a connected person can be a settlor, trustee or beneficiary of the trust. If the promoter is a company, it includes a director, employee or shareholder of the promoter.

The general rule about disclosure is subject to an exception if there are reasonable grounds for believing that the person's activities are subject to legal professional privilege.

Nevertheless, the scope of those definitions looks worryingly wide, and the element of judgment and discretion that can be exercised by HMRC has resulted in concerns being raised by the CIOT.

Published information

If information is to be published, it may be published in any manner HMRC thinks fit. However, if HMRC intends publishing information that identifies a person, HMRC must first notify that person and give them 30 days to make representations about whether the information should be published, for consideration by an authorised HMRC officer. In addition, HMRC's publishing powers don't authorise the publication of information if its disclosure would breach the 'data protection legislation', or the 'investigatory powers legislation'.

HMRC's 'new' powers were first used in a press release on 31 August 2022 to name directors of tax avoidance promoting companies. They were used again on 3 May 2023 to publish marketing materials from a promoter in relation to a tax avoidance scheme.

A 'Current list of named tax avoidance schemes, promoters, enablers and suppliers' has been published on the Gov.uk website, which is regularly updated (tinyurl.com/HMRC-TAS-info).

HMRC has also started publishing documents such as evidence of marketing material used by scheme promoters and suppliers to encourage taxpayers to use their tax avoidance schemes (tinyurl.com/HMRC-TAS-Evidence).

People who believe they're involved in a tax avoidance scheme are being advised to contact HMRC as quickly as possible (03000 534 226). People who have been encouraged to get into a tax avoidance scheme or have had contact with someone selling tax avoidance schemes are also being urged to report this by using an online form (www.gov.uk/report-tax-fraud). And with HMRC gathering an increasing amount of information from a multitude of other sources as well, the chances of tax advisers who are caught up in marketing tax avoidance schemes for their clients being 'named and shamed' are high.

Conclusion

The scope for reputational damage, and the commercial damage that could cause as a result, means that tax advisers need to think very carefully before becoming involved in tax avoidance schemes, even those arrangements where HMRC only has a reasonable suspicion about them. HMRC is required to amend or withdraw published information if it's later considered to be significantly misleading or incorrect. However, the reputational damage already caused might be irreversible.

Contributed by Mark McLaughlin

Information relating to property transactions

Summary – A non-resident and non-domiciled individual was required to provide HMRC with the information requested. HMRC was not on a 'fishing expedition'; their request for information was reasonable.

The First Tier Tribunal agreed to anonymise their decision in order to protect the taxpayer from any adverse action from their home country and was referred to as FN throughout.

FN was:

- A citizen of Jurisdiction X and was neither resident nor domiciled in the UK.
- Connected to a building construction company, referred to as Company Y.

FN owned the following properties:

- ABC Court bought with his daughter for £320,000 in November 2009 and rented out from November 2010;
- DEF Court bought with his wife for £490,000 in October 2009 and disposed of in May 2014 for £690,000;
- GHI Court bought with FN's son-in-law in August 2010 for £495,000.
- JKL Court bought by FN for £780,000 in October 2014 and disposed of in May 2015 for £1,325,000. The refurbishment on the property was carried out by Company Y, a connected company.

In 2018 FN submitted a non-resident landlord form NR1 seeking to receive rental income gross.

HMRC issued FN notices to file tax returns for 2014/15 to 2016/17 which were submitted in April of that year.

HMRC was concerned that rental income and property disposals had not been reported and that JKL Court met several badges of trade meaning he could be property trading.

In 2019, HMRC opened enquiries into the returns and issued information notices under Sch.36 FA 2008 as well as a jeopardy assessment for 2015/16.

FN appealed to the First Tier Tribunal, arguing that the Sch. 36 notices were not reasonably required.

Decision

The First Tier Tribunal found that the information notices were reasonably required and were not a 'fishing expedition' as suggested by FN's agent.

The information requested was a 'carefully drawn-up list' of documents needed to check FN's position where HMRC were uncertain.

FN's appeal was dismissed.

Foreign Nation v HMRC (TC08835)

How to prepare for a meeting with HMRC **(Lecture P1395 – 13.53 minutes)**

This article will help you prepare your client for a meeting with HMRC. The article will also address the fundamental question of whether your client should be attending a meeting with HMRC. The guidance offered only extends to meetings in the context of HMRC's civil enquiry powers, but excludes cases where HMRC are investigating under the Contractual Disclosure Facility (Code of Practice 9).

