Tolley®CPD

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Budget 2017

The government has announced that the 2017 Spring Budget will be published on Wednesday 8 March 2017.

This will be the last Budget to take place in the spring as confirmed by the Chancellor of the Exchequer in the 2016 Autumn Statement.

Personal Taxes

Burden of proof over residence status

Summary –The Tribunal judge directed that a mutual exchange of lists of documents and witness statements was appropriate so both parties cases were known to each other

The taxpayer was born in the UK. He was UK resident until 2000. From March 2000, he took steps to become resident in Monaco. His 2000-01 return was completed on the basis that he was not resident in the UK. HMRC challenged this. Using the discovery provisions, HMRC issued a CGT assessment for £84m relating to a share sale in May 2000.

Previously the taxpayer had applied to the Court of Appeal that the point of discovery should be the subject of a preliminary hearing. His contention was that if HMRC could not sustain a discovery assessment, a hearing on the substantive point of his residence status would be unnecessary. The Court of Appeal rejected this argument and remitted the case to the First-tier Tribunal for a directions hearing.

This hearing dealt with two issues:

1. Which party should open the substantive hearing and

2. The evidence that should be provided.

The taxpayer took the position that the burden of proof on a discovery assessment appeal was on HMRC. Therefore he should not be obliged to provide evidence to enable HMRC to establish its case; rather, it was for HMRC to make its case and then for the taxpayer to respond that there was no case to answer or to provide evidence on the substantive issue.

Decision:

The judge issued directions requiring the taxpayer to produce a statement of case in response to HMRC's statement and to provide a schedule of agreed facts and a 'day count' to support his claim for non-residence.

Comments - This is the second case management hearing for directions to progress this appeal to a hearing. The decision of Judge Gort in the first case management hearing in May 2013, to dismiss the appellant's application for a preliminary hearing to consider the competence of a discovery assessment under s 29 TMA 1970 led to unsuccessful appeals by the appellant, Mr John Hargreaves, to the Upper Tribunal and the Court of Appeal. Andrew Hubbard said: 'On the face of it this might be seen as a sterile argument about the order of events in an appeal. But it is important because it shows just how difficult issues of burden of proof can be in tax disputes.'

J Hargreaves v HMRC TC5499

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Was the receipt of £250,000 income or capital?

Summary – The judge found the receipt should be treated as a capital receipt

The lease of 18 flats in an apartment block, known as Jordan House (in Nairn), which had previously been between Silk Estates and Albyn Housing Society, was assigned to Mr Thornton. The tenants were responsible for the upkeep of the flats but they did not do so. Although the flats were vacant for a year as they were no longer fit for habitation, Albyn Housing continued to pay the rent. Negotiations occurred with a view to reaching a settlement so that the lease would be terminated and Mr Thornton could take possession of the flats to prevent further disrepair. A payment of a £250,000 settlement was made to Mr Thornton on Friday 30 July 2010.

HMRC argued that the settlement should be treated as an income receipt, because it covered the loss of rental income due to the dilapidated state of the flats. Mr Thornton contended that it should be treated as a capital receipt, since it allowed him to safeguard his capital investment and had been used to repair the property.

Decision:

The FTT highlighted … no single infallible test for settling the vexed question whether a receipt is of an income or a capital nature (Lord MacDermott CJ). Each case must depend on its particular facts and what may have weight in one set of circumstances may have little weight in another. The FTT found that when the lease was terminated, due to the inaction of Albyn, Mr Thornton had suffered a permanent diminution in the capital value of his investment and the settlement was to make good that loss. In Para 39 of the judgement the judge said "The receipt of the funds falls to be regarded as a capital receipt in the hands of Mr Thornton".

Comments – There are lots of cases dealing with income v capital but the FTT said the facts in this case can be distinguished from the many authorities (to which we were not referred) as, unsurprisingly, it is not wholly in point with any. They had earlier commented that there was a lamentable lack of relevant documentation and also a lack of clarity in what little had been produced in the joint bundle of documents lodged. Neither party had done themselves a service

James Allan Thornton v V HMRC TC5494

Using ISAs to boost pension funds **(Lecture P991 – 11.28 minutes)**

When approaching retirement it might be worth utilising your ISAs to increase pension provisions.

