Tolley®CPD

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Personal Tax

Delivery drivers - employees or independent contractors?

Summary – Drivers providing haulage services were employees rather than self-employed contractors

The Appellant, a partnership, delivered asphalt, tarmac and other aggregates for the construction industry from its customers' sites to the location where the materials were to be used. This work was carried out under written 'franchise agreements' with its customers using 'franchisee's substitutes' to drive its lorries to deliver the goods. The 'franchisee's substitutes' could be employees or contractors provided that they had been approved by the customer to carry out the services. The partnership was responsible for training the 'franchisee's substitutes' and was required to indemnify the customer for any losses arising from their actions.

The partnership built up a pool of potential drivers for its lorries, with new drivers being carefully assessed and trained by Mr Dhillon, one of the partners, to ensure that they could carry out their work unsupervised for their customers. During this period they were not paid, nor were they paid for attending any site training required by the Appellant's customers.

The drivers:

- had no written contracts;
- were not guaranteed any work;
- received a fixed rate of pay per job;
- decided what work they chose to accept but if they refused work, they were less likely to be asked next time
- provided their own legally-required personal protective boots and trousers but spare hard hats, gloves and high visibility jackets were available in case the driver forgot.
- could arrange for a replacement driver to carry out their job on his behalf but only if the substitute driver had been approved by the partnership and their customer.

On 4 March 2014, HMRC issued determinations for PAYE and National Insurance for the income tax years 2009-10 to 2012-13 inclusive relating to drivers who worked for the partnership in those periods.

On 9 February 2015, the partnership requested a review of these determinations and decision notices. In a review decision letter, dated 13 May 2015, HMRC upheld the original decisions.

The partnership appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal held that neither the control nor substitution tests were conclusive either way.

- How, when and where the work was done was controlled as much by the partnership 's customers as the partnership.
- Although drivers could send a substitute, they had to be approved by both the partnership and their customers.

However, there was little evidence that the drivers were in business on own account. They were paid based on weekly sheets produced by the partnership and signed by the drivers rather than drivers invoicing on their own account. There was no evidence that when a substitute driver was engaged, how much that substitute driver was paid and whether the original driver made a profit. The partnership provided the lorries and paid fixed fees for the work undertaken so there was no financial risk to the drivers who were not in a position to make investment or management decisions.

On balance there were indicators both ways but looking at the facts, the partnership, rather than the drivers, was clearly carrying on business on its own account. The drivers were essentially day labourers working for non-negotiable amounts with Mr Dhillon as the boss.

The drivers were held to be employees.

RS Dhillon and GP Dhillon Partnership v Revenue and Customs Commissioners (TC05583)

Trade union branch secretaries receiving honoraria

Summary - branch secretaries were office holders taxable on honoraria paid

'Community' is a trade union that was formed in 2004 when a number of small trade unions representing a variety of industries amalgamated. The union is divided into eight regions, sub-divided into branches, each of which has a branch secretary.

The secretaries are the only members of the union who receive payment, called an honorarium. The amount due is paid quarterly and is calculated as a percentage of the branch members' contributions.

HMRC and the 'Community' agreed that the honoraria are taxable subject to relief for an expenses element, The dispute arose over whether the payments are within the scope of the Income Tax (PAYE) Regulations 2003 ('the Regulations'), or should they be dealt with in a different manner. HMRC issued determinations on that basis for tax years 2010/11 to 2013/14 looking to recover £108,000 of tax. They argued that branch secretaries are office holders (S5 ITEPA 2003) with income to be treated as employment income within the PAYE Regulations.

HMRC, and before them the Inland Revenue, had had an understanding since 1981 that such honoraria were paid gross using an agreed formula for calculating deductible expenses.

It was only in 2012, and without warning, that HMRC insisted on a change in practice, demanding tax through PAYE, amounts that the branch secretaries had already paid.

The Tribunal judge described the characteristics of an 'office' as follows:

1. The office continues irrespective of the identity of the holder for the time being, and irrespective of the fact that at any given time it may be vacant (McMenamin v Diggles)

2. The position carries with it some responsibility and, in the context of tax, some remuneration

He said that from this it follows that the holder of the 'office' at any time must be an 'office-holder'. The position of branch secretary satisfied both of these conditions and so he held that branch secretaries were office holders liable to tax under PAYE. However, given that in raising their determinations, HMRC had failed to take account for tax that had already been paid by others means, HMRC agreed to adjust their determinations accordingly.

Although the Tribunal had no jurisdiction to consider arguments of legitimate expectation, the judge did comment:

> "Community and its predecessors, with the full knowledge and acquiescence of HMRC and before it the Inland Revenue, had been paying the honoraria gross for at least 30 years. Without warning ……. HMRC insisted on a change in the practice, not merely for the future but for the past, and they have demanded tax which there is every reason to think the branch secretaries have already paid.
>
> The correspondence to which I was taken revealed an uncompromising attitude on HMRC's part based on an overarching presumption, which I regret to say spilled over into Mr Burke's submissions, that if HMRC say so, then it is so. That attitude was reflected in the recitation in the statement of case of HMRC's interpretation of the law rather than of the law itself, as if HMRC's interpretation was unquestionably correct….
>
> Thus although I have determined the main issue in the appeal in HMRC's favour, I find much in their approach to deprecate."

Community (a trade union) v Revenue and Customs Commissioners (TC05549)

Who is taxable on a benefit in kind? **(Lecture P996 – 11.29 minutes)**

In *Baylis v HMRC (2016)*, the First-Tier Tribunal found that care home fees paid by a company called Val Wyatt Marine Ltd (VWML) constituted a benefit in kind for the patient's spouse rather than for the patient's daughter where both parties worked for the company in question.

VWML runs a marina business on the Thames. The taxpayer (B) had worked for the company for a number of years and her father was the managing director and controlling shareholder throughout the period in question. The care home fees related to B's mother.

By virtue of S201(2) ITEPA 2003, a tax charge is imposed on any 'employment-related benefit' (such as the relevant care home fees) provided for an employee or – more importantly in this case – for a member of an employee's family or household.

S721(4) and (5) ITEPA 2003 lists those parties who are considered to be a member of a person's family or household. They are the person's:

- spouse (or civil partner);
- children and their spouses (or civil partners);
- parents;
- dependents;
- domestic staff; and
- guests.

When B's mother entered the care home (Harwood) in 2009, B signed the contract with Harwood, but VWML paid the monthly fees directly to Harwood until the time of the mother's death in January 2011.

HMRC raised discovery assessments on B that the care home fees were a benefit in kind for her. B appealed against these assessments on the ground that the payments represented a benefit in kind for her father (with whom she had now fallen out), and not for herself.

The First-Tier Tribunal upheld B's appeal, finding that:

- B had contracted with Harwood as an agent of VWML;
- Where two employees are potentially liable to tax on the same benefit in kind, it is not down to the employer – in this case, VWML – to decide which one suffers the tax charge;
- Instead, S721 ITEPA 2003 sets out a hierarchy with 'spouse' taking priority over 'children';
- The care home fees were therefore a benefit in kind taxable on B's father, and not on her personally.

Some parts of ITEPA 2003 specifically identify which of two employees is liable to tax on a benefit in kind – see, for example, S169 ITEPA 2003 in connection with company cars. Other sections provide for a 'just and reasonable' apportionment. It should be noted that no equivalent rule exists to deal with the issue in this case. Interestingly, the First-Tier Tribunal resorted to interpreting the definition of 'family or household' as being a hierarchy with 'spouse' ranked at the top and 'guest' ranked at the bottom. This interpretation, if unchallenged by HMRC, will not resolve all such difficulties, especially where two siblings are employees of the same company. But that will be a matter for another day!

Contributed by Robert Jamieson

Share options cancelled under a compromise agreement

Summary – Share options cancelled under a Compromise Agreement did not constitute deductible consideration in arriving at the taxable amount on termination.

Sjumarken's employer terminated his employment contract in October 2005.

At that date Sjumarken had unexercised share options with a value in the region of £130,000 that had been granted two years earlier. These were given up on termination but whether they had lapsed or been cancelled was unclear.

As part of his termination package, Sjumarken had entered into a Compromise Agreement whereby he received a cash termination payment, a payment in lieu of notice as well as shares and additional cash from Share and Cash Incentive Plans. Having deducted the £30,000 exempt amount, the balance received under the Compromise Agreement was charged to income tax.

The First Tier Tribunal had dismissed Sjumarken's claim that the value of the options lost on termination should be treated as reducing his amount of taxable income arising as a result of the Compromise Agreement. Sjumarken had appealed to the Upper Tribunal.

Sjumarken argued that he had agreed to give up his options in return for cash and shares in the Plan and so part of the value of the options constituted deductible 'consideration given for the securities acquired'.

Decision

The Tribunal did not believe that the Compromise Agreement provided that the options should be released as a price for the Plan shares but rather that as part of the overall Agreement, Sjumarken had no claim in relation to the options and so could not be treated as consideration given by him.

The appeal was dismissed.

Sjumarken v R & C Commrs [2017] BTC 501, the Upper Tribunal

Lifetime ISA and help to save schemes

On 16 January 2017 The Savings (Government Contributions) Act received Royal Assent allowing savers to take advantage of two new government backed savings schemes.

Lifetime ISA

These will be introduced from this April and will allow adults under 40 to save up to £4,000 per annum, with the government adding 25% top up to the amounts saved. Interest will be received tax free.

Funds can be used to put towards a saver's first home or held until the age of 60.

Help-to-Save scheme

From 2018, any adult who is receiving working tax credit, or Universal Credit with minimum household earnings equivalent to 16 hours a week at the National Living Wagesavers can save up to £50 a month for up to four years and will benefit from a 50% government top up. The bonus will be based on the highest balance achieved in the account and not the standing balance.

Unauthorised payment charges on loan advanced to taxpayer

The results of two similar cases were released this month, one by the Upper Tribunal followed by a similar First Tier Tribunal case. Both cases produced the same result that HMRC were correct to charge an unauthorised payment charge as result of loans made to the taxpayers that were linked to their SIPPs.

Danvers v Revenue and Customs Commissioners, (2016) UKUT 569 (TCC)

Mr Danvers was too young to access his pension fund and so arranged for these funds to be transferred to a SIPP with instructions that they must be invested in KJK Investments Ltd, a lending company. Danvers also entered into a loan agreement with G Loans Ltd, substantially financed by KJK. The loan agreement specified that the loan was to be repaid from Danver's SIPP.

Decision:

Without guaranteeing that the SIPP invested in KJK preference shares, Danvers would not have received the loan and so they were linked. The First Tier Tribunal were correct to conclude that the loan was made 'in connection with' the KJK shares that were bought. The Upper Tribunal agreed that the loan was held to be an unauthorised payment subject to an unauthorised payment charge.

Following this Upper Tribunal finding we can expect a number of similar cases to follow the first of which is discussed overleaf.

White v Revenue and Customs Commissioners (TC05527)

The taxpayer has pension rights under the British Airways final salary occupational pension scheme. (BA) and met with SKW Investments Ltd (SKW) regarding those rights.

In October 2010 the taxpayer applied to join a SIPP provided by Pilgrim Trustee Services (Pilgrim) and £515,794 was transferred from the BA to the Pilgrim. Also in October the taxpayer contacted another SIPP provider (Rowanmoor) stating that they wanted to invest in a SIPP with them and would like £300,000 of that money to be invested by the SIPP in Imperium.

On 29 October the taxpayer instructed their bank to transfer £303,000 from Pilgrim to Rowanmoor and then on 2 November Rowanmoor authorised the investment in Imperium and subscribed for £300,000 of ordinary shares. Imperium lent money to its investment managers,

BOH Investments Ltd who owned SKW. On 26 October the taxpayer signed a loan agreement with SKW that was to be repayable out of the proceeds of the Rowanmoor SIPP and on 2 November the taxpayer received a loan of £70,762.

In April 2012 HMRC opened an enquiry in respect of the taxpayer's 2010/11 affairs and the following month issued a closure notice levying an unauthorised payment charge of £30,000 in respect of the loan.