Is it necessary for the client to attend the meeting?

Although this article is about preparing your client for a meeting with HMRC, advisers should, firstly, consider whether their client should be attending the meeting. There isn't anything in tax law which requires a client to meet with HMRC in the context of a civil enquiry. In my view, advisers should only be taking their client to a meeting with HMRC where there is a clearly defined benefit (for the client) for their attendance. In my experience, that is likely to exclude the majority of potential meetings at which a client has been requested to attend by the HMRC officer. The adviser needs to consider not only the circumstances of the case, but also the client. If the client is one who is likely to come across as nervous, the inspector may draw a negative inference from their demeanour, and that should be taken into consideration before deciding whether to take the client to a meeting.

I am firmly in favour of meetings with HMRC, but not, usually, where the client is present. Advisers should consider the client (how will they come across at a meeting), the nature of the enquiry, the stage of the enquiry, and the issues that the HMRC officer wishes to discuss with the client. The adviser needs to be satisfied that there is a need for the meeting, and also that it would be beneficial to the client for them to attend. The case might, as an example, be one where there are very technical matters to be addressed, and the client is

the best person to explain the position, perhaps to avoid protracted correspondence with HMRC.

Even in this type of case, the adviser should firstly consider whether the information can be conveyed to HMRC in another way, including by correspondence.

It can be helpful for the adviser to attend a meeting with the HMRC officer (without the client present). A considered response can then be provided to the officer's queries, without putting the client through the stress of a meeting. A meeting without the client is also likely to be less stressful for the adviser. In such a meeting, the adviser can focus on the issues, and making progress, rather than constantly having to be aware of the client's actions and comments.

There is HMRC guidance on meetings, in the context of an enquiry, in the Enquiry Manual, at EM1822 to EM1865, as well as in the Compliance Handbook, including at CH204500. The Enquiry Manual, at EM1825, addresses the issue of resistance to attending a meeting. There are further comments on this issue in HMRC's guidance, at CH840300, although, unhelpfully, the relevant section includes the heading of 'poor agent behaviour'. The guidance states "Agents sometime consider that their clients' interests are best served by declining to bring their client to a meeting. This is perfectly legal and does not necessarily mean the client has anything to hide, but it results in a level of engagement which is unnecessarily adversarial and less than desirable in a professional 'Working Together' relationship". I do not consider that this is an "adversarial" approach. It is not in HMRC's interest to see a taxpayer who is, for example nervous and not able to give considered answers in the stressful arena of a meeting with the HMRC officer.

Advisers need to remember that there is nothing in law that requires that their client must attend a meeting with HMRC, and they should focus on the client's interests, rather than HMRC's, when determining whether the client attends the meeting with the HMRC officer.

When the adviser considers that their client should attend the meeting with HMRC, they must make the client aware that HMRC cannot legally insist on them being present. Advisers need to take care in this area, as they are exposing their client to a situation that they do not need to be in. This could have repercussions for the adviser's professional indemnity insurance, particularly if they have not adequately explained their client's rights.

Most clients will not want to meet with the HMRC, and those that do are likely to be unaware of the risks involved and any sense of bravado is misguided.

Before the meeting

When the adviser has determined that the client is one who should be taken to a meeting with HMRC, and the client agrees to attend the meeting, the adviser must ensure that they, and the client, are fully prepared.

The adviser should ask the officer for a copy of their detailed agenda, and opening questions, for the meeting. The reality is that most officers will not provide their opening questions, and will only provide a very broad agenda. The adviser should also establish who will be present from HMRC, and what their respective roles are.

The adviser needs to consider what the officer's objectives from the meeting are likely to be. Similarly, the adviser should determine the objectives for his client in attending the meeting and ensure that he has a plan to meet those objectives.

The officer will spend time in advance of the meeting, reviewing the available documents and information, which is likely to include items not supplied by the client.

The adviser needs to mirror the actions of the officer in this regard, as far as possible, and make sure he is familiar with the information provided to HMRC. The adviser is working to different considerations to the officer, who can spend numerous hours in advance of the meeting. The adviser will, usually, need to justify the time spent to the client when it comes to billing, although fee protection insurance may soften the blow.