Illustration

Phil, aged 53, has taxable income of £100,000 and plans to retire at age 57. His current pension fund stands at £200,000 and he has £200,000 in ISAs etc.

Should Phil use his ISAs and savings to increase his pension fund?

Utilising his brought forward annual allowances Phil could make a contribution of £70,000 a year for next 3 years, then £40,000. This amounts to gross contributions of £250,000 over a four year period or £200,000 net.

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His pension fund would then be worth £450,000 plus growth and he would have received higher rate relief on most of his £250,000 contributions i.e. another £50,000 of tax relief via his self assessment return.

Ignoring any growth he turns £400,000 into £450,000 over a three to four year period as he approaches retirement. The additional high rate tax saving of £50,000 via his self assessment return could be used to replenish his ISAs. So £400,000 becomes £500,000 over a reasonably short period.

Pensions are one area of saving for retirement. Other investments such as ISAs and property are often used to supplement their retirement income. From April 2017 LISAs could be incorporated into IHT planning.

From 6 April 2017 any adult under 40 will be able to open a new Lifetime ISA and contribute up to £4,000 each year and will receive a 25% bonus from the government at the end of the year. The savings may be kept in cash or investments and will be allowed to grow tax free within the Lifetime ISA

Savers will be able to contribute to one Lifetime ISA in each tax year, as well as a cash ISA, a stocks and shares ISA, and an Innovative Finance ISA, within the new overall ISA limit of £20,000. A Lifetime ISA can be funded by transfers from other ISAs in accordance with normal rules.

Contributions can continue to be made with the bonus paid up to the age of 50.

Funds, including the Government bonus, can be used to buy a first home at any time from 12 months after opening the account, and can be withdrawn from age 60 for use in retirement. The limit for property purchased using Lifetime ISA funds will be set at £450,000 and will apply nationally.

Grandparents could fund up to £4,000 a year for their 18 year old grandchild. Over a seven year period the gifts total £28,000. If the gift is out of income the IHT saving is £11,200 i.e. £28,000 x 40%).

There are Government LISA bonuses of £7,000 over the 7 years so the LISA balance is £35,000 with no investment growth. So grandparents have turned £16,800 into £35,000 over a seven year period (per grandchild) i.e. £28,000 - £11,200.

Is Director's loan interest "annual" (Lecture P992 – 7.02 minutes)

If a director's loan account is in credit, interest can be paid to the director. HMRC are known to accept a rate of between 6% and 8% on an unsecured director's loan account.

Paying interest can utilize the £5,000 0% starting rate and the personal savings allowance in 2016/17. This can result in up to £6,000 of tax free interest for the recipient.

It is generally accepted that tax should be deducted from the interest via the CT61 process. This is on the basis that the interest is yearly (or annual) interest rather than short interest.

Given we are probably treating the director's loan account as a current liability on the company balance sheet is this correct?

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Yearly interest

S.874 ITA 2007 requires income tax to be deducted at the basic rate from "yearly interest" (annual interest) arising in the UK. Interest is yearly interest if the debt on which it is paid is capable of being outstanding for a period exceeding one year. Otherwise it is short interest.

Whether interest is annual interest or short interest is determined when the loan is made and is dependent on the intentions of the parties involved.

So interest will be annual unless the debt has a fixed repayment term of 364 days or less and the parties intend at the outset that the term of the loan should be for less than a year. So you cannot deem a loan to be "short" just by repaying early. The loan must be legally incapable of being outstanding for more than a year. A loan "repayable on demand" is capable of being outstanding for more than a year so the loan would be a current liability on the Balance Sheet but the interest would be yearly interest and a CT61 is in point. Short interest is likely to be paid under revolving credit facilities and other debts of a relatively short life.