Following a rejected appeal, the taxpayer requested a statutory review by HMRC where HMRC upheld their decision and so the taxpayer appealed to the First Tier Tribunal.

Decision:

The Tribunal decided that the loan had been a 'payment' for the purposes of S161 FA 2004 and the loan was made in connection with the investment in Imperium shares which had been an investment acquired using sums held for a registered pension scheme.

Professional bodies approved for tax relief

On 10 January 2017 HMRC published an updated list of fees and subscriptions paid to approved professional organisations and learned societies that are deductible for tax (s343 ITEPA 2003).

Don't forget that only fees and subscriptions paid to listed bodies qualify for relief and then only if membership is relevant to the work that is carried out. Life membership is not included. Members of the ICAEW are able to claim relief for annual subscriptions to individual faculties as well as the standard membership fee.

You can view the new list at www.gov.uk/government/publications/professional-bodies-approved-for-tax-relief-list-3.

Filing Class 1A NIC returns

On 12th January 2017 HMRC updated their guidance employers and agents on filing Class 1 A returns.

Clients will need to submit a P11D(b) form to report the amount of Class 1A National Insurance due on all the expenses and benefits provided if they have:

- been sent a P11D(b) or P11D(b) reminder letter by HMRC and have Class 1A NI liability;
- submitted any P11D forms;
- paid employees' expenses and benefits through their payroll.

If clients receive a P11D(b) or P11D(b) reminder letter but have not paid any expenses or benefits to employees they must inform HMRC that they don't owe any Class 1A National Insurance by either::

- Employers telling HMRC online using the Government Gateway; or
- Agents telling HMRC by email

https://www.gov.uk/government/publications/paye-no-return-of-class-1a-national-insurance-contributions

EIS shares (Lecture P997 – 13.33 minutes)

The issue of EIS or SEIS shares to investors in order to be able claim valuable tax reliefs is growing. The rules are complicated and it is important to check that all of the many qualifying conditions are met. There have been a number of recent cases which illustrate firstly that it is an area where HMRC do a lot of compliance but also that there is a degree of complacency among practitioners about checking that the conditions are met.

The following is a very brief review of the qualifying conditions. These are not definitive and need to be checked carefully as we will see!

The investor must be a qualifying investor meaning:

- He must not be connected with the issuing company;
    - Employee of company or any partner
    - Partner of issuing company or subsidiary
    - Paid director (although there are exemptions for business angels)
    - Owns or can acquire more than 30% of the shares
- No linked loans must be made to the investor or his associates – broadly any loan which is linked with the investment ie is only made because of the investment;

- The existing shareholding requirement must be satisfied meaning that if the individual already holds shares then certain requirements have to be met for new issues to qualify (this is a new requirement from 18 November 2015);
- He must subscribe for the shares for a genuine commercial reason and not as part of a scheme or arrangement which has a main purpose of avoiding tax.

The company must be a qualifying company

- The company must have a UK permanent establishment;
- The company must exist for the purposes of carrying on one or more qualifying trade or be a parent company of a group meeting that requirement; the list of excluded trades includes dealing in land, banking and similar financial activities, leasing, providing legal or accounting services, property development, farming, operating hotels or nursing homes, various energy generation activities – most of these have additional conditions to be considered;
- Financial health requirement met meaning that the company cannot be regarded as being in difficult;
- Qualifying business activity being carried on solely by the company or a qualifying 90% subsidiary;
- Unquoted at the date of the share issue and there must be no arrangements in place for this to change;
- Control and independence requirement met – meaning that it cannot be under the control of another company and cannot control any other company unless it is a qualifying subsidiary;
- At the date of issue, the gross assets must not exceed £15m immediately before and £16m immediately after the issue of shares;
- The company must have less than 250 full-time equivalent employees;
- All subsidiaries must be qualifying subsidiaries, meaning that the company owns more than 50% of the ordinary share capital or more than 90% if it is a property management subsidiary;
- Shares must be issued for the purpose of the qualifying business activity and must be used within two years - it cannot be used for the purposes of buying a company;

There can be withdrawal of relief if value is received by the investor unless it is insignificant

SEIS is also available and the conditions are similar but there are differences such as directors being able to invest without restriction (although employees still cannot). A company must raise money through SEIS first and then EIS, although there is no requirement for any of the SEIS money to have been utilised before EIS can be used (previously you had to have used 70% of the SEIS money first).

As stated above, there are some significant pitfalls and these have been illustrated in a number of recent cases.

Abingdon Health Ltd [2016] TC05525

EIS shares were issued and accepted as eligible for relief. In May 2013, the management of the company were issued with non-EIS 'growth' shares and the Articles were amended to show that on a return of assets such as liquidation, the EIS shares were entitled to receive first an amount equal to the 'Hurdle Amount'. The new growth shares then only participated in profits above that amount. It is a common technique to reduce the value of shares for employment related securities provisions. HMRC took the view that this priority gave the EIS shares a preferential right to the assets on a winding up compared with other shareholders and therefore breached one of the conditions for EIS relief to be available. The company argued that the preferential right was theoretical only due to the terms on which the growth shares had been issued and relied on a contingency which was extremely unlikely to be met. The Tribunal (emphasising the prescriptive nature of the EIS code) dismissed the appeal stating that there was a preference and that they could not take into account degrees of contingency.

Flix Innovations Ltd V Revenue And Customs Commissioners [2016] BTC512

The company required further finance to market its product and to make the investment into the company more attractive to external investors, they converted share capital held by the two founder shareholders into deferred shares that ranked after the ordinary shares in the event the company was ever wound up. HMRC argued that this meant that the EIS shares had a preferential right to the company's assets on a winding up and refused issue of EIS compliance certificates. The company argued that the preferential right was insignificant as it was only the repayment of the nominal value of the shares but the Courts found that there is no deminimis which allowed trivial preferential rights to be ignored. EIS relief was therefore not available.

Gdr Food Technology Ltd [2016] TC05219

The company issued shares which satisfied the conditions to obtain SEIS relief and documentation demonstrated that they were intending to claim SEIS relief but the company's accountant submitted form EIS1 establishing a right to claim EIS relief. When the error was discovered, the accountants attempted to withdraw the EIS claim but HMRC refused to entertain the possibility of issuing SEIS certificates on the basis that an EIS investment had previously been made in the company. The FTT found that the combination of the issue of the shares and the making of the compliance certificate by the company meant that an EIS investment had been made by the investors and so SEIS could not now be claimed. The company argued that HMRC had lost the original compliance certificate but the FTT found that it was the making of the compliance certificate which created the EIS issue and not its authorisation. This followed from the similar case of **X-WIND POWER LTD [2016] TC05086** with the major difference being that the error came to light before the compliance certificate had been authorised (it had already been authorised in X-Wind Power) so they were hopeful of a different result, but it was not to be.

Bell [2016] TC04969

Mr Bell had acquired ordinary shares in a company which appeared to qualify for EIS in January 2008 and became a paid director in February 2008. He then made further investments in July 2008, August 2010, April 2011 and February 2013.

He claimed EIS relief on all of these but HMRC denied relief. This focussed on the interpretation of the connection provisions. EIS relief is not available if you are a remunerated director of the company at any time in the restricted period relating to the shares unless the remuneration is reasonable in the light of duties; the shares were issued before you became a remunerated director or (if the previous condition is not met), the shares were issued before the termination date (3 years from issue) of a qualifying issue. There was an esoteric discussion about the interpretation of the provisions but the FTT found that the only qualifying issue was the one in January 2008 and so only issues within 3 years of that date would qualify for the relief, therefore meaning the April 2011 and February 2013 issues did not qualify. This is another example of a lack of understanding of the relevant provisions.

Ames [2015] TC04523

Mr Ames had made an investment into an EIS qualifying company but did not claim the income tax relief at the time because his taxable income was below the personal allowance. When he sold the shares, he claimed the gain was exempt from capital gains tax on the basis that these were EIS qualifying shares. HMRC denied this on the basis that the exemption from CGT is only available where a claim had been made for income tax relief. They also refused to accept a late claim for the income tax relief. The FTT found that the legislation was only intended to apply when a valid income tax claim had been made and so the disposal did not meet the relevant conditions. The FTT did not feel there was any justification to apply anything other than the literal interpretation of the legislation. It was not felt there was any breach of Human Rights or any legitimate expectation or any disproportionate effect of the legislation. Mr Ames could have disclaimed his personal allowances (or more correctly not claimed the personal allowance) so that the claim for income tax relief could have been made. You still have to make the claim though. It was also found that there was no reasonable excuse for the late claim so the appeal against the refusal to accept a late claim was rejected.

East Allenheads Estate Ltd [2015] TC04513

HMRC refused to issue a compliance certificate in respect of an investment of £6.5m into a company (this was EIS deferral relief) on the basis that the investment was not made for the purposes of carrying on a qualifying trade. The business was running a grouse shooting estate but much of the money was spent on additions and improvements to Allenheads Hall which was used by the business but was owned by the investor. Included within the costs was a Magritte painting bought for £2.9m. Whilst it was accepted that the items under dispute was to enhance the ambience of the property as part of its trading activities, there was an inescapable investment purpose in many of the purchases particularly when the turnover was around 20% of the total amounts paid for art and antiques. There was also the personal benefit conferred on the owner of the property to be taken into account. It is not any real surprise that the EIS relief was denied.

Contributed by Ros Martin

Using family company shares to support a student **(Lecture P998 – 16.53 minutes)**

University students can easily build up debts of £50,000 (or more) by the time of their graduation, but it may be possible to reduce or avoid this financial problem by the judicious use of dividends from family company shares.

Universities in England and Wales currently charge tuition fees of up to £9,000 annually for their undergraduate courses and most of them charge the maximum permitted amount. This cap is due to rise to £9,250 for the 2017/18 academic year. In addition, students have to fund their living costs at university which (depending on where they are studying) may, on average, be around £8,500 per annum.

The Student Loans Company (SLC) will generally pay the tuition fees directly to the university and the amount paid is added to the student's debt held by the SLC at the start of each term. Students can also apply for a maintenance loan of up to £8,200 per annum to cover their living costs, but the level of any loan provided will depend on the family's financial circumstances and on whether the student is living at, or away from, home. Any maintenance loan is added to the student's tuition fees – this represents the full student loan managed by the SLC.

Interest is added to the student loan from the date when the funds are made available. The rate of interest charged is typically 4.6% (for the present academic year). It used to be somewhat lower. Although former students are not required to start repaying their loans until they are earning over £21,000 per annum, the outstanding balance will continue to increase due to the accrual of interest. If a borrower has not repaid his loan after 30 years, any balance will normally be written off.

Clients who run a successful family company are starting to appreciate that the shares of their business can be used to provide an annual tax-free dividend income of up to £5,000 for a student son or daughter without utilising any of the parents' personal tax bands or allowances. If the youngster does not have any other income to set against the personal allowance, he or she could, in theory, receive up to £43,000 in dividends for 2016/17 and only have to pay tax at 7.5% on £27,000 (ie. £43,000 – £5,000 – £11,000) of that income. This would give rise to an income tax liability of just over £2,000.

Of course, such dividends can only be paid to students who hold sufficient shares in the company. The first step is therefore to check how many shares are presently authorised and in issue. The company will often need to issue new shares – perhaps 'A' shares – to the shareholders to allow for flexibility in future dividend payments.

The shareholder parent can then transfer the 'A' shares directly to the student son or daughter. It is assumed that the student is aged 18 or over and it is normally recommended that the shares are entitled to receive, in addition to dividends, liquidation proceeds in the event of a winding up. It will be sensible to evidence the gift with a letter stating that the share transfer was made as part of their 'parental love and affection' for the student.

In most cases, any gain on the gift of shares from parent to child can be the subject of a holdover claim under S165 TCGA 1992. Similarly, there should be no IHT issues, given the availability of 100% business relief should the donor fail to survive the gift by the requisite seven years.

With an extended family, the same technique can be used for uncles, aunts and grandparents to support their nephews, nieces and grandchildren through a university career.