The adviser should, ideally, meet with the client, to help prepare them for the meeting. This can be done a couple of weeks in advance. The adviser should explain to the client how the meeting will unfold and go through the agenda points from the officer. The client needs to be made aware of the different type of questions that the officer will ask, broadly, open and closed, and how to respond. The exact questions asked will depend on the case, and the stage at which the meeting is being held. When an open question is asked, the client needs to know how much information to give in response to the query. There can be a tendency for clients to ramble and end up giving more information than is necessary to answer the query, which can lead to further questions. When an answer has been given, the officer may stay silent, waiting for the client to fill the silence, and give further information. Clients should be advised to give concise answers to the officer's queries, and the adviser can, if necessary, prompt the client to provide further details.

The officer may want to question the client about their standard of living, particularly where means may be an issue. It is important to ensure that the client is ready for this, and that they give accurate and considered answers, as it can take months to unravel the position where inaccurate responses have been given, albeit innocently, which gives the officer a false picture of the client's circumstances. Any questions about such personal matters need to be proportionate to the officer's aims, under the Human Rights Act 1998 (Article 8), and the adviser should intervene where necessary.

Consideration needs to be given to the venue for the meeting. This should usually be in the adviser's office, or a neutral venue, rather than HMRC's premises or the client's business premises, and certainly not the client's home.

At the meeting

On the day of the meeting, the adviser should ensure that the client arrives early, to help settle any nerves, and cover any relevant points.

HMRC should not record the meeting, whether by an audio or video device. If the adviser or client asks to make a video recording of the meeting, the officer will normally refuse the request. Where the client or adviser wishes to make an audio recording of the meeting, the officer will normally allow this (although, legally, they cannot prevent such a recording). If an audio recording is made, the officer will ask for a copy of the recording at the end of the meeting, or a full typed transcript of the recording. The officer will take notes of what is said at the meeting, and the adviser should do the same.

It is important to ensure that adequate breaks are taken during the meeting, and that any health issues are taken into consideration. The client can request an adjournment at any time during the meeting – this may be a comfort break, or to discuss a matter with the adviser. If the adviser considers it necessary, or appropriate, to request an adjournment, he should do so.

A situation may arise where the client provides new information during the meeting, and the adviser may want to discuss this with the client before deciding whether to proceed. Where the client indicates that there is, for example, a new irregularity to disclose to HMRC, the adviser should end the meeting so that the matter can be fully explored with the client, and update the officer as appropriate.

The adviser may also note a behavioural change in the client, and seek a brief adjournment to discuss. Although adjournments are a normal part of a meeting with HMRC, the adviser needs to ensure that there are not too many. If there has been adequate preparation of the client, and the adviser is fully briefed, this should not be an issue. If there are frequent adjournments without good reason, the HMRC officer may draw negative inferences. The adviser needs to remember that the officer is there to get the client's explanations and answers. However, the adviser should not be passive during the meeting. The adviser should clarify the officer's questions, where necessary, or clarify the client's response, where it is apparent that the client has misunderstood the question. The adviser should also intervene where further information may help the officer's understanding of the client's answer.

The adviser should ensure that they, and the client, are always courteous to the officer, or officers present. The officer(s) should act in the same way. They may ask questions in an assertive way, but that should never become aggression. If the officer becomes aggressive, the meeting should be terminated. If the client is one who is likely to become aggressive, they should not be taken to the meeting in the first place. If, however, the client becomes aggressive, the officer is likely to terminate the meeting. If that does not happen, the adviser should do so.

Contributed by Phil Berwick (Berwick Tax)

Deadlines

1 September 2023

- Corporation tax for periods ended 30 November 2022 if not by instalments
- Check HMRC website for changes to car mileage fuel rates

7 September 2023

- Due date for VAT return and payment for 31 July 2023 quarter

14 September 2023

- Quarterly corporation tax instalment payment for large companies
- File paper monthly EC sales list –businesses in Northern Ireland selling goods only

19 September 2023

- PAYE/NIC/student loan/CIS payments for month to 5 September 2023 if by cheque
- File monthly CIS return

21 September 2023

- File online monthly EC sales list – businesses in Northern Ireland selling goods only
- Supplementary intrastat declarations for August 2023
    - arrivals only for a GB business
    - arrivals and despatch for a business in Northern Ireland

22 September 2023

- PAYE/NIC/student loan/CIS payments for month to 5 September 2023 if paid online

30 September 2023

- Accounts to Companies House
    - private companies with 31 December 2022 year end
    - public limited companies with 31 March 2023 year end
- File CTSA returns for companies with an accounting period ended 30 September 2022
- End of CT61 quarterly return period
- Business rates – small business relief claims for 2022/23
- Businesses to reclaim EC VAT chargeable in 2022
- Companies with a 30 June 2023 period end must notify profits within the diverted profit tax unless none would arise

News

Late-payment interest rates

Following the Bank of England's announcement to raise the bank base rate, from 22 August 2023, HMRC increased the:

- late-payment interest rate to 7.75%; and
- repayment rate 4.25%.