It would be difficult to argue that interest paid by a company on a director's loan account is short unless you had a formal agreement in place between the director and the company that the lending director would only have this debt facility available to the company for 364 days and not a day longer. This is highly unlikely. HMRC would also take a dim view of directors making a number of consecutive short interest loans to their company to get round the CT61 withholding.

Accounting rules

The accounting standard looks at this area very differently.

From an accounting perspective there might well be a rush to charge market rates of interest on director loans to avoid the need for loan remeasurement on initial recognition to NPV and subsequent remeasurement to amortised costs. The accounting is very unpleasant when loans are interest free or at below market rates!

However, the first line of defence against this treatment is accepting that the loan is repayable on demand. The absence of repayment terms or unclear/unenforceable terms both default to repayable on demand. This avoids the remeasurement issues and the loan account is left as is and will be shown as a current liability in the company's Balance Sheet.

Any interest payable will however be yearly interest for tax purposes as it is not incapable of being outstanding for a year or more.

Sometimes it is commercially impossible to present creditors in this way because the Balance Sheet suffers liquidity issues so the loan has to be presented as repayable in more than one year. For this treatment to work then the loan has to be incapable of being recalled within one year.

Loan interest continues be annual interest and this would need to be charged at market value to avoid the remeasurement issues individuals are charging interest on their loans.

Dealing with non-resident landlords (Lecture P993 – 8.34 minutes)

If a landlord usually lives outside the UK their letting agent or tenant normally has to deduct tax from property income. However, these landlords can apply to HMRC for approval to receive the income of their rental business with no tax deducted.

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Outline of the Non Resident Landlords (NRL) Scheme

The NRL scheme applies to:

- letting agents who handle or control UK letting income on behalf of a landlord whose usual place of abode is outside the UK and
- tenants who make payments directly to a landlord whose usual place of abode is outside the UK

Unless they have been notified by HMRC that they must pay rental income with no tax deducted, letting agents must deduct and account for tax on rental income received less allowable expenses paid. Tenants must deduct and account for tax on rental income paid direct to the overseas landlord.

Letting agents and tenants must account quarterly to Accounts Office Shipley (using return form NRLQ) for the tax deducted, without the need for an assessment, within 30 days of the end of the quarter. Quarters run to 30 June, 30 September, 31 December and 31 March.

Letting agents and tenants with no tax liability for a quarter need not complete a quarterly return (unless, exceptionally, HMRC issues them with a notice requiring a return).

Letting agents and tenants of non-resident landlords must also make annual information returns to HMRC (on form NRLY) with the exception of tenants authorised to pay their landlord with no tax deducted. Letting agents must complete annual information returns even if they are authorised to pay all their non-resident landlords with no tax deducted.

Letting agents must also provide the landlord with an annual summary of income and tax deducted (NRL6). Both NRLY and NRL6 must be submitted/provided by 5 July following the tax year.

Letting agents

For the purposes of the scheme, ‘letting agents’ are persons who act in the management or administration of a non-resident landlord’s rental business. This may include friends and relatives of a non-resident landlord as well as professional letting agents.

Meaning of ‘usual place of abode’

‘Usual place of abode’ is not identical in meaning to residence, or ordinary residence, but a person who is not resident in the UK should normally be treated as having their usual place of abode outside the UK. You should interpret the term in accordance with the following guidelines.

Individuals have a usual place of abode outside the UK if they usually live outside the UK. You should still regard the term as applying to them even if in a particular year they are resident in the UK for tax purposes, as long as the usual place of abode is outside the UK.

For example the individual may count as resident in the UK in a particular year because of a six months’ visit, or a visit of a shorter time when he has a place of abode available in the UK. Do not treat someone as having their usual place of abode outside the UK if they are only temporarily living outside the UK, say for six months or less.

Companies that have their main office or other place of business outside the UK, and companies incorporated outside the UK, will normally have a usual place of abode outside the UK. However if the company is treated as resident in the UK for tax purposes, do not treat it as having a usual place of abode outside the UK.