When the student graduates, the company can buy back the shares. In this situation, it may often be preferable to have income tax treatment and the fact that the shares may not have been held for a five-year period will not present too much of a problem.

Alternatively, the graduate could gift the shares to a younger sibling who will shortly be embarking on his or her own higher education course.

Contributed by Robert Jamieson

Capital Taxes

Failure to reside

Summary – HMRC were correct to deny PPR relief on the sale of a flat bought during the temporary separation of a couple.

In 2006, the taxpayer, Oliver, who ran a letting business, separated from his partner and put in an offer to buy a flat. As the lease had only 41 years left to run, he asked that the lease be extended. On 5th January 2007 the purchase was completed and later, on 21 February 2007, the lease extension was agreed for a premium of £153,000.

By March 2007, Oliver had put the flat back on to the market with photos showing it to be unfurnished. On 12th March Oliver accepted an offer on the flat and four days later Oliver and his partner agreed to try again with Oliver moving back to the family home.

On 12th April 2007 the lease extension was finalised and the flat sale completed, enabling Oliver to pay the lease premium.

Throughout Oliver maintained that he had bought the flat following the breakdown of his relationship.

HMRC challenged Oliver's 2007/08 tax return and denied PPR on the sale of the flat. They argued that he had been 'engaging in adventure in the nature of a trade' because he had obtained an extension to the lease, thereby substantially increasing its value.

Decision:

It is a question of fact and degree as to whether occasional and short periods of occupation satisfy the 'residence' test. Oliver may have stayed at the property but with there was no indication that he intended to reside there with any permanence. There was no telephone or internet connection. Although other utility bills were sent to the flat, all other correspondence to Oliver at the flat post-dated his buyer's offer in March.

PPR relief was denied.

Oliver v Revenue and Customs Commissioners (TC05521)

Entrepreneurs' relief – the meaning of 'personal company' (Lecture P999 – 7.53 minutes)

Where there is a disposal of shares by an individual, the entrepreneurs' relief legislation in TCGA 1992 requires the claimant to own at least 5% of the company's ordinary share capital (and two recent First-Tier Tribunal cases – *McQuillan v HMRC (2016)* and *Castledine v HMRC (2016)* – have considered the meaning of 'ordinary share capital') and also to be able to exercise at least 5% of the voting rights attributable to those shares.

In this context, what is meant by 5% of a person's voting rights? The following exchange of correspondence with HMRC provides some insight into the question.

A well-known tax practitioner wrote as follows to HMRC:

> 'In the case of a disposal of shares, the relief is available if the taxpayer owns at least 5% of the:
>
> (i) ordinary share capital; and
>
> (ii) voting rights which are exercisable by the individual by virtue of that holding.
>
> It is the meaning of (ii) above which I find problematic. At one extreme, it is clear that a 5% shareholding which carries no votes does not meet the requirements. But, beyond that, does it mean voting rights on all questions affecting the company as a whole or does it suffice that the taxpayer has 5% of the votes on any question affecting the company as a whole? Or if the shares are, say, preference shares which only have restricted voting rights (basically only on questions affecting the preference shares), does it mean 5% of those rights?
>
> To take an example, the provisions of some company Articles allow a class of shareholders, say "A" shareholders, to vote on matters other than the appointment or removal of directors. Would this suffice? Or what if the shareholders can vote on all "major transactions" and matters such as the amalgamation or liquidation of the company?'

HMRC in due course provided this response:

> 'The term "voting rights" is not defined within TCGA 1992 (and) so it has to take its everyday meaning within the context of the legislation. The (requirement) is included to ensure that the individual has an element of control over the company in which they hold shares rather than the investment being more passive in nature. It is logical, therefore, that the voting rights should give the person the power to vote on all, or substantially all, of the affairs of the company. Restricted voting rights would not be included if they fell outside the "substantially all" category. There is no rule of thumb to follow – each case would need to be decided on its own merits.'

Contributed by Robert Jamieson

Failure to draw life time benefits and transfer of funds to a PPP

Summary – The Upper Tribunal overturned the FTT decision in the taxpayer's favour based on the expression of wishes and upheld the decision on the transfer of funds not being a transfer of value

Following an acrimonious divorce, in July 2000 Mrs Staveley transferred funds from the couple's company pension scheme to a registered pension scheme (S32 policy).

She was advised that if she died without taking lifetime benefits, the trustees would pay any death benefits to her personal representatives. However she remained concerned that at that time the pension fund, to the extent that it was over funded, could revert in whole or part, to her ex-husband or his new family.

Following changes in pension law I effective from April 2006, and now terminally ill with ovarian cancer, in November 2006 she transferred her funds into a new personal pension plan (AXA PPP). She died on 18 December 2006 having never accessed any lifetime benefits.

The AXA PPP administrators paid the lump sum death benefit to the persons nominated in her 'expression of wishes', namely Mrs Staveley's sons, in equal shares.

There were two points on appeal to the Upper Tribunal:

1. HMRC were looking to overturn the ruling that the transfer of funds to the AXA PPP was not a transaction intended to confer gratuitous benefit on any person, and that it was made in a transaction at arm's length between persons not connected with each other and so not a transfer of value for the purpose of s 3 IHTA. The appeal was dismissed.

2. The personal representatives and Mr Piney and Mr Staveley as beneficiaries appealed against the FTT decision that Mrs Staveley's omission to take lifetime pension benefits should be treated as a disposition and transfer of value – s 3(3) IHTA. The appeal was allowed.

Transfer of funds

The FTT held that transferring the funds from the s32 policy to the AXA PPP was a disposition and it gave rise to a diminution in value of Mrs Staveley's estate. However, they also found that the transfer was not intended to confer any gratuitous benefit on any person (S10 IHTA 1984) namely Mrs Stavely's two sons.

HMRC disputed this fact, arguing that the transfer had several motives, one of which included that it was important to Mrs Staveley that her sons benefitted from her estate and indeed, one of the reasons why she had not accessed her pension funds during life, was to preserve the death benefits thus conferring a gratuitous benefit under s10 IHAT 1984.

HMRC also argued that s10 IHTA 1984 takes into account associated operations (s268(1) IHTA 1984), arguing that failure to draw funds from her pension during life were associated to her motive to confer a gratuitous benefit on her sons on her death.

Having considered the facts, the Upper Tribunal concluded that Mrs Staveley's sole motive for the pension transfer was to exclude her husband from benefitting from her pension and that the omission to draw benefits during life and transferring the funds were not linked operations by motive. The appeal was upheld by the Upper Tribunal.

Omission to draw lifetime benefits

The FTT found that it was common knowledge that pension administrators invariably follow a members 'expression of wishes' and that Mrs Staveley had deliberately omitted to take lifetime pension benefits, intending to confer a benefit to her sons. S10 IHTA 1984 did not apply. There was no dispute over these findings.

The dispute arose over the finding that the omission should be treated under s3(3) IHTA 1984 as a disposition immediately before her death. The question that needed to be answered was whether, by omitting to take the pension benefit during life, the sons' estates increased:

1. At the time of the omission (Timing argument)

2. As a result of the omission (Causation argument)

Timing argument

The Upper Tribunal agreed with the FTT and rejected HMRC's argument that the diminution in the transferor's estate had to happen at the same time as the increase in value of the transferees' estate. This was not what the law had intended.

Causation argument

The Upper Tribunal found that the FTT had made an error of law, saying that they had failed to give proper weight to the existence of the independent discretion exercised by the scheme administrator.

There was no evidence submitted to show that the discretion conferred on the AXA PPP scheme administrator was a sham and in the Upper Tribunal's view, the scheme administrator's exercise of its genuine discretion was clearly the cause of the increase in the sons' estates. Mrs Staveley's expression of wishes did not deprive the scheme administrator of an effective discretion, and did not reduce the role of the scheme administrator to one of mere paymaster. (*Drummond v Collins).*

The conditions of s 3(3) are not satisfied with respect to Mrs Staveley's omission, and that omission cannot be treated as a disposition or as a transfer of value within s 3(1).

The appeal was allowed.

The Personal Representatives of Rachel Frances Staveley Deceased v The Commissioners for Her Majesty's Revenue & Customs

UT/2014/0051 and UT/2014/0053

Case studies on the IHT residence nil rate band (Lecture P1000 – 27.10 minutes)

On 8 November 2016, HMRC published their detailed guidance on the IHT residence nil rate band legislation introduced by F(No2)A 2015 and FA 2016. A selection of some of the more unusual points is set out below.

Inheriting the home

The residence nil rate band only applies to a home which:

- is included in the deceased's estate; and
- was lived in by the deceased at some stage prior to his death.

If the deceased owned two or more homes, his personal representatives can nominate which one should qualify for the residence nil rate band.

The home does not have to be the deceased's main residence or to have been lived in for a minimum period. It can be any property that the deceased occupied as long as it is included in his estate on death. A property which the deceased owned but never lived in (eg. a buy-to-let property) is not eligible for the residence nil rate band.

The value of the home for residence nil rate band purposes will always be its open market value less any liabilities secured on it such as a mortgage. If the value of a home that is inherited by the deceased's direct descendants is below the maximum available residence nil rate band, the amount of relief is limited accordingly.

The whole of the home does not have to be left to direct descendants of the deceased. If a share of the home is inherited by direct descendants then the value of the home must be apportioned. The residence nil rate band is calculated on the basis of that apportioned value.

Illustration 1

Frances died in January 2021. Her estate included a home valued at £500,000. In her will, she left one-quarter of the property to her stepson and the remaining three-quarters to her three nephews.

The maximum available residence nil rate band is £175,000, but the actual relief for Frances' estate is the lower of that maximum (£175,000) or the value of the one-quarter share of the property passing to the stepson (¼ x £500,000 = £125,000) so in other words, £125,000.

The deceased's property does not have to be situated in the UK, but it must be within the scope of IHT and included in the deceased's estate. This may therefore depend on the deceased's domicile and the location of the home.

For residence nil rate band purposes, a person's direct descendants inherit a home if it is left to them:

- on death in the deceased's will;
- under the rules of intestacy; or
- by some other legal means as a result of the owner's death.

The home does not have to be mentioned specifically in the deceased's will. It can be inherited as part of the residue of the estate. Where a home is included in residue and that residue passes to a number of different legatees, HMRC treat each one as inheriting an appropriate proportion of the property.

The home does not have to end up in the hands of the deceased's direct descendants. An estate will still be eligible for the residence nil rate band if the personal representatives sell the property as part of the administration of the estate and only pass on the sale proceeds. Similarly, once a direct descendant such as a son has inherited the home, there are no restrictions on what he can do with it. The estate will qualify for the relief even if the son decides to sell the home as soon as he has inherited it.

Illustration 2

Georgina died in June 2019, leaving her apartment (valued at £600,000) to her three grandchildren as part of the residue of her estate. Georgina's overall estate did not exceed the £2,000,000 taper threshold.

The maximum residence nil rate band for 2019/20 is £150,000. The grandchildren are not interested in retaining the property jointly. Georgina's personal representatives therefore sell the apartment and distribute the proceeds between the three grandchildren.

Given that Georgina's apartment passes to her grandchildren under the terms of her will, a residence nil rate band of £150,000 is available. The fact that the property was sold as part of the administration of her estate does not affect the availability of the relief.

Downsizing

If an estate does not qualify for a full residence nil rate band, it may still be entitled to a further relief known as a downsizing addition if three conditions apply:

1. deceased disposed of a home on or after 8 July 2015 and either downsized to a less valuable property or ceased to own a home;
2. former home would have qualified for the residence nil rate band if it had been retained; and
3. at least some of the deceased's estate is inherited by his direct descendants.

The amount of the downsizing addition will generally be equal to the residence nil rate band which has been lost because the former home is no longer in the estate. It will also depend on the value of the other assets in the deceased's estate that are left to his direct descendants.

The downsizing addition cannot of course exceed the maximum residence nil rate band that would have been available if the downsizing or disposal had not taken place. The personal representatives must make a claim for the downsizing addition within two years of the end of the month in which the person died. HMRC are prepared to extend this time limit in certain circumstances.