From 14 August 2023, interest:

- charged on underpaid corporation tax quarterly instalment payments is 6.25%; and
- paid on overpaid quarterly instalments will be 5%.

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

Business Taxation

Failure to declare trading income (Lecture B1391 – 23.58 minutes)

Summary – Having previously been found to be trading on eBay, the taxpayer continued to so, and deliberately failed to declare this income.

In 2014, HMRC enquired into Vitalie Milasenco's eBay activities, concluding that he had been trading under the name geminis73 and in January 2015, he was assessed to income tax for tax years 2009/10 to 2012/13 in relation to that trading activity. These assessments were not appealed.

Vitalie Milasenco submitted tax returns for 2013/14 to 2015/16 and declared income from employment as a security officer but no income from self-employment.

In 2016/17, he informed HMRC that he had no income from self-employment and as a result he was not required to submit a tax return.

In 2017, HMRC opened an enquiry into his 2014/15 return, finding that he was still trading on eBay trader. HMRC raised assessments for the years 2013/14 to 2016/17 as well as penalties.

Vitalie appealed, arguing that his eBay account had been hacked, which had resulted in unauthorised transactions.

Decision

The First Tier Tribunal found that the seller had items for sale on eBay ranging from electronic recording tapes to smartphones.

Vitalie's Milasenco's bank account contained payments to mobile phone suppliers as well as delivery companies and multiple deposits.

His bank account for 2014/15 showed deposits of £125,234 through PayPal and amounts transferred to others via PayPal of £48,164. Further, he had created a new online store on eBay and joined a wholesale trading platform.

The First Tier Tribunal found that Vitalie Milasenco's had traded on eBay since at least 2008 and, given the volume of transactions and PayPal deposits, he was continuing to trade between 2013/14 and 2016/17.

The appeal was dismissed.

Vitalie Milasenco v HMRC (TC08861)

Underdeclared puppy sales (Lecture B1391 – 23.58 minutes)

Summary – Puppy sales between 2013/14 and 2017/18 were deliberately under-declared by the taxpayer who traded as both a sole trader and partnership during this time.

Sylvia Hook:

- traded as both sole trader (Sylml) and in partnership (Pinetrees) with her husband, claiming that each business dealt with different types of dog breed.

- was licensed to trade as a dog trader with her local council. The licence to own 43 breeding bitches, covered both the sole trader and partnership's businesses.

- had a dog breeder insurance account with Petplan and later Buddies. Each puppy was sold with four weeks of free insurance.

In June or early July 2017, HMRC opened an enquiry into Sylvia Hook's Self Assessment return for 2015/16. Concluding that her business records were insufficient, HMRC undertook further work, cross-referencing a sample of sales to the values submitted on the Petplan Insurance linked with each sale.

Sylvia Hook claimed that:

- the value recorded was often inflated for the insurance but a number of buyers confirmed they had paid the value as recorded on the insurance;

- under her licence, she was able to breed a maximum of 194 puppies a year but insurance policies showed that in one year that number was actually 297.

The taxpayer claimed that in 2015, there was a sharp increase in puppy sales by the partnership and virtually no sales by the sole trader business in the same period.

However, cashbook entries confirmed that:

- where the VAT threshold for Sylml was close to being breached, puppy sales were transferred to the partnership;

- not all money was paid into the business bank accounts, with unexplained cash deposits appearing in personal bank accounts.

On 18 July 2017, Sylvia Hook registered Sylml for VAT and by the end of the month the partnership was terminated.

Following their investigations, HMRC issued a closure notice for 2015/16 and discovery assessments for 2012/13 to 2017/18 for the businesses along with penalties for deliberate behaviour. The effective VAT registration date for both businesses was amended to 2011 for Sylml and 2015 for the partnership.

Sylivia Hook appealed.