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Trustees have a usual place of abode outside the UK if all the trustees have a usual place of abode outside the UK.

De minimis limits

Tenants who make payments directly to a landlord whose usual place of abode is outside the UK and who pay less than £100 a week in rent, do not have to deduct and account for tax unless they have been told to do so by HMRC.

There is no de minimis limit for letting agents.

Approval to receive rental income with no tax deducted

Non-resident landlords can apply to HMRC for approval to receive their rental income with no tax deducted if:

- their tax affairs are up to date, or
- they have never had any UK tax obligations, or
- they expect not to be liable to UK income tax.
- They must also undertake to comply with SA.

HMRC Website

Pensions and the expression of wish **(Lecture P995 – 13.18 minutes)**

Where the pension holder dies under the age of 75 the fund can pass IHT free to nominated beneficiaries. The beneficiary is then able to take a lump sum or regular income withdrawals from the fund completely free of income tax. The beneficiary does not have to wait until they are 55 to enjoy tax free withdrawals from the deceased's pension fund.

Where the pension holder dies over the age of 75 the fund can pass IHT free to nominated beneficiaries. The beneficiary is then able to take a lump sum or regular income withdrawals from the fund but both will be subject to income tax. If the lump sum was taken prior to 6 April 2016 it will be taxed at 45%. All other withdrawals are subject to the beneficiary's marginal rate of tax.

Nominations are prepared by way of an expression of wish and this can stipulate multiple beneficiaries at varying %. It is important that the expression of wish takes effect within two years of death to secure the IHT free movement to the nominated beneficiaries.

Illustration

James is 68 when he dies in flexi-access drawdown. He leaves the pension fund to Beth, a 77 year old friend. As James was under 75 when he died, Beth can take a tax free lump sum or draw tax free income.

When Beth dies she leaves the fund to her son Frank. As Beth was over 75 on her death, Frank can take a taxable lump sum or taxable income draws from the fund.

Frank leaves the fund to his daughter Amy. Frank dies at 74. Amy can draw a tax free lump sum or tax free income as Frank was under 75 when he died.

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Illustration

Chris and Diane have a large buy to let investment portfolio and are comfortable in retirement.

When Chris was 55 he drew a tax free sum of £100,000 from his pension fund but he has not drawn any further income from the fund.

As Diane is well catered for Chris has decided to nominate his son Alex as sole beneficiary of his pension fund. Chris dies at 73 and Alex inherits his fathers pension fund. As Chris died under 75, Alex can draw any sum from this fund tax free.

Expression of wishes

Most pension providers allow you to nominate your beneficiaries at any time. The nomination is not usually legally binding but your pension provider should follow your nominations.

The nominations can be to anyone of your choosing.

The expression of wishes will identify the individuals you wish to nominate and their proposed %

We must ensure all expressions of wish are up to date to enable the IHT free nature of the pension fund on death.

Practitioners must take care with expression of wishes made in the two years before death, especially if taxpayer is in poor health. HMRC are likely to argue that the nomination is a transfer of value and as a result the fund remains in your estate. The case of *RWJ Parry, HFA Piney and SA Staveley v HMRC TC3548* demonstrates HMRC views in this area.

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Capital Taxes

How to compute capital gains on foreign assets (Lecture P994 – 4.07 mintes)

The recent case of Knight v HMRC TC5544 highlights a situation which is much misunderstood. How do you compute a capital gain with the disposal where a foreign currency is involved?

The appellants, George and Ingeborg Knight, were appealing against discovery assessments to capital gains tax ("CGT") that HMRC made in consequence of the appellants' disposal of a property in Switzerland and associated penalties.

The appellants purchased the property in 1988 for a price in Swiss Francs. They disposed of the property in January 2010 and received a consideration in Swiss Francs and also incurred expenses connected with the property which they paid in Swiss Francs.