HMRC do not have to be told when the downsizing move or the disposal of the former home occurs. The personal representatives must make the claim for the residence nil rate band and any downsizing addition as part of their completion of the deceased's IHT return. However, it will be helpful for the property owner's tax advisers to make a contemporaneous note of the details of the downsizing move or disposal so that the personal representatives are aware of it and have the information available to allow them to make an appropriate claim.

If only part of a house in the estate is left to direct descendants, that part is used for the purpose of calculating the residence nil rate band. This can also affect the total residence nil rate band for the estate in downsizing situations.

Illustration 3

Neil, who is married, downsized from a house worth £400,000 to a bungalow in March 2019. The maximum residence nil rate band for 2018/19 is £125,000.

Neil died in February 2021, leaving the bungalow (which was valued at £105,000) to his widow and son equally. He also left other assets worth £180,000 to his daughter. The maximum residence nil rate band for 2020/21 is £175,000.

The calculation of Neil's actual residence nil rate band proceeds as follows:

Step 1: The maximum residence nil rate band at the date of the downsizing was £125,000.

Step 2: Neil's house was worth £400,000 when it was sold. Divide this value by the figure in Step 1 and express the result as a percentage. However, this can never exceed 100%.

Step 3: When Neil dies, the bungalow is worth £105,000. Divide this value by the maximum residence nil rate band available at the date of his death (£175,000) and express this as a percentage, ie. 60%.

Step 4: Deduct percentage found in Step 3 from percentage found in Step 2, 100% – 60% = 40%.

Step 5: Multiply the maximum residence nil rate band at the date of Neil's death by the percentage found in Step 4. This produces 40% x £175,000 = £70,000 – it represents Neil's 'lost' residence nil rate band.

Neil only leaves one half of the bungalow to his son so the residence nil rate band due for that home is:

½ x 105,000 = <u>£52,500</u>

Neil leaves other assets worth £180,000 to his daughter, the downsizing addition is the lower of:

(i) the 'lost' residence nil rate band (£70,000); or

(ii) the value of other assets bequeathed to a direct descendant (£180,000),

ie. £70,000.

This amount should be added to the residence nil rate band relating to the bungalow of £52,500 to give a total relief of £122,500.

The maximum residence nil rate band is £175,000, but Neil's estate can only utilise £122,500. The shortfall is available to be transferred to his widow's estate when she dies.

As you can see, the calculations will often be quite complicated!

Contributed by Robert Jamieson

Administration

HMRC continue their efforts to crack down on tax evasion.

On 5th December 2016 HMRC published a consultation document that runs until 27th February on a proposed new legal requirement that businesses and individuals that create or promote certain complex offshore financial arrangements must notify HMRC of their creation and provide a list of clients using them. In turn, clients would be expected to notify HMRC of their involvement via a notification number on their personal tax account.

On the same date HMRC published a policy paper introducing the' Requirement to Correct' legislation that will require taxpayers who have undeclared UK tax liabilities in respect of offshore interests to disclose the relevant information to HMRC. Failing to do so by 30 September 2018 will result in tough new penalties for 'Failure to Correct'.

From 1 January 2017 new civil penalties have been introduced for accountants, lawyers and other advisors who deliberately enable offshore tax evasion by providing planning, advice or other professional services or help physically move funds offshore. The fines will be levied at the higher of £3,000 or 100% of the tax evaded, with the enabler being publicly named.

Later this year a new corporate criminal offence will be introduced whereby companies will be liable if an individual acting on its behalf as either an employee or contractor facilitates tax evasion.

www.gov.uk/government/consultations/tackling-offshore-tax-evasion-a-requirement-to-notify-hmrc-of-offshore-structures

https://www.gov.uk/government/publications/tackling-offshore-tax-evasion-requirement-to-correct

www.gov.uk/government/news/new-year-brings-in-new-penalties-for-enablers-of-offshore-tax-evasion

Fact sheet CC/FS24: Tax avoidance schemes – accelerated payments

HMRC have issued an updated version of their August 2015 Factsheet, stressing that no further information in support of representations made against an accelerated payment notice will be accepted more than 90 days after the notice date. So it is important to ensure that all relevant information is given in time.

As a reminder, an accelerated payment is the amount that a taxpayer must pay for using a tax avoidance scheme before the final amount due has been determined.

A notice to pay such an amount is sent when a taxpayer has used an avoidance scheme and either condition A or Condition B apply:

- Condition A: There is a current compliance check into their return or there is an open appeal
- Condition B: the return, claim or appeal is made on the basis that there is a tax advantage from the avoidance scheme used

In addition, one or more of the following must apply:

- HMRC have issued the person with a follower notice
- The person used arrangements that are disclosable DOTAS. Legislation
- The person is subject to a counteraction notice under the General Anti-Abuse Rule

Amount payable

The accelerated amount payable will be the amount of the tax advantage that using the scheme tries to achieve calculated based on the information that HMRC have available to them and will be due 90 days after the notice date.

There is a penalty calculated as 5% of the amount due where payment is late unless the taxpayer has a reasonable excuse. This penalty increases by another 5% if payment is five months late and a further 5% if more than 11 months late.

New transparency rules for tax rulings

From 1 January 2017, Member States must automatically exchange information on all new cross-border tax rulings that they issue through a central depository, accessible to all EU countries. This must be done every six months with the first taking place by 1 September 2017 at the latest. Other Member States will then be able to check those lists and to ask the issuing Member State for more detailed information on a particular ruling.

The Commissioner for Economic and Financial Affairs, Taxation and Customs, said: *"We have a duty to make corporate taxation fairer and more transparent, and to use every means possible to block tax abuse and profit shifting. The entry into force of the automatic exchange of information on cross-border tax rulings on 1 January marks a major step forward. It equips Member States and their national tax administrations with the information they need to detect certain abusive tax practices and take the necessary action in response."*

By 1 January 2018, Member States will also have to provide the same information for all cross-border rulings issued since the beginning of 2012.

European Commission - Press release

Brussels, 3 January 2017

Reasonable excuse - paranoid schizophrenia

Summary – The taxpayer's mental illness was a reasonable excuse that justified the taxpayer's late appeal but it did not excuse her from paying tax.

Over an extended number of years, the taxpayer, who remains anonymous due to her health disorder, failed to file tax returns and when they were filed, they were not complete. Where possible, HMRC issued assessments, penalty and surcharge notices. The Appellant appealed to the First Tier Tribunal for her appeal against the penalties and surcharges to be admitted out of time and to determine those penalties and surcharges.

Due to her severe and enduring mental illness, the appellant was not capable of properly managing her affairs, submitting correct tax returns on time, and/or instructing a representative to act on her behalf to do these things. The FTT found that mental illness in this case was a reasonable excuse for long term non-compliance. Paranoid schizophrenia justified the taxpayer's late appeal against various penalties and surcharges and the Tribunal allowed the appeal against all of the surcharges and penalties.

However her mental illness did not excuse her from her liability to file returns, pay tax as well as interest if tax was paid late. Judge Mosedale described this position as highly unsatisfactory for both HMRC and the appellant.

The appellant v HMRC (TC 05564)

Insufficient funds to settle liability

Summary – Insufficiency of funds was a reasonable excuse for late payment of CGT but not income tax.

This is an appeal against a first late payment penalty imposed under paragraph 3(2) of Schedule 56 Finance Act (FA) 2009 for a failure to pay tax on time for the year ending 5 April 2015.

The facts

Mr Crossley owned a number of buy to let properties funded by Royal Bank of Scotland (RBS) where he had a business loan secured by charges on each property owned.

In September 2014 he sold a property for £112,000, net of expenses. However, he could only conclude the sale if he could give a clean title and he could only do that if 100% of the sale proceeds went to RBS to clear the legal charge. This was an event that was entirely outside his control. So were his insufficiency of funds capable of being a reasonable excuse?

Mr Crossley was short of cash to settle both of his 2014/15 liabilities: £12,908.38 (CGT) and £3,858.40 (Income tax).

However, on 27 February 2016 a savings policy matured with funds clearing his account on 7 March 2016. Mr Crossley cleared his outstanding tax due in two amounts on 9th and 10th March 2016, being forced to spread payment over two days as his maximum daily transfer allowed was £10,000. So he cleared the tax bill as quickly as he could.

He understood that he would be late paying his tax but believed that he would meet the 30 day limit for a 5% penalty to apply. As it was he was 8 days over.

The First Tier Tribinal believed that he did act both wholly reasonably and without unreasonable delay. He did the best that he could in the situation in which he found himself. The Tribunal judge upheld the penalty for his income tax but not the capital gains tax.

Neil Crossley v Revenue and Customs Commissioners (TC05535)

Late application for enhanced protection

Summary –Failure by taxpayer to take appropriate action led Tribnla to deny late application.

In February 2015, the taxpayer applied for reliance on paragraph 12 of schedule 36, Finance Act 2004 (Lifetime allowances: “enhanced protection”) for his pension.

Paragraph 4(3) and 4(4) of the Regulations provides as follows:

> (3) If the individual intends to rely on paragraph 12, the individual must give a notification to the Revenue and Customs on or before the closing date.
>
> (4) For the purposes of this regulation the closing date is 5th April 2009.

Clearly he should have informed HMRC by 5 April 2009 and was late. HMRC refused the application on the ground that the taxpayer had no reasonable excuse for the delay and the taxpayer appealed.

Decision

While the Tribunal judge acknowledged that the taxpayer was no pension expert, he concluded that:

- he had been aware that 'material sums of money' depended on his obtaining protection and that he needed to sign a form provided by his adviser
- a reasonable taxpayer would have checked with his advisers that progress was being made and having changed advisors in 2008 he should have checked that the protection election was being made

The tribunal was not satisfied that he had done this and dismissed the appeal.

Gordon Anthony Yablon v Revenue and Customs Commissioners **(***TC05539)*

MTD Update – HMRC consultation response (Lecture B996 – 21.29 minutes)

Those of us all too familiar with the struggle to get everything done by 31 January will have enjoyed the irony of HMRC having to meet their self-imposed deadline of 31 January to publish their response to the Making Tax Digital consultation. Like many taxpayers, they only just made it.

What was published?

Altogether 17 new items connected with MTD were published. Some of these are summaries of other documents or press releases, but stripping away those we are left with:

- 6 consultation response documents, one for each of the consultations published on 15 August;
- Draft legislation and Tax Impact Notes for digital reporting, cash basis and property profits.

The headlines

In summary the key points that were published are:

- No change to the timetable but a relaxation of penalties for the self-employed in year one
- No requirement to keep invoices etc in digital form
- Ability to keep records on spreadsheets
- Increased piloting of MTD during 2017
- Formal exemption for the digitally excluded
- Extension of the cash basis

Using spreadsheets

The good news is that HMRC will permit the use of spreadsheets and will not require copies of individual invoices and receipts to be kept electronically. Of course businesses will still be able to use software to keep electronic copies if they wish. It is important to understand that the use of spreadsheets does not completely remove somebody from MTD requirements. It won't be a case of simply e-mailing the spreadsheet to HMRC every quarter. The information in the spreadsheet will still have to go through some form of MTD compatible software. There are a number of implications here.

Quarterly updating

In the first place quarterly updating is going to be based on the existing categories within self-assessment. This must mean that HMRC will require updates that split down income and expenditure into the categories in boxes 15- 31 of the tax return. So if the spreadsheet that your client currently uses does not have these same categories it appears that it will need to be modified to be compliant.

The response document (page 10) says:

> "A business will need to ensure that their chosen spreadsheet functionality is able to meet all of the necessary requirements of MTD for business"

In other words, this means keeping *digital records*, providing quarterly summary information and the end of year activity. This means using the spreadsheet in real time to keep records. Many people of course already do this, but others don't and leave it to their agent.

There will be no requirement for the quarterly updates to include tax adjustments. These can be included if the taxpayer wishes, but tax adjustments can be left to the final end-of-year activity.