Decision

Having reviewed the evidence, the First tier Tribunal concluded that:

- the dogs sold by each of Sylml and Pinetrees did not fall "readily fell into two categories" as claimed and there was cross-over between the two businesses;

- the business cash books were not "robust" and there were a large number of payments that did not go into the business bank accounts of either Sylml or Pinetrees;

- criticisms that HMRC made of the cashbooks were justified, and that the declared turnover of both businesses was a significant understatement of the true turnover;

- Sylvia Hook had allocated sales between the two businesses to prevent having to register for VAT.

The appeals were dismissed.

Sylvia Hook v HMRC (TC08859)

That's entertainment…(Lecture B1393 – 11.35 minutes)

Football. "The working man's game". Well, it used to be.

Nowadays it seems that more and more of us 'working folk' do like to attend an event and be "entertained". Not necessary by the teams on the pitch (that's often secondary), but by our "host" in an air-conditioned box, with a glass of Sauvignon Blanc and a salmon and dill blini. It's football Jim, but not as we know it.

For the host, it can be argued that hospitality of this kind can strengthen business relationships with clients and customers, increase customer retention, create networking opportunities and improve in-work relations with employees. And you could get to watch Aston Villa at the same time. It's a win-win.

The next question is whether the host can set the costs of the event against business profits and recover the input VAT which has been added to their invoice. Like many tax questions, the answer is…"it depends".

This article will look at the provision of business entertaining by way of hospitality at sporting or other cultural events from three angles:

- The corporation tax deduction position for the provider.

- The benefit-in-kind position for employees attending the event (and third-party benefit issues for non-employees).

- The VAT position with regard to input tax recovery.

The Corporation Tax deduction

Putting aside certain exceptions for a moment, the general rule is that expenditure on business entertainment is not allowable as a deduction against profits, even if it is a genuine expense of the business.

"Business entertainment" means the provision of free or subsidised hospitality or entertainment of any kind. The definition is deliberately wide and no further meaning is provided. The person being entertained may be a customer, a potential customer or any other person.

The purpose of the entertainment is irrelevant. The provider of the entertainment or hospitality may, in good conscience, believe that the costs are incurred wholly and exclusively for the purposes of the business. Nevertheless, such costs will still be disallowed by virtue of S.45 ITTOIA 2005 (for sole traders and partnerships) and S.1298 CTA 2009 for companies.

Costs which are incidental to disallowable business entertainment costs are also disallowable. These include payments to a third party for the organisation of entertainment, and travelling costs incurred in connection with the business entertainment (for example, where a company pays for clients to travel to and from an event).

There are a handful of exceptions to this general rule, the main one concerning the entertainment of employees.

An employee is someone on payroll being paid a salary. This includes directors and other persons engaged in the management of the company, partners of employees and retired members of staff. It does not include contractors or shareholders who do not work in the business.

Staff entertaining is an allowable deduction so long as:

- The costs are incurred 'wholly and exclusively for the purposes of the trade' (which they generally will be as we can file this under 'employee welfare'); and

- The entertaining of staff is not 'merely incidental to entertainment which is provided for customers' (which is a potentially sticky one where 'mixed' staff and client events are concerned).

Whether or not the staff entertaining is 'incidental' to the entertainment of clients depends upon the nature of the occasion (the "primary purpose" test).

The question to ask is: "Would the employer have paid for the event if there had been no external guests present"? If the employer would not have agreed to meet the costs of the event had that event been for staff only, then the event is primarily 'business entertainment' and the entertainment of employees attending the event is incidental to this. The costs are then fully disallowable (there is no apportionment for the staff attendees).

For example, assume a company hires a box at Lords for a Test Match. The box is primarily for use by its employees. The costs of providing that hospitality will be allowable as a corporate tax deduction on the grounds that this is staff entertaining. If a client is invited (making this a mixed event), the cost of the employees' use of the box continues to be allowable on the grounds that the hospitality would have been paid for by the employer anyway, even if that guest had not been present.

However, the cost of providing hospitality to the client remains 'business entertaining' and should be disallowed (BIM45034). Sensible apportionment of costs should therefore be made (and a record kept of all attendees to enable the appropriate adjustments to be made).

On the other hand, if the purpose of hiring the box was primarily for entertaining clients and some staff were allowed to attend (as would be normal for client events), this mixed event would be classed as 'business entertaining' and all costs should be added back.