The matters in dispute, and in respect of which the Tribunal had jurisdiction, can be summarised as follows:

1. The appellants argue that the correct way to calculate the chargeable gain on disposal is firstly to calculate the gain that they made in Swiss Francs by subtracting the aggregate of the expenditure that they incurred in respect of the property (in Swiss Francs) from the Swiss Franc disposal proceeds. That produces a gain in Swiss Francs which should then be converted into sterling at the exchange rate applicable on the date of disposal for the purposes of calculating their CGT liability. That method of calculation was referred to, at the hearing, as "Method A".
2. HMRC argue that Method A is incorrect and they adopted a different method ("Method B") when making the assessments. Under Method B, each item of expenditure that the appellants incurred in respect of the property (including the cost of acquisition) was converted into sterling at the exchange rate applicable on the date that expenditure was incurred. The sum of those sterling amounts represented the appellants' total allowable expenditure in respect of the property. HMRC then determined the sterling equivalent of the sale proceeds that the appellants received by converting the Swiss Franc disposal proceeds into sterling at the exchange rate applicable on the date of disposal. The difference between the sterling equivalent of the sale proceeds and the sterling amount of total allowable expenditure represented the gain arising on disposal and HMRC used this figure to calculate the appellants' respective CGT liabilities.

Mr Knight was unable to convince the Tribunal of the correctness of his methodology.

When computing a gain in such circumstances you have to recognise there are four steps:
1. Acquisition of foreign currency
2. Disposal of foreign currency and acquisition of another asset – in this case the property
3. The disposal of the property and the acquisition of foreign currency and
4. The disposal of the foreign currency and the conversion into sterling

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The acquisition and the disposal of the foreign currency is unlikely to give rise to any significant gain or loss because the currencies will not have moved due to the short time scale involved. Similarly the same is likely to be true of Step 4.

The two intervening steps are the ones that cause the problem – calculating each figure in Sterling and then taking the difference between the results to arrive at the gain (or loss).

Caveat – tax does not always work the way that a logical person would think!

Contributed by Tony Jenkins

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Administration

Confusion over the SA loss relief process

Summary – The High Court rejected the taxpayer's repayment claim on a loss carry back

The taxpayer incurred a capital loss in 2011-12 with the liquidation of a trading company. Under s131 ITA 2007, the taxpayer elected to set the loss against his income tax liability for the previous year (2010-11) and the balance against that for 2011-12. Consequently the result was that the former liability was reduced to nil. The taxpayer claimed a tax repayment of £63,188 previously paid in respect to that year. HMRC refused to make the repayment. The taxpayer made a claim in the High Court for an order for HMRC to make the repayment plus interest.

HMRC resisted on four grounds.

A. The claim was not properly quantified.
B. HMRC had validly opened an enquiry into the claim and thus had the power to refuse to give effect to the claim until the enquiry was concluded.
C. The claim was premature because there was a valid enquiry into the 2011-12 claim based on the same loss.
D. The claim was not for repayment, but for a credit and therefore was outside para4(4) Sch 1A TMA 1970

Decision:

On A, HMRC's argument was not accepted. Although the taxpayer had set out the loss on the disposal rather than the monetary value of the claim, the judge accepted that the return followed HMRC guidance notes and was properly quantified.

On B, the correspondence showed that HMRC had written to the taxpayer saying 'I will be opening an enquiry into your claim'.

The taxpayer argued that this was not sufficient to establish that an enquiry had in fact been opened. The judge clearly found this a difficult point, but concluded 'perhaps rather by luck than judgment, HMRC had given sufficient notice of the enquiry'.

On C, the judge was bound by *R (oao De Silva and another) v CRC* in 2016. Following this, until the enquiry into the 2011-12 return (the one in which the actual disposal giving rise to the loss was included) the claim to carry back was merely 'inchoate' and did not crystallise until the 2011-12 enquiry was concluded. The taxpayer argued that *De Silva* applied only to partnership losses rather than individual losses, but the judge did not accept that distinction.