The software which allows the spreadsheet to produce the quarterly reports to HMRC will have to include a basic level of "prompts and nudges" and allow HMRC to send information to businesses about their tax liabilities. Quite what that means is not clear at the moment and of course there are no examples yet which we can look at. However, HMRC has confirmed that free software will be available to meet MTD requirements and that it is up to the private sector to produce this software.

Most businesses will still be required to make at least some changes in the way in which they record and report their financial information and will need to interact with HMRC digitally.

- A large number of businesses who use spreadsheets currently on a real time basis can continue as is, albeit having to engage with the software for the quarterly reporting;
- Businesses that are currently eligible to use 3 line accounts, those with turnover below the VAT threshold, will only be required to give quarterly updates of those three numbers.

The reporting timetable

There is no change on the timetable for quarterly reporting. The submission date for the update will be one month from the end of the quarter. If taxpayers will want their agents to prepare, or at least check the update information this will have a big impact on the working cycle of most accounting practices. HMRC's view is that there will be very little involved in making an update. They say:

> "updates are intended to be quick submissions of receipts and expense data that reflects the trading recorded in a businesses' records. The month's submission period is not intended to be a lengthy window of time which a business starts to enter all its transactions in the digital records from paper. If a business has been keeping digital records "as they go" the update should be straight forward to generate and send".

"End-of-year" activity

The consultation response document says that:

> "end-of-year activity has to be provided by the sooner of 10 months after the last day of the period of account or 31 January of the year of assessment in which the profits of the year of assessment for that period of account are chargeable to income tax".

Let's take the 12 months accounts to 31 December 2020. These will form the basis of assessment for the tax year 2020-21 in the normal way. 10 months from 31 December is 31 October 2021. Those profits are chargeable to income tax year 2020-21 and 31 January in the year of assessment in which those profits are chargeable is 31 January 2021. We have to take the *earlier* of those two dates, which means that the final report must be made on 31 January 2021, which is only a month after the end of the period of account. Is this correct? The reference should surely be to 31 January *following* the year of assessment in which the profits are taxed. This is evidenced by the fact that the deadline would be *before* the accounting year-end for those who prepare accounts to, say, 31 March.

The timetable

Almost without exception the feedback has been that the timetable is too ambitious. The big question on which we were waiting for an answer was whether or not there was going to be a relaxation in the timetable.

We now know that he core plan is unchanged with the introduction to MTD being phased in as follows:

- sole traders in 2018
- VAT in 2019; and
- Corporation tax in 2020.

However, HMRC did announce that they would not impose any penalties for late filing of quarterly updates in the first year of operation of MTD for sole traders. In reality this seems to be saying to people: do your best in year one but make sure you get yourself organised properly for year two. If you were cynical you could say that this is HMRC in effect delaying the introduction of MTD for a year without actually having to climb down on the principle. Of course that puts professional advisers in a difficult position. The law is the law and we can't simply advise our clients to ignore legal obligations to file quarterly updates: HMRC would come down hard on any adviser who told his clients simply to ignore MTD for a year. We are going to have to help our clients cope as best they can.

Smaller businesses

There is no further progress on deferring MTD for smaller businesses. We know that those with turnover of less than £10K will be exempt and the government is still considering what level of turnover above that should qualify for a deferral. Views were mixed in the consultation and it is not clear yet where this will eventually land.

Large partnerships

HMRC had always suggested informally that large partnerships would only come into MTD at the same time as corporates but no details had been given. Now it is confirmed that partnerships with a turnover of more than £10m will not come into MTD until 2020.

Costs and benefits

There was widespread concern that HMRC's figures for the additional tax revenues generated by MTD and the cost/benefit analysis for the taxpayer didn't accord with adviser's perception on the true economic impact. HMRC has not changed its model for the yield of MTD, still saying that it will bring in £945m by 2020-21. It is now also saying that by 2021-22 it will have brought in a total of £2bn. That is the net impact of errors currently in the system being eradicated by MTD. Is the tax compliance error rate really that high at the moment?

There has been some shift on the cost/benefit to taxpayers, with HMRC now making it clearer that in the initial years there will be net costs and it is only from 2020-21 that taxpayers will start to see reductions in compliance costs. The net annual benefit from 2020-21 is now assumed to be £100m per year. As there are something like 6 million taxpayers who will be within MTD by that time, the average benefit will be something like £16 per year for each taxpayer and no one notice it.

What now?

Clearly MTD is going to happen and, despite some welcome changes and relaxations, fundamentally little has changed as a result of the consultations. So much of the current self assessment system relies on returns and how it will work in a world where the tax return is no more is still unclear.

Adapted from an article in Taxation magazine (9 February 2017) by Andrew Hubbard

February Deadline

1 February 2017

- £100 penalty and extended enquiry window if 2016 SA tax returns not filed by 31 January 2016
- Corporation tax due for SME accounting periods ended 30 April 2016 if not paying by instalments

2 February 2017

- Due date of filing for P46(Car) for quarter ended 5 January 2016

7 February 2017

- Due date for filing VAT returns and making electronic payment for 31 December 2016 quarter

14 February 2017

- Quarterly corporation tax instalment for large companies due, depending on year end
- Filing date for monthly EC sales list if paper return used
- Due date for application to defer Class 1 NICs (leaflet CA72A) for 2016/17, subject to approval of deferred employer(s)

19 February 2017

- Due date to pay PAYE, National Insurance, construction industry scheme and student loan liabilities for month ended 5 February 2017 if not paying electronically
- Due date to file monthly construction industry scheme return

21 February 2017

- File online monthly EC sales list by this date.
- Submit supplementary Intrastat declarations for January 2017 by this date

22 February 2017

- PAYE, National Insurance, construction industry scheme and student loan liabilities should have cleared HMRC's bank account by this date

28/29 February 2017

- Payment of 2016/17 self-assessment liabilities after this date will be subject to a 5% surcharge. (This deadline may be deferred if liability notified by 5 October 2016.)
- Companies House should have received private companies’ accounts with May 2016 year end
- Should also have received public limited companies’ accounts with August 2016 year end
- HMRC should have received corporation tax self-assessment returns for companies with accounting periods ended 28 February 2016

HMRC News

Treasury committee call to delay making tax digital and CIOT agree

Making Tax Digital by introducing mandatory digital record keeping and quarterly reporting for tax has been much talked about in the news, with many concerned that the introduction date of April 2018 was too soon.

The CIOT has welcomed the report from the House of Commons Treasury Committee asking for the introduction to be delayed to at least 2019/20 so that taxpayers, their advisors and their software providers are able prepare for the major administrative and technological change that will be required.

To ensure that the project works for all concerned, the CIOT believe that it will be important for HMRC to consult closely with taxpayers, their advisors, professional bodies and charities at all stages through to the final implementation. Rather than the limited piloting that has taken place so far, the CIOT agree with the Committee that HMRC must run comprehensive pilots covering a range of taxpayers, both in size and business types, making sure that we cover the whole reporting and payment cycle including the end of year reconciliation. Software must be fully tested and include free software for smaller and less complex businesses. To date, the government has not indicated how this will be achieved.

The Committee has also recommended that the threshold for Making Tax Digital should be significantly higher than the proposed £10,000. Like many, the Committee believe that the VAT threshold (currently £83,000) may well be a more suitable figure. We will need to wait and see what is finally decided.

Voice identification and fingerprint access for helplines

From January 2017 customers can now choose whether to continue to access HMRC services in the usual way or switch to Voice ID.

Taxpayer who opt for this new system will be asked to repeat a vocal passphrase up to five times when they first call and then be passed back to an adviser to finish their call. This passphrase will be securely stored, enabling taxpayers to use their voice to confirm that identity in future.

Taxpayers are already able to download HMRC's mobile App to gain access to their information but currently fingerprint identification is only available on Apples and Android devices. HMRC plan to introduce this facility for the Windows version of the app later this year.

www.gov.uk/government/news/voice-id-showcases-latest-digital-development-for-hmrc-customers

Consultation on the withdrawal of four Extra Statutory Concessions

The House of Lords' decision in the Wilkinson case resulted in HMRC needing to review its existing concessions and deciding what action to take for those concessions that are considered to be beyond the scope of HMRC's administrative discretion:

- some need to be legislated to preserve their effect;
- others are no longer necessary;
- a number will need to be withdrawn as they are beyond HMRC's discretion.

This consultation document identifies four extra-statutory concessions that HMRC plan to withdraw as part of the review with planned withdrawal to be effective from April 2018.

1. ***Zero-rating of central processor – Notice 701/7*** - if sold as part of a system designed as a complete package to aid a disabled person to overcome communication problems. HMRC considers that this now falls within existing legislation and so the concession should be withdrawn.

2. ***Composite rate of VAT for computer systems – Notice 701/7*** - This concession was intended to be used in conjunction with the zero-rating concession above and so should also be withdrawn. Businesses wanting to use a simplified calculation method going forward can negotiate this directly with HMRC.

3. ***Affiliation fees for sports clubs – Notice 701/45*** - affiliation fees charged by governing bodies are often recharged on to their members by the clubs. The concession put profit making commercial clubs in a similar position to non-profit making clubs, making the charge exempt from VAT by treating the recharges as disbursements. However, this goes beyond HMRC's discretion as recharges are not legally disbursements and so the concession will be withdrawn, making future affiliation fee recharges by such clubs standard rated for profit making clubs..

4. ***C12 Retail co-operative societies: accounting periods (Former Inland Revenue booklet IR1.4)*** - there are now only 12 retail co-operative societies all of whom now have annual accounting periods and so the concession relating to short periods is no longer needed.

HMRC are looking to gather data by 7 March 2017 from those who have relevant information about the potential impact of withdrawal of each of the concessions.

www.gov.uk/government/consultations/withdrawal-of-extra-statutory-concessions-2017

New Customs Special Procedures Manual

On 17 January 2017, HMRC published the new Customs Special Procedures Manual in January 2017, which replaces previous guidance on customs warehousing, imported goods end-use relief, inward processing relief, outward processing relief and processing under customs control.

http://www.gov.uk/hmrc-internal-manuals/customs-special-procedures

BREXIT

Prime Minister's announcement

On 17th January 2017 at Lancaster House, the Prime Minister confirmed that under BREXIT, rather than remaining as a member of the European single market, the UK will seek a bespoke customs agreement with the EU but is open as to what form this might take.

The Chancellor has stated that he hopes that we remain 'in the mainstream of European economic and social thinking' but recognizes that if the rest of Europe denies this, 'we could be forced to change our economic model and we will have to change our model to regain competitiveness. And you can be sure we will do whatever we have to do'.

Our government's stated aim is to have the lowest corporate tax rate among industrialised countries which could be interpreted as meaning that the UK's aim is to be the tax haven of Europe. Will that happen?

Business Taxation

Undeclared sales and wife's earnings

Summary – Failing to produce evidence to support their claims, HMRC's assessment for undeclared cash sales and an adjustment for excessive earnings was confirmed.

HMRC opened an enquiry onto the taxpayer's affairs for 2013/14. Following initial investigations HMRC were concerned that:

1. Sales were understated. They identified deposits that were neither drawings nor transfers in two private bank accounts and noted that cash drawn from the couple's joint bank account was minimal with gaps, often long gaps, when no cash was withdrawn. They asked for evidence of how private cash expenditure was covered which was never produced.

2. The wages paid to his wife were excessive. She was paid £90 a week for answering telephone calls checking part prices and ordering parts, work which HMRC believe Mr McAdam would have done using his mobile phone. HMRC believed that a more reasonable estimate of her work was no more than four hours a week to include, taking a few calls, checking part prices and ordering parts as well as two hours a month updating the accounting ledger. They considered that three hours a week at an hourly rate of £8 for 48 weeks a year was more appropriate. The Tribunal judge was not convinced that even this level of work was undertaken.

With no evidence to support the assessment raised by HMRC, the Tribunal judge agreed with HMRC and agreed that HMRC's penalties based on a prompted disclosure was appropriate as Mr McAdam had allowed access to his records including private bank accounts in the year of enquiry. However, at no stage did Mr McAdam offered any assistance in quantifying the adjustments.