The benefit position for employees

As a general principle, staff entertaining will be taxed as a benefit for the employee.

Therefore, where an employer provides hospitality for its staff at a sporting or cultural venue, the employees are normally subject to a benefit charge.

The benefit will be based on the employer's cost of providing. This will typically be the cost of hiring the box or equivalent facility (this may be a daily or annual rate), plus any additional entertainment costs incurred (such as food and drink). This total cost should be apportioned between all those who use the facility (staff and non-staff) in order to arrive at a unit cost per person. Apportionment should be "on common sense lines based on the facts of the case".

The unit cost benefit should be reported on form P11D and will be accompanied by a Class 1A NIC charge for the employer. There is no NIC charge for the employee as the provision of hospitality benefits is not earnings. Any hospitality benefits provided to the employee's family or household by reason of the employee's employment will also be taxed on the employee.

There is little scope here for using the "Christmas Party" exemption for staff entertainment as this requires the entertainment to be in the form of an annual event, which is open to all employees and which costs no more than £150 per head per year. A hospitality box will probably fail all three tests.

There is no taxable benefit for the employee if the entertainment is 'business-related. Therefore, in the case of a mixed event which is primarily client entertaining, the staff attending would not be burdened with a taxable benefit in kind by reason of enjoying the hospitality as this would be essentially a work event which they are attending by reason of their employment.

Only entertainment or hospitality which is provided as a form of reward to an employee is taxable on the employee as a benefit. It then follows that the cost of providing that benefit will be tax-deductible for the employer being in the nature of remuneration.

It would be a stretch to argue that the provision of primarily staff hospitality at a sporting or cultural venue would ever be wholly business-related (with any personal benefit being incidental to that), but no doubt some have tried.

Where a benefit arises to employees in respect of such events, it is open for employers to approach HMRC and ask for the benefits to be included in a PAYE Settlement Agreement (PSA) or Taxed Award Scheme (TAS) under which the employer will pay Income Tax and NICs on behalf of their employees of a grossed-up basis. This may be appropriate where it is practically difficult to accurately assign the benefit to particular employees.

Clients (being those not treated as employees) in receipt of entertaining or hospitality will normally be exempt from a benefit charge under the third-party entertainment rules in S.265 ITEPA 2003. HMRC takes the view that this exemption covers items such as hospitality (dinners, parties, hospitality tents at sporting events) and theatrical or sporting events where a host invites someone to accompany them as a guest. The exemption also covers costs associated with the entertainment, such as travelling expenses and overnight accommodation.

VAT recovery

When it comes to the VAT treatment, provided that hospitality tickets are used in the business, it would normally be to entertain clients, and that would be disallowed.

But if the tickets etc are only used by the directors of the business would that be deductible staff entertainment? In small businesses HMRC may well argue that "it has no connection to the business". In other words, it is not used in the business at all. Entertaining the directors who own the business at a sporting event does not really have any connection to making taxable supplies. No input VAT would be recoverable.

Unfortunately, there are just some things that you have to buy with your own money!

Contributed by Steve Sanders

Payment on incorporation **(Lecture B1391 – 23.58 minutes)**

Summary – With value of business on incorporation was reduced from £8.25 million to £1, intangibles relief claimed was reduced to £1 and the difference taxable as a distribution and not as a capital gain.

In 2007 Jasper Conran expanded his design range into branded eyewear. A limited liability partnership, Jasper Conran Optical LLP, was formed with him as a controlling member. It entered into a licensing agreement with Specsavers for the design, manufacture and sale of spectacle frames branded with the trademarked name 'Jasper Conran'.

In 2008, the business of Jasper Conran Optical LLP was transferred to JC Vision Ltd. Mr Conran subsequently received £8.25 million which he treated as a capital gain and paid capital gains tax. JC Vision Ltd treated the sum as a business expense which it amortised in its accounts and claimed intangibles relief.

HMRC considered the open market value of the assets transferred was overstated and revised the figure to £1. Therefore, no intangibles relief arose. It also considered that the payment of £8.25 million to Mr Conran was a distribution and subject to income tax.

The First Tier Tribunal agreed with HMRC about the market value but said the £8.25 million payment to Mr Conran was not taxable because he received it as a partner rather than a shareholder.

JC Vision Ltd and HMRC appealed.