On D, the judge found for the taxpayer. But because HMRC needed to win on only one of these four points and had won on the second and third, the claim for repayment was rejected.

Comments - The way of for giving effect to loss carry-backs under self-assessment has been demonstrated to not be straightforward. This is an issue that needs thought before we move into the digital environment.

Mark Wickersham v CRC, Chancery Division,

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No jurisdiction over APN

Summary – The tribunal struck out the appeal on the grounds that it had no jurisdiction to hear it

The taxpayer received an accelerated payment notice (APN). He was one of the parties to the judicial review (*R oao Graham and others v CRC* in the High Court in 2016), which upheld HMRC's decision to issue the notice. That decision is the subject of a possible appeal to the Court of Appeal.

HMRC had agreed not to enforce payment of the APN, pending resolution of the judicial review proceedings. The due date for payment of the APN was 1 September 2015 and, because it had not been paid by then, HMRC issued a penalty under s26 FA 2015 (non-payment of APNs).

The taxpayer appealed citing that the issue of the APN contravened the principle of innocence until proven guilty. The effectiveness of the planning scheme itself was still under enquiry and it had not been proved that the scheme did not work.

HMRC applied to strike out the appeal on the basis that the tribunal had no jurisdiction to hear it.

Decision:

The tribunal agreed with HMRC. The taxpayer was not, in reality, appealing against the penalty but against the APN itself, and that was not something the tribunal had the power to consider.

The tribunal struck out the appeal on the grounds that it had no jurisdiction to hear it.

Comments – The decision is self-explanatory.

Kuldeep Delay v HMRC TC5501

Penalties imposed for late filed CT returns

Summary – The Tribunal reduced the penalties as HMRC had wrongly applied the regime applicable to serious defaulters

The taxpayer was late submitting four corporation tax returns. HMRC imposed penalties for each one and the company appealed. It said it had a reasonable excuse because of errors made by HMRC when the company began to trade and pressure of work.

Decision:

The FTT concluded there was no reasonable excuse. The judge confirmed the amount of the first two penalties as £100 each. However, HMRC had increased the penalties to £500 for each of the other late submissions. This was incorrect. The increased penalty was aimed at the serial defaulter and applied after three late filings. In this case, the taxpayer had filed three of the returns simultaneously, so the increased penalties should not apply. The £500 penalties were reduced to £100 each.

The taxpayer's appeal was allowed in part.

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Comments – The judge put it succinctly at para 23 of the discussion (using American parlance) " It seems to me that this result is in accordance with the policy of the paragraph. The substantially increased penalty is clearly aimed at the serial defaulter: a "three strikes and you're out" approach. In this case there was only one strike. Whether that was due to the HMRC errors alleged by the accountants is neither here nor there, but it is a fact that the company was not required annually to file a return."

Flame Introductions Ltd v HMRC TC5478

Application for closure notices

Summary – The taxpayer failed in his attempt to get disclosure noticesI

The taxpayer applied for a direction that closure notices (s28(1) TMA 1970) be given for investigations into his self-assessment tax returns for the years 2008-09 to 2013-14.

Decision:

The First-tier Tribunal noted that HMRC had issued several notices for information under Sch 36 FA 2008, but the taxpayer had failed to comply with any of them. He had supplied some documents but these gave rise to more questions. He had developed a property business over 20 years, but produced few business records. It was not possible therefore for HMRC to verify those presented as authentic, accurate or complete.

The judge said it was 'stating the obvious' to describe the taxpayer's dealings with HMRC as lacking in 'candour, if not duplicity'. The returns showing nil or negligible income for at least four years suggested 'not only glaring inaccuracies but possibly deliberate and concealed behaviour'. Information had been drip-fed to the Revenue, and disclosed only on repeated promptings.

HMRC's enquiry had 'just touched the surface' and would require a lot of time to fathom the extent of the under-declared income. The taxpayer had numerous opportunities to co-operate and, given that he asserted he had provided 'everything', the tribunal agreed with HMRC that it should issue third-party information requests. To do this would take time since third-party notices had to be applied to the tribunal before being served and the recipients would need time to respond. It was therefore impossible to give a time limit on when it would be reasonable for HMRC to conclude its enquiries.