The appeal was dismissed.

William McAdam v Revenue and Customs Commissioners (TC05535)

Discovery assessment and bad debt relief

Summary – Discovery assessment was valid and no relief available for bad debts

The taxpayer operated a profitable consulting business but also owned an oil water separator that he leased out. This second activity was loss making and under S83 ITA 2007, the taxpayer carried forward the losses from his leasing business and set them against the profits of his consultancy business as if they were a single trade.

At a preliminary hearing (TC04898), the First-Tier Tribunal had decided that the two businesses were separate trades and that the losses could not be offset this way and relief was denied. The appeal considered three things:

1. Was HMRC entitled to make a discovery assessment for the tax year 2011-12?
2. Whether the taxpayer was entitled to bad debt relief for debts outstanding?
3. How his tax liability should be computed ?

1. Discovery assessment (S29(5) TMA 1970)

The First-Tier Tribunal agreed with HMRC that nothing in either the taxpayer's 2011/12 tax return or related papers that were submitted would have alerted a reasonable officer to form the view that the taxpayer ran two businesses and that the losses of one could not be used against the other. The discovery assessment was valid.

2. Bad debt relief

The First-Tier Tribunal said that there were anomalies in the figures as well as timing of the credit notes and it appeared that the debts had become doubtful only recently. If the taxpayer had been able to show that the debts went bad or the taxpayer issued the credit notes in the relevant tax years, the relief may have been available. However, due to the timing, bad debt relief was not available.

3. Computing the tax liability

Finally, on computing the taxable income, the First Tier Tribunal produced calculations of the taxpayer's profits for both trades and instructed HMRC to assess them accordingly.

The taxpayer's appeal was dismissed.

A Adelekun v Revenue and Customs Commissioners (TC05531)

Sideways loss relief for farming losses

Summary – Sideways loss relief was not available to dairy farmers

As dairy farmers, Mr and Mrs Scrambler had little control over the price that they could sell their milk for. Despite selling land, some of their dairy herd and introducing new milking technology, between 2005 and 2011 when they sold their partnership, the business was loss making.

In 2010/11 they claimed sideways loss relief against their general income that was denied by HMRC who sought to apply S67 ITA 2007 which says that if a trade is one of farming or market gardening, sideways loss relief is denied if losses have been made in each of the previous five tax years.

The First-tier Tribunal concluded that sideways loss relief was not available because the farming activities did not meet the reasonable expectation of profit test that a competent farmer carrying on the Mr and Mrs Scambler farming activities in 2005 would not have had a reasonable expectation that no profit would be made for the next five years and therefore would not satisfy the reasonable expectation of profit test in ITA 2007, s. 68(3).

The couple appealed to the Upper Tribunal.

Decision

To satisfy s68(3)(b) ITA 2007, and so prevent s67 applying, the Upper Tribunal found that Mr and Mrs Scambler had needed to show a specific reason why profits could not be made in 2010/11, despite the business being run competently but that it would be profitable in the future. All agreed that profitability was uncertain due to the uncertainty of the milk price.

The Scamblers believed that the price of milk was unlikely to increase to a profitable level and so based on this, the Upper Tribunal concluded that sideways loss relief was not available to Mr and Mrs Scambler for 2010–11.

Scambler v R & C Commrs [2017] BTC 503, Upper Tribunal

Loans and relief for bad debts

Summary – Loans that had turned bad were wholly and exclusively for the business but not quantifiable and capital in nature so relief for bad debts was denied

Mr Jamie White (Jamie) ran two separate skip hire businesses (BP Skips and LJ Skips) as a sole trader. He owned his own skips but used the premises, lorries, licences and permits as well as telephone ordering and answering service owned by M White Limited (MWL), a company owned by his father. In return Jamie paid 35% of his revenue to MWL by settling invoices raised by MWL to each of his two skip businesses. Without MWL, Jamie's business would not be able to operate.

Jamie claimed that from April 2002 onwards he made loans to MWL on an adhoc basis, initially to pay specific bills like wages, suppliers and tax bills, but later as round sums to prevent MPW going into liquidation. No interest was charged but it was always understood that the money would be repaid by MWL.

When money was lent, it was paid from BP Skips', LJ Skips' or Jamie's personal bank account to either MWL or his father's personal account. Unfortunately there were no accurate records kept so the Tribunal were presented with summary schedules that did not indicate how much was lent by each lender or to who, when it was lent or when it was repaid.

Relief for bad debts is not available where the underlying loans are capital in nature (S33 ITTOIA 2005) and where they are not incurred wholly and exclusively for the purposes of the trade (S34 ITTOIA 2005.

Whilst Jamie did make loans to MWL, the Judge could not be satisfied at any particular date whether there was any debt owed and neither could he identify at any particular date the amount of any debt outstanding or the minimum amount of any debt outstanding.

Had they been able to identify a specific or minimum amount then he would have been able to treat them as bad debts and wholly and exclusively for the purposes of his business.

However, no relief would have been available to Jamie because the loans were made to ensure the long-term survival of MWL and were capital in nature and not revenue. The appeal was dismissed.

Jamie White v Revenue and Customs Commissioners (TC05516)

Updated guidance on ATED

HMRC have issued updated guidance on ATED including the new chargeable amounts from 1 April 2017.

Companies and partnerships where one partner is a company owning UK residential property will need to complete an ATED return where property is valued at 1 April 2012, or at acquisition if later more than £500,000.

The amount payable is worked out using a banding system as follows:

Chargeable amounts for 1 April 2016 to 31 March 2017

Property value	Annual charge
More than £500,000 but not more than £1 million	£3,500
More than £1 million but not more than £2 million	£7,000
More than £2 million but not more than £5 million	£23,350
More than £5 million but not more than £10 million	£54,450
More than £10 million but not more than £20 million	£109,050
More than £20 million	£218,200

Chargeable amounts for 1 April 2017 to 31 March 2018

Property value	Annual charge
More than £500,000 but not more than £1 million	£3,500
More than £1 million but not more than £2 million	£7,050
More than £2 million but not more than £5 million	£23,550
More than £5 million but not more than £10 million	£54,950
More than £10 million but not more than £20 million	£110,100
More than £20 million	£220,350

Excluded properties

Properties will be caught if all or part of it is used, or could be used as a residence but excludes:

- hotels
- guest houses
- boarding school accommodation
- hospitals
- student halls of residence
- military accommodation
- care homes
- prisons

www.gov.uk/annual-tax-on-enveloped-dwellings-the-basics

Double tax arrangements - Isle of Man, Jersey and Guernsey (2016 Protocols)

FA 2016 amended Section 5 CTA 2009 and Section 6 ITTOIA 2005 to expand the scope of the UK legislation to treat dealing in and developing UK land as trading; this is regardless of the residence of the company or individual, or whether that company or individual is trading in the UK through a permanent establishment

This new legislation applies from 5 July 2016 with anti-forestalling rules applying to transactions on or after 16 March 2016. These 2016 Protocols:

- amend the existing double taxation arrangements between the UK and the Isle of Man, Jersey and Guernsey with effect from 16 March 2016, the date from which the anti forestalling rules apply;
- are designed to preserve the UK's taxing rights over a company's trading profits derived from land in the UK under these new rules.

Dividends in specie (Lecture B997 – 8.57 minutes)

Introduction

Dividends are normally in the form of cash or transfers to directors' loan account.

If dividends take the form of assets such as property, this is known as a dividend in specie. When dividends in specie involve property the ownership of the asset passes from company to shareholder.

The tax consequences of a dividend in specie can be complex.

Corporation tax

There will be a deemed disposal of the property at market value. Corporation tax will be payable on the resultant gain which can be reduced if the company has capital losses.

Due to the reliance on the accuracy of the valuation it would be advisable to obtain to formal valuation of the property.

Income tax

The dividend in specie is treated as a normal dividend in the taxpayers hands.

The market value of the property will be the value of the dividend.

VAT

The removal of assets from the company will represent a deemed disposal for VAT purposes.

The value of the deemed supply will be the value of acquiring identical or similar property.

If the asset in question is new residential property the deemed supply is zero rated. Any other residential property will be exempt.

If the asset in question is commercial property the deemed supply will be standard rated if under three years old or of the company has opted to tax the property. The deemed supply will be exempt in all other cases.

If land is the assets in question the deemed supply will be exempt unless an option to tax is in point.

Where output VAT is paid to HMRC the shareholder should be given a certificate of tax as they may be in a position to recover input tax.

SDLT

Dividends in specie tend to be free of SDLT as there is no consideration (FA 2003, Sch 3, para 1).

If a shareholder assumes a mortgage or loan attached to the property we then have consideration and SDLT is due (FA 2003, Sch 4, para 8).

Documentation must be clear that this is a distribution of an asset in specie. The minutes must not state a dividend of £x. If the minutes state a monetary amount this creates a "pre-existing debt" and as a consequence this creates consideration for SDLT purposes (FA 2003, Sch 4, para 8).

Pension contributions in specie

This is where a property (or other assets) are transferred into a pension fund as a contribution in specie.

Once again we have a market value disposal for corporation tax with corporation tax on the gain.

The pension contribution is equal to the MV of the property and this should be deductible for the corporate if it is wholly and exclusively incurred. HMRC have however started to question the deductibility of pension contributions in specie and some pension funds have stopped accepting such contributions.

The VAT issues are the same as dividends in specie ie deemed disposal for VAT purposes.

SDLT is a problem as you must state the monetary value of the contribution. It is not permitted to say "contribution is equal to market value of asset". As the dividend is quantified the amount stated then creates a "pre-existing debt" and SDLT becomes an issue.

FRS 102: Tax effects of accounting for lease incentives (Lecture B998 – 12.13 minutes)

Old UK GAAP required the spreading of lease incentives (e.g. rent-free periods) over the period to the next rent review. In contrast, FRS 102 requires spreading over the entire lease term, on a straight-line basis (unless another method gives a fairer result).

However, you do not have to restate the accounts for lease incentives granted before the transition date (which is the start of the comparative year, being 1 January 2015 for an accounting year ended 31 December 2016 of a small company). Old UK GAAP will continue to apply in these circumstances.

Lease incentives relating to leases commencing **in** the comparative year **must** be restated though, with any tax effects impacting in the year of adoption.

Example – operating lease incentives

Fonte Ltd is adopting FRS 102 for the first time in its year ended 31 December 2016. It leases the premises used in its business.

Two leases have been entered into recently:

1. 12-year lease on a warehouse on 1 July 2014, rent-free for 2 years followed by annual rentals, initially at £30,000 p.a. The first rent review will be on 30 June 2020.
2. 20-year lease on its main operating premises on 1 January 2015, rent-free for three years, followed by annual rentals initially at £60,000 per annum. The first rent review falls due on 31 December 2021.

Let's look at the adjustments that may be required in Fonte Ltd's accounts and tax computations on adopting FRS 102 in 2016.

Lease 1

There is no need to restate the first lease, because it began before 1 January 2015; however, it is optional to do so.

A restatement would change the annual expense from £20,000 [(£30,000 x 4 years) ÷ 6 years] to £25,000 [(£30,000 x 10 years) ÷ 12 years].

This reduces retained earnings and profits, but creates additional tax deductions, until the next rent review. Old GAAP would then revert to the new rental level, whereas FRS 102 would still be amortising the incentive.

As the lease began on 1 July 2014, any decision to adopt the new treatment would produce

- a small transitional deduction at 1 January 2015 (i.e. £2,500), plus
- a restatement of the 2015 figures to show the extra leasing deduction of £5,000 for that year.

These would both produce tax effects in 2016.

Note that, with corporation tax due to be cut at 1 April 2017 to 19%, with a further cut to 17% at 1 April 2020, having larger deductions in the earlier part of the lease term will save corporation tax, as well as giving a cash flow advantage.

Lease 2

The second lease must be restated up to 31 December 2015.

Annual rent expense under old UK GAAP was £34,286 [(£60,000 x 4 years) ÷ 7 years], based on the period to the first rent review of 7 years (1 January 2015 to 31 December 2021.