Decision

On the valuation of the market value of the business, the Upper Tribunal found that the transfer did not include use of the trademark; no inclusion was necessary because JC Vision Ltd already had access to the trademark. This 'rendered the goodwill inoperable'. The judges agreed with HMRC that the open market value was £1 and JC Vision Ltd was not entitled to intangibles relief. The taxpayer's appeal was dismissed.

On the tax payable by Mr Conran, the Upper Tribunal agreed with HMRC that the £8.25 million payment amounted to a distribution. Mr Conran was the ultimate owner of the

various entities and received the payment as indirect shareholder of the LLP. He was in effect 'simply moving his assets/cash around wholly controlled vehicles'.

The tribunal said the 'tax reducer clause – where if JC Vision Ltd did not get a certain tax treatment from HMRC the consideration reduced to £1 – showed Mr Conran was willing to protect shareholder value in that company at the expense of the LLP'. It was also consistent with Mr Conran being the architect and decision maker in the transaction. It was not consistent with a party acting at arm's length. The tribunal concluded the clause was far more consistent with the payment being made to Mr Conran as shareholder and not a partner.

HMRC's appeal was allowed.

HMRC v Jasper Alexander Thirlby Conran; JC Vision Ltd v HMRC [2023] UKUT 00166 (TCC)

Adapted from the case summary in Taxation (20 July 2023)

VAT and indirect taxes

Leased accommodation to travellers (Lecture B1391 – 23.58 minutes)

Summary – The supply of furnished and unfurnished apartments leased from landlords and let on to provide accommodation to travellers fell within the tour operator's margin scheme.

From 2017, Sonder Europe Limited provided accommodation in the UK to corporate and leisure travellers. Self-contained apartments, furnished and unfurnished, were leased from third party landlords and then sublet, with an average stay being five nights. The company made only cosmetic changes to the apartments before they were let in order to align the apartments with their brand's style. Occasionally, minor decorating work was carried out.

In VAT accounting periods ending 10/17, 01/18 and 04/18, the company accounted for VAT under the tour operator's margin scheme (TOMS), meaning VAT was accounted for on the net value of the taxable rent charged less the exempt leases from landlords.

In 2019, HMRC decided that the TOMS did not apply and sought to charge Sonder Europe Limited VAT at the standard rate totalling just over £250,000 on the rent charged to travellers, with no deduction for the exempt leases paid to landlords.

The company appealed.

Decision

The First Tier Tribunal disagreed with HMRC that to fall within the TOMS, the accommodation had to be holiday or hotel accommodation when bought in and when it was supplied onto the traveller. Nothing within EU or UK legislation suggested that this was the case.

To fall within the TOMS, the company needed to show that it provided services for the benefit of travellers which were the kind of services that were commonly provided by tour operators or travel agents.

The First Tier Tribunal stated that to do this the company must:

- acquire the accommodation for the purposes of its business;
- provide the accommodation for the benefit of travellers without material alteration or further processing.

The First Tier Tribunal found that the company:

- leased accommodation for the purposes of its business;
- provided serviced apartments on a temporary basis for the benefit of travellers, typical of the accommodation commonly provided by travel agents and tour operators.

Finally, the First Tier Tribunal found that the cosmetic changes made by the company prior to letting were not sufficient to make them 'material' or for them to be regarded as 'further processing'.

With Sonder Europe Limited satisfying the TOMS Order requirements, the appeal was allowed.

Sonder Europe Limited v HMRC (TC08853)

Cancellation of Flat Rate Scheme (Lecture B1391 – 23.58 minutes)

Summary – HMRC had correctly applied best judgement but were wrong to retrospectively cancel the trader's ability to use the Flat Rate Scheme.

Pierre Divisia was a trader based in France who sold products via the Amazon retailer website. With some stock that he sold held in a UK warehouse, he was registered for VAT. Further, HMRC had authorised him to account for VAT under the Flat Rate Scheme.

Following a compliance review, HMRC:

- discovered errors;
- retrospectively cancelled the trader's ability to the use the Flat Rate Scheme under its power 'to protect the revenue';
- issued a best judgment assessment based on Amazon VAT transaction reports for the periods April 2018 to April 2020, with output tax calculated based on 20% of UK sales.

Pierre Divisia appealed.

Decision

The First Tier Tribunal sympathised with the taxpayer. Had the goods stayed in France and only been sent to the UK to fulfil orders from UK customers, the taxpayer would have had no UK VAT liability 'as his "distance sales" to the UK would be below the threshold'.