The judge refused the taxpayer's application for closure notices.

Comments – It is worth reading the case report to see how the taxpayer acted without any real honesty and this was a hopeless attempt to stop further enquiries. At para 75 the Court stated "it will require a substantial amount of time to fathom the true extent of under-declaration of income that appears to have been going on for a decade or two. The disclosure of the information to date by the taxpayer raises a host of questions that require more investigation and can be addressed probably only by information requests made to third parties"

Alan Featherstone v HMRC TC5474

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Failure to register under MLR penalty

Summary – The FTT reduced the penalty for failure to register under the MLR

HMRC had written to the taxpayer saying it was unable to find a registration for it as an estate agency under the Money Laundering Regulations (MLR). It asked the business to file a form MLR100, which the taxpayer did. However, HMRC issued a late registration penalty of £500 on the basis that it had prompted the company to register. The taxpayer appealed.

The company said it had not been 'fully trading as an estate agent' and the director, who had since resigned, had not been aware that it should register. As soon as the director had realised, she registered the company immediately.

Decision:

The FTT said it was clear 'that, if a person carries on an estate agency business as defined in the Estate Agency Act 1992 they are required to register'. Further, reg 23 of the Money Laundering Regulations specified that registration was to be with HMRC, and it must take place before the business began to carry on its trade. In this instance, there was no evidence to show the company had not been trading before it registered.

However, the judge had doubts whether the taxpayer's registration was prompted. This was because HMRC's letter was addressed to Black Horse Property Group, which was not and never had been the name of the taxpayer. It was only when the MLR100 was submitted that HMRC realised it had been referring to the wrong company. But it never acknowledged this. As a result, the penalty should be reduced to £100 for an unprompted disclosure.

The taxpayer's appeal was dismissed.

Comments – The taxpayer was partially successful in the appeal but this was not due to the taxpayer but largely because of judge's opinion of HMRC's conduct.

Blackhorse Property Management Ltd v HMRC TC5449

Failure to pay class 2 National Insurance contributions

Summary – The Tribunal concluded that the taxpayer had shown the non-payment of Class 2 NICs was not due to a lack of care

The taxpayer was a self-employed musician. He applied to HMRC to pay backdated class 2 National Insurance contributions for the period 1967-68 to 2007-08 because he had paid only class 4 contributions. He accepted that his failure to pay class 2 was the result of his error and ignorance, but this was not because he had failed to exercise due care and diligence. He said the National Insurance agencies had also failed to contact him about the class 2 liability, even though he was making class 4 contributions.

HMRC refused to allow backdated contributions. The taxpayer appealed.

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Decision:

The First-tier Tribunal found the taxpayer was not familiar with the class 2 National Insurance system. In 1976, he had appointed an accountant to ensure that his affairs were in order. He had asked about class 4 contributions and had accepted the response that these were his contributions as a registered self-employed person.

The taxpayer was 'uncomfortable but cautious with paperwork' and used an adviser to ensure he complied with his obligations. Further, his behaviour with regard to his other tax affairs supported his claim that he would have paid class 2 contributions had he known they were due.

The judge concluded that the taxpayer had shown the non-payment was not due to a lack of care. He was entitled to make late payments.

The appeal was allowed.

Comments – Normally we get cases relating to previous years contributions which do not end with a positive result so it is a pleasant surprise to get a case with a happy ending particularly since the taxpayer had worked for decades in the UK rather than overseas. Additionally he had two firms of accountants and it is somewhat surprising that neither firm identified the lack of Class 2 NICs.

Richard Thomas v HMRC TC5463

Late notice of appeals

Summary –The Tribunal refused the taxpayer's appeals

The taxpayer, a barrister, made late appeals against assessments for the years 2005-06 to 2007-08 and 2009-10 to 2011-12. HMRC was seeking a bankruptcy order against him but this was stayed pending the outcome of the appeals. The taxpayer said he was a 'busy man', had medical problems and did not have 'time to focus' on his tax affairs.