The revised annual rent expense under FRS 102 is £51,000 [(£60,000 x 17 years) ÷ 20 years].

This reduction of £16,714 in the previously reported 2015 profits produces a tax saving of £3,343 in y/e 31 December 2016.

Break clauses in leases

The accounting rules say that you must make the best estimate of how long the lease will last, where there is a 'break clause' or 'option to extend'. This would consider, for example, past practice of the business and current management plans.

The tax treatment will then be based on whatever has been included in the accounts.

Contributed by Kevin Read

Corporate interest restriction

On 5 December HMRC had published its original draft legislation stating that from 1 April 2017 rules were to be introduced to restrict the amount of interest and other financing costs that companies can claim as tax deductible:

- all groups will be able to deduct up to £2 million of net interest expense per annum;
- above this, a fixed-ratio rule will restrict deductions to 30% of taxable earnings before interest, taxes, depreciation and amortisation (EBITDA) in the UK; or
- if higher, a group-ratio rule will allow a proportionate share of the worldwide group's net interest expense, equal to UK taxable EBITDA multiplied by the ratio of worldwide net interest expense to worldwide EBITDA, with a modified debt cap to ensure the net interest deduction does not exceed the total net interest expense of the worldwide group.

On 26th January 2017 and following initial consultation, HMRC published a revised version of the draft Finance Bill legislation. The following will now apply:

- A group EBITDA 'alternative calculation' election;
- A public infrastructure exemption;
- Film tax relief, television tax relief, video games tax relief, relief in relation to theatrical productions, orchestra tax relief, and museums and galleries exhibition tax relief will be disregarded from EBITDA
- The anti-avoidance rule will not apply to certain 'commercial restructuring arrangements', covering cases where loan receivables held offshore are transferred to be within the charge to corporation tax and where there is straightforward restructuring to benefit from the legitimate use of reliefs within the interest restriction rules;
- If a group has aggregate net tax-interest income for a period it is added to the interest allowance for that period, meaning that carried-forward interest amounts will be able to be deducted in subsequent periods to the extent they can be set off against net tax-interest income in those periods

Comments on the revised draft are invited by 23 February 2017.

www.gov.uk/government/publications/draft-legislation-corporate-interest-restriction

Carry forward of corporate losses from April 2017

Also on 26th January 2017, HMRC issued a revised version of the draft Finance Bill legislation relating to the carry forward of corporate losses. As we already knew, from April 2017:

- Companies can carried forward losses and set them against trading and non-trading profits or used as group relief in future periods
- If above a £5million annual allowance, relief will be restricted to a maximum of 50% of the company's total profits for the period,
- Losses arising before April 2017 will remain subject to the existing rules but will be subject to the 50% carry forward restriction.

The revised draft legislation introduces additional rules targeted at insurance companies, the creative industries and anti-avoidance provision to prevent these new rules being exploited. Comments on the revised draft are invited by 23 February 2017.

www.gov.uk/government/publications/draft-legislation-relief-for-carried-forward-losses

VAT

Mitigating tax to reward staff

Summary – Tribunal allowed the company's claim that an invoice related to a business expense

A tax consultant, Qubic Tax, invoiced Doran Bros (London) Ltd for £40,000 plus VAT for tax advice looking to mitigate the company's tax and NI liabilities. Following the advice, the company invested in gold that was held in an employee trust for an employee who was the sole director.

HMRC refused the input tax claim arguing that the money spent was for the director's sole benefit rather than a cost of operating the business.

Decision

The First Tier Tribunal found that the:

- business was making taxable supplies;
- contract was between the tax adviser and Doran Bros;
- director had no rights at all, even though ultimately they benefited;
- advice was to mitigate Doran Bros' tax and NI liabilities which increased the company's profits.

They held that there was a direct link between the advice and the business's taxable supplies and was for business purposes.

The appeal was allowed.

Doran Bros (London) Ltd v Revenue and Customs Commissioners (TC05554)

Reclaiming overpaid VAT by a group

Summary – Representative member must make the claim for any VAT repayment within the group

Following Taylor Clark Leisure PLC v HMRC, where a company forming part of a VAT group wishes to claim a repayment of overpaid VAT, under normal circumstances this must be claimed by the group's representative member.

However, despite accepting this, Gala 1 Ltd appealed against HMRC's rejection of its claim for repayment of VAT under s80 VATA 1994 relating to supplies made by it whist it was a member of a number of groups.

Gala argued that that VAT was wrongly collected by HMRC and so was repayable to them rather than the representative member as:

- they were the ones holding the relevant documents; and
- it did not know who was the representative member of the relevant group at the time the supplies were made.

Decision

The Upper Tribunal held that the tax could not be repaid to the wrong person and that it would have been possible for the representative member to make the claim. Equally there was n evidence to support the claim that the representative member had appointed Gala as its agent.

GALA 1 Ltd v HMRC UK Upper Tribunal UT [2016] 564 (TCC), UT/2015/0097

Suspension a careless error penalty

Summary – HMRC ordered to suspend careless error penalty

Parklane is a UK resident company that registered for VAT from 15 September 2012. On their VAT return for the quarter to December 2013 they claimed a VAT repayment of £66,000.

In 2014, following a visit, HMRC advised Parklane that since all of its supplies were exempt supplies it could not claim input tax and that it was not entitled to be registered for VAT. HMRC disallowed the claim and issued a careless error penalty.

Parklane was de-registered for VAT with effect from 1 April 2014 and on the same date became a member of a group of companies of which Properties (Management) Limited was the representative member.

In 2015, following a review by HMRC they said that they could not suspend the penalty, stating:

> "Unfortunately in your case suspension is not possible due to the fact that you are no longer registered under VRN [Parklane's original VAT number] and are now part of a VAT group. HMRC therefore cannot impose conditions against VRN [Parklane's original VAT number]. Suspension conditions cannot be transferred to another VRN"

Decision

The First-tier Tribunal disagreed with HMRC saying that their approach was flawed. Nothing in the legislation suggested that membership of a VAT group led to the loss of legal identity for all members other than the representative member. Under s43(1) VATA 1994, all members of a VAT group retain joint and several liability for the VAT debts of the group.

The judge said:

> "There is no insurmountable barrier to imposing suspension conditions in circumstances where a company is a member of a VAT group and no reason in practice why conditions could not be imposed on Parklane, with implications for the whole group if those are not complied with."

The Tribunal ordered HMRC to suspend the penalty.

Comment

Neil Warren, independent VAT consultant, said: 'This is a ground-breaking case and it will be interesting to see whether HMRC reviews its internal guidance as a result of the taxpayer's successful appeal. The court's view was clear that a group registration does not mean that group members lose their legal identity, only that the business of the group is deemed to be carried on by the representative member. The court acted boldly in overturning HMRC's decision.'

Parklane UK Investments Ltd ***Revenue and Customs Commissioners (TC05528)***

Input tax win for Durham Cathedral (TC5477) (Lecture B999 – 13.14 minutes)

It is an accepted principle of VAT that input tax can only be claimed on expenditure that relates to taxable sales. There have been times when HMRC have been reluctant to allow input tax claimed on some overheads because they like to see a 'direct and immediate' link between an input and an output. So it was good news that the First-tier Tribunal agreed with the taxpayer that the costs of maintaining a bridge leading to Durham Cathedral was partly claimable for input tax purposes ie it was partly linked to its business activities.

The business/non-business split

Many clients (particularly charity clients) get confused about the difference between non-business VAT and exempt input tax.

If an expense is partly business and partly non-business, then an initial block of VAT must be made to take out the non-business element.

There is no prescribed method of making this calculation as long as it is fair and reasonable. The calculation might be made according to use of the expense (a time split) or based on customer numbers or, in some cases, an agreed split with HMRC. The latter situation applied to Durham Cathedral – a historic 35/65 split for business/non-business use had been in place for many years.

Note – the business activities of the cathedral include a café and gift shop, whereas the non-business activities obviously relate to the cathedral as a place of worship.

Partial exemption

Having taken out the non-business VAT, the remaining amount will be subject to a further restriction for partial exemption purposes.

So let us say that VAT of £100 was paid for repairing the cathedral roof. An initial deduction of £65 for non-business use means that a potential input tax claim of up to £35 could be made when this figure is included in the partial exemption calculation. A roof repair cost will be included in the category of 'residual input tax' ie it is relevant to both taxable and exempt sales so can be partly claimed. The amount claimed is based on the standard method and turnover:

Residual input tax to claim = Taxable sales (exc. VAT)/(Taxable sales (exc. VAT) + Exempt sales) ie T/T+E.

Note – the percentage claimed is rounded up to the nearest whole number as long as total residual input tax is less than £400,000 a month, otherwise the calculation is make to two decimal places – VAT Notice 706, para 4.7.

Facts in Durham case

The FTT considered if input tax could be partly claimed on the repair costs of a bridge that led to the Cathedral. The bridge was the responsibility of the Cathedral to maintain and the taxpayer argued that the VAT on repairs should be treated as partly relevant to its business activities.

HMRC's argument was that there was no direct and immediate link between the bridge and any taxable supplies made by the Cathedral so the costs must be wholly non-business.

The taxpayer's view was that the CJEU case of Sveda (C-126/14) had confirmed that there did not need to be a link between a specific output tax and input – it was sufficient that the bridge gave 'the public access to the cathedral more readily' (para 22).

Note – the Sveda case related to the cost of a path in a public park, which was of benefit to park walkers but also the gift shop and café operated by Sveda, which paid for the costs of the path. The court concluded that there was a link between the input tax on the path and increased visitor numbers in the shop and allowed input tax recovery.

The Durham appeal was allowed: "overheads are ipso facto components of the price of services, and that, contrary to the view of the UK in other cases, no enquiry into the way a person establishes the price for its goods and services is necessary." (para 52).

Conclusion

It is useful to quote the Sveda and Durham Cathedral cases if HMRC dispute input tax claimed by a business on overheads. The best approach is to always look at the purpose of an expense and the outcome it achieves for the business.

Contributed by Neil Warren

Default surcharge tale of woe….The Posnett case **(Lecture B1000 – 10.32 minutes)**

This article focuses on a First-tier Tribunal case about a one-woman sole trader business getting a default surcharge for £217,701. To add a twist to the tale, she had never received a surcharge of more than £159 before the bill for £217,701 landed on her doormat, even though she had submitted late VAT returns and payments for seven of the previous eight quarters. This is a very important case to ensure that your clients and businesses do not suffer similar problems. The facts are probably quite unique but Susanna Posnett (TC5306) lost the appeal and will have to pay the surcharge, assuming there is no appeal to a higher court.

Background to default surcharge system

The mechanics of the default surcharge system can be complicated. The concessions and quirks in the rules are the reason that Ms Posnett had such a good run for her money and was able to pay seven VAT returns late between August 2013 and May 2015 and only incur total surcharges of £268.

The killer blow and her £217,000 bill (enough to buy a parking space in London) came in the August 2015 period.

- The first time that a small business is late with a return or payment, it gets a polite letter from HMRC offering advice and support. The threshold for this gentle touch is that annual taxable sales must be less than £150,000 (VAT Notice 700/50, para 4.2). Ms Posnett qualified for this concession with her first late payment in August 2013.

- If the small business defaults again within 12 months it will receive a default surcharge liability notice. A notice is also issued on the first offence committed by a larger business with sales exceeding £150,000. The liability notice is the 'yellow card' in footballing speak. It means that another late payment or return within the next 12 months will incur a default surcharge of 2% for the first offence, rising to 5%, 10% and finally 15%. Once a business is in the surcharge system, it needs to have a clean record for the next 12 months by submitting all returns and payments on time.

- The good news is that a surcharge is waived if it is less than £400 for either the 2% or 5% periods. Paradoxically, my view is that this particular rule, which is good news in many respects, proved to be the downfall of Ms Posnett. I will explain why later.

- There is also a £30 de minimis figure for 10% and 15% penalties as well.

- If a VAT period shows a 'nil' or repayment return, then no default surcharge is issued but the business will move into a higher percentage category in the following period.