However, with no control over how Amazon moved his goods, once stored in a UK warehouse, this created a VAT liability. The Tribunal stated:

> "Amazon moved his goods around between warehouses and, to the extent Amazon brought goods to the UK, this brought transactions in, or movements of, goods into the scope of UK VAT. As Amazon forced him to register for VAT in the UK, it brought his distance sales to the UK into the charge for VAT."

The Tribunal found that HMRC had applied best judgment correctly using material submitted by the taxpayer and adopting a methodology that was carefully reviewed internally.

However, HMRC was wrong to withdraw Pierre Divisia from the Flat Rate Scheme as it was not clear to the Tribunal how terminating his authorisation retrospectively would protect the revenue. There had been no abuse but rather a misunderstanding leading to compliance failure. Terminating authority to use the Flat Rate Scheme would not help resolve this.

As a result, HMRC's assessment was reduced to reflect the additional supplies as determined by HMRC, but the VAT had to be recalculated using the applicable Flat Rate Scheme rate.

The taxpayer's appeal was allowed in part.

Pierre Andre Divisia v HMRC (TC08843)

Share sale with a direct and immediate link (Lecture B1391 – 23.58 minutes)

Summary – Although the share sale was exempt, the reason for selling the shares was to raise funds to be used to make taxable supplies, meaning that the input tax on the professional fees was recoverable.

Hotel La Tour Ltd sold its 100% subsidiary, Hotel La Tour Birmingham, to fund a new hotel in Milton Keynes. The company sought to reclaim input tax on professional fees of approximately £77,000.

HMRC refused the claim on the basis that as the sale of shares was exempt from VAT, it broke the direct and immediate link to taxable supplies.

On appeal, the First Tier Tribunal agreed that the direct and immediate link to "downstream" taxable activities with the construction of the hotel in Milton Keynes was not broken by the exempt share sale transaction.

HMRC appealed to the Upper Tribunal.

Decision

The Upper Tribunal agreed that Hotel La Tour Ltd sold the shares in order to raise funds which were used to facilitate future taxable supplies.

Consequently, the input tax on the professional fees related the company's economic activity rather than the exempt share sale. With a direct and immediate link between the professional services and the company's "downstream" taxable economic activities; the chain was not broken by the sale of the shares.

The input VAT was recoverable.

HMRC's appeal was dismissed.

HMRC v Hotel La Tour Ltd [2023] UKUT 00178 (TCC)

Time limits for VAT and penalties (Lecture B1391 – 23.58 minutes)

Summary – Input tax claimed was denied for VAT periods December 2013 to June 2014. HMRC were out of time to claw back the input tax previously claimed in earlier periods.

Maxxim Residential Design Ltd carried on an architectural business and submitted repayment returns for the VAT periods from 03/13 to 06/14.

The repayment returns for the periods 03/13 to 03/14 were paid to the company. However, the repayment return for the VAT period 06/14 was selected by computer for checking before payment was released.

On cross-checking two invoices where input tax of £2961.67 and £2,765 had been claimed, HMRC discovered that both the description and totals on the invoices had been changed. The suppliers had charged only £50 and £80 of VAT respectively.

In October 2015, unable to arrange meetings or contact the sole director and shareholder, HMRC:

- declared the company as a missing trader;
- cancelled the company's VAT registration;
- issued assessments to cancel all input tax claimed on returns for the periods March 2013 to June 2014.

Maxxim Residential Design Ltd appealed, arguing that the assessment was out of time as it had been issued more than 12 months after HMRC had sufficient facts available to raise an assessment.

Decision

The assessments were made on 28 October 2015 covering the VAT period 03/13 to 06/14.

S.73(1) VATA 1994 requires that assessments "shall not be made later than" the time limits set out in s.73(6) VATA 1994. These time limits were:

- two years after the end of the prescribed accounting period; or
- one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge."

The First Tier Tribunal confirmed that HMRC were in possession of the full facts on 4 August 2014, when they discovered the false input tax claims. With the 12-month deadline being 4 August 2015, the assessment dated 28 October 2015 was out of time.

However, the VAT periods from 12/13 to 6/14 were not out of time as they were periods which were less than two years after the end of the prescribed accounting period.

As a result, the assessments were:

- withdrawn for periods March to September 2013;
- upheld for periods December 2013 to June 2014.

Maxxim Residential Design Ltd (TC8834)