Decision:

The First-tier Tribunal said the taxpayer had 'no good reason' for failing to submit appeals in time. He persistently filed late returns. The judge described him as an 'intelligent man with a legal background', so he must have realised he had to do something with the assessments and closure notice issued by HMRC.

If the late appeals were accepted, there would be some prejudice to HMRC in that it would result in extra work, but the taxpayer would benefit in that he would be able to try to persuade a tribunal that he had been overcharged.

The tribunal refused the application to make late appeals.

Comments – This was a demonstration of a really hopeless case. The taxpayer was an expert in legal matters and to expect success in his arguments might arguably have been a miracle. Needless to say it did not occur.

Wayne Lewis v HMRC TC5465

Scope of a closure notice

Summary -The UT dismissed the taxpayer's appeal not to strike out HMRC's case.

The underlying dispute related to a claim for a loss of over £7m. This was attributable to a 'net realisable value adjustment' in respect of two properties owned by the partnership. After an enquiry, HMRC had issued a closure notice amending the loss to a profit of £672,285. This reflected the disallowance of the revaluation adjustment. Both parties accepted that the partnership must have been engaged in a trade at the relevant time. Additionally the properties must have been held as trading stock for the revaluation adjustment to be taken into account

Until HMRC's skeleton argument was served shortly before the hearing date through the enquiry, HMRC's focus had been on whether the partnership had commenced a trade, rather than on the question of whether the properties were held as trading stock. In its skeleton argument, HMRC instead switched to focusing on the stock issue, contending that the properties were investment assets.

As a result of this, the taxpayer argued that the FTT had no jurisdiction and consequently the appeal should be struck out.

The issue was the interpretation of the closure notice, applying *Tower MCashback* in the Supreme Court in 2011, in order to define the object of the appeal; and, more specifically, to determine whether the commencement issue was the sole conclusion in the closure notice or whether it was merely a reason for a broader conclusion that the appellant was not entitled to make the revaluation adjustment.

Decision:

The UT observed that a narrowly drawn closure notice could not be widened by reference to the scope of the enquiry that preceded it. It commented, however, that context was also relevant so that the subject matter of the enquiry must be considered. The UT found that the FTT had taken account of the subject matter of the enquiry to an appropriate extent. It therefore had been entitled to find that neither the initial notice of enquiry, nor the correspondence during it, were confined to the commencement issue.

Comments – Although the Tower MCashback case is now some time ago there are issues to be identified in other cases. This is another case which explores the scope of the principle.

B & K Lavery Property Trading Partnership v HMRC UT

Late appeal

Summary – The Tribunal's conclusion was this is not a case in which it would be appropriate for the time limit for giving notice of appeal to be extended

Mr Patel ran a 'mini market' in Brixton, trading as Kirshen News. This operated as a grocers and off-licence and also sold confectionery, tobacco and newspapers. He had purchased the business in March 2003 and commenced trading in April 2003. HMRC had opened an enquiry on 7 December 2010 and had found no clear records of sales. It established that Mr Patel had paid a £45,000 deposit on a mortgage, which he could not have funded from private savings. HMRC therefore adjusted Mr Patel's recorded income on the basis of information obtained from one of his suppliers and issued both a closure notice and a penalty.

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Alternative dispute resolution (ADR) was offered to and taken up by Mr Patel but he did not provide the required information and the ADR process was brought to an end. Mr Patel appealed after the expiry of the time limit and therefore applied for permission for a late appeal.

Decision:

The FTT observed that the statutory time limit for the notification of an appeal is important for the orderly administration of the tax system and that the 14 month delay was both 'serious and significant'. *RCC v BPP Holdings Ltd and others* in 2016 required that all circumstances should be considered, but placed more weight on the need for compliance with rules and procedure. Applying *BPP*