Example 1

ABC Ltd will be subject to a 5% surcharge if it pays VAT late on its June 2016 return. The return was submitted seven days late but it was a repayment claim. This means that no default surcharge will be applied for the period but the business will be subject to a 10% surcharge if the September 2016 tax is paid late.

What if VAT cannot be paid on time?

Many businesses face a cash flow crisis at some stage and the business owner will be faced with the dilemma about whether to pay Peter or Paul…..or HMRC.

However, the opening strategy should be to contact HMRC's Business Payment Support Service (BPSS) (0300-200-3835) and hopefully agree a time to pay deal. The telephone call and agreement must be made before the tax is legally due for payment to avoid a surcharge (VAT Notice 700/50, para 3.2). .

But what happens if the BPSS refuses to accept an agreement? To share a planning tip, always be clear that a default surcharge is only levied on the unpaid balance of tax by the due date. So there is a clear incentive to pay as much tax as possible on time, and if you are very shrewd, you could plan the payments to utilise the £400 de minimis limits for the 2% and 5% periods.

Example 2 – use of £400 de minimis limits

John is in the default surcharge system and liable to a 2% penalty if he defaults in the March 2016 period. He submits the return on time but instead of paying the full tax due amount of £25,000 can only make a part-payment of £5,000 on time. His accountant suggests he increases the part payment to £5,001.

The payment of £5,001 means unpaid tax by the due date will incur a default surcharge of £399.98 ie £19,999 x 2%. But as this amount is less than £400, it will be waived by HMRC.

For the next period to June 2016, John must ensure that any unpaid tax by the due date is less than £8,000 because the 5% period is also subject to the £400 de minimis limit. But a late payment for the September 2016 period will then produce a surcharge of 10%, with no de minimis threshold if the penalty is more than £30.

The Posnett case

Susan Posnett was a sole trader producer of television documentaries – a small business who did not employ staff. So how could she suddenly go from incurring default surcharges of £268 over eight VAT quarters to a single hit of £217,701 for the August 2015 period? The answer is because in the crucial August period, by which time she was subject to 15% surcharges because of her past misdemeanours, she sold some land she owned for £10.36m:

The land was inherited from her father and was suitable for residential development. However, she made the decision before selling the land to make an option to tax election on the site. This was sensible because she had incurred costs of about £3m plus VAT, and the only way of claiming input tax was to opt to tax the land so that the sale was taxable rather than exempt. The buying company could claim input tax because it intended to build and sell new dwellings on the land (zero-rated sales).

Ms Posnett's return for August 2015 therefore included output tax of £2.07m on the land sale and about £600k of input tax, so a net payment of about £1.45m would be subject to a 15% surcharge if it was paid late.

As you have probably guessed, Ms Posnett submitted the return and payment on 15 October 2015 ie after the due date, and incurred a surcharge of £217,701.52.

Possible arguments for taxpayer

A business that incurs a default surcharge only has two possible escape routes to avoid payment to HMRC:

- Reasonable excuse
- Proportionality

The argument that Ms Posnett had a reasonable excuse was based on the fact that she had heavy work commitments on two TV documentaries "with the Prince of Wales and his family and Ant and Dec which required exceptional time management and flexibility". She did not have time to focus on submitting her VAT return on time. She referred to her professional life as "stressful, inexorable and unremitting". However, the tribunal agreed with HMRC's view that "any reasonable taxpayer would have made arrangements to accommodate the demands put upon her." (para 29).

The main argument was that the surcharge was disproportionate. The key principle of proportionality is that the content and form of any action taken by the tax authorities to collect tax should not exceed what is necessary to achieve the objectives of the EU treaties. As the tribunal noted (para 53): "The bar is extremely high". This is because the surcharge escalates with each offence committed by the taxpayer and is also based on the amount of unpaid tax outstanding by the due date rather than being a flat rate penalty. The tribunal rejected the taxpayer's claim of proportionality.

Case conclusions

Ms Posnett said during the hearing that she thought (incorrectly) that the level of VAT surcharges were similar to the £100 penalties charged by HMRC for late self-assessment tax returns. This is logical when you think that she submitted seven VAT returns and payments late and only incurred two surcharges of £139.16 and £158.61. And this is why I think the £400 de minimis thresholds can give a false sense of security to a taxpayer because they encourage complacency.

If there was ever an argument that a default surcharge should be overturned because it was disproportionate, this must surely have been the ideal case. However, the tribunal took into account a lot of factors and comments from other decisions, and also noted that it was the taxpayer's decision to opt to tax the land before it was sold in order to claim input tax on the project costs. The case yet again shows that VAT is the most important tax to get right.

As a final comment, VAT enthusiasts will recall the tribunal case of Enersys Holdings UK Ltd (TC1765), when a default surcharge for £131,000 was overturned on the basis that it was disproportionate. The company was only one day late with its VAT payment and a key fact was that the business was seasonal, and this particular period was its busiest of the year. HMRC did not appeal the verdict to the Upper Tribunal and accepted the decision. Many advisers thought this outcome was the beginning of a new dawn with scope to overturn many other surcharges. But this did not happen. HMRC have had an excellent record in defending similar charges since the Enersys decision was given in 2010 and the Posnett case is probably the final nail in the coffin. The Enersys decision was a one-off.

Contributed by Neil Warren

Prepaying tax prior to appeal

Summary –Prepayment prior to appeal was not an infringement of the EU principle of equivalence.

HMRC had assessed the taxpayer to VAT of £1.5million on the grounds that it had wrongly treated it as input VAT in its returns The Upper Tribunal had held that to appeal against such an overpayment, the company must first pay the VAT due.

Totel appealed to the Court of Appeal claiming the following:

- Prepaying tax prior to appeal is not a requirement for income tax and stamp duty land tax and the taxpayer argued that VAT was no different as the appeal process and the Tribunals involved were the same.
- They also argued that requiring this prepayment was an infringement of the EU principle of equivalence described by Lord Hope in *Test Claimants in the FII Group Litigation v CRC* [2012] STC 1362:

> 'The principle of equivalence requires that the rules regulating the right to recover taxes levied in breach of EU law must be no less favourable than those governing similar domestic actions.'

Decision

Lady Justice Arden in the Court of Appeal said, said that given the EU's lack of harmonisation on the remedies for overpayment of taxes and the diversity in the procedural rules set by member states, 'it was inevitable that there would have to be some leeway in the application of the equivalence principle'.

She said a member state could apply any set of rules, already applied to similar domestic claims, to an EU-derived claim, as long as the latter was not selected for the worst treatment. There was no need for HMRC to justify the different treatment of other tax rules.

The taxpayer's appeal was dismissed.

Totel Ltd v R & C Commrs [2017] BVC 3,
Court of Appeal (Civil Decision)

Supplier of deed poll services – Jersey or UK based?

Summary – Taxpayer had establishments I both the UK and Jersey

Multimedia Computing Ltd (MCL) was a UK company based in Essex that dealt with deed poll applications from private individuals living in the UK. Deed Poll Services Ltd (DPSL) was a Jersey based company, employing a single employee who dealt with queries and matters relevant to the MCL activities and without who, supplies to customers could not be made. This employee was also a director of MCL.

The taxpayers argued DPSL rather than MCL made the supplies of deed poll services. With DPSL based in Jersey these supplies, as well as work that was outsourced to MCL, were outside the scope of VAT.

The First-tier Tribunal concluded that DPSL had a fixed establishment in Jersey and the UK. It was:

> 'impossible to conclude, as a matter of fact, that, although it was a Jersey company with an office in St Helier, DPSL had more than a nominal operational existence there'.

The employee could work from anywhere where there was an internet connection. However, without the Essex office, he could not carry out his work and no supplies would be made.

The taxpayers' appeals were dismissed.

Comment

Neil Warren, independent VAT consultant, said that ‘When a business has establishments in two different countries, it is the one that is most connected with the supply that is relevant. I suspect the taxpayer will appeal and has a good chance of success because higher courts tend to focus more on contractual issues in their decision-making process.'

Multimedia Computing Ltd and Deed Poll Services Ltd v Revenue and Customs Commissioners (TC05506)

Cancellation of registration due to no business activity

Summary – The taxpayer intended to pursue a commercial business making taxable supplies and so was entitled to be registered for VAT on a voluntary basis.

On 28 May 2009, Gravel Road Records Ltd (GRR), originally registered in Scotland, changed its name to Crag Records Ltd and transferred its business to a new company incorporated in England. The company had decided to expand its operations from an independent record label to offer a production and sound recording facility as well.

The company applied for voluntary VAT registration on the basis that it intended to make taxable supplies exceeding the registration limit by 1 January 2010.

In order to provide production and sound recording facilities, the company needed to construct a studio which was financed almost entirely by a third party, Icealarm Limited. GRR leased industrial premises in Wantage and engaged builders to convert the premises to a suitable studio. Anticipating the completion of the studio, two potential clients were identified.

However, the building work took much longer than expected and by the time the studio was ready, the company was unable to generate any income as the two potential clients had found other studios and the recording and music business was suffering a severe economic downturn and contraction. Eventually Icealarm withdrew funding the venture with the company ceasing to trade in 2012.

HMRC concluded that no business activities had taken place during the period of VAT registration and that therefore the company had no entitlement to claim a repayment of the input tax it had suffered.

HMRC looked to:

1. deregister the company for VAT with effect from 29 May 2009;
2. reduce the VAT repayment claim to 'nil' for the period to March 2012; and
3. issue a VAT assessment relating to the previous VAT returns on which VAT had been reclaimed.

Decision

The Tribunal judge held that the scale of investment involved in converting the leased property into a recording studio indicated an intention to pursue a commercial business rather than 'hobby' activity. At the outset, they intended to repay their investment and make a commercial return. It was clear that they intended to make taxable supplies and were entitled to request that they be registered for VAT.

The company's appeal was allowed.

Given that HMRC had not presented evidence at the hearing supporting the VAT repayments, the Tribunal did not consider resolving these issues but said that they were at liberty to apply to the Tribunal for a final determination of those two matters should they be unable to agree.

As the company had ceased trading and was at best least dormant with no remaining assets, the Tribunal judge suggested that HMRC might consider discharging the assessment and not enquire any further into the company's VAT affairs.

Gravel Road Records Ltd v Revenue and Customs Commissioners (TC05598)

VAT claimed under the DIY scheme

Summary – Reclaim of input tax relating to a conservatory was allowed but reclaim restricted on conversion costs where VAT was overcharged by builders.

In 2005 the taxpayer started work converting a barn that adjoined their property into a new residential property. The following year, in September 2006, the planning authorities confirmed that the converted property would be a new dwelling rather than an extension to their existing site.

The conversion was finally completed in 2015 and the taxpayer submitted a claim to HMRC under s35 VATA 1994 to reclaim £32,185 of input tax that they had incurred on the conversion costs.

HMRC refunded just under £8,000 of the input tax claiming that:

1. The builders had incorrectly charged VAT at 17.5% on their services rather than 5%; As the period between the builders raising the invoices and the claim was longer than four years, under S80(A) VATA 1994, the builders could not raise a credit note to refund the 12.5% overcharged.

2. The work had included a conservatory which was not part of the new dwelling as it was not included in the planning documents

Decision

The First Tier Tribunal said that the:

- builders were correct to charge VAT at 17.5% until September 2006 because it was not established until this date that the project related to a new dwelling rather than an extension to an existing one. Thereafter HMRC was right to rule that the VAT had been incorrectly charged at 17.5% and that it could not be repaid at that rate.

- conservatory did not require planning consent and therefore input tax was recoverable.

The taxpayer's appeal was allowed in part.

Comment:

Neil Warren, independent VAT consultant, said: 'Despite being a part of the VAT system for over 40 years, many appeals about the DIY scheme are decided at least part in favour of the taxpayer. This suggests that some HMRC staff dealing with claims are not familiar with the quirks of planning consent and building regulations that are sometimes relevant in making an accurate repayment.'

CD Smith v Revenue and Customs Commissioners (TC05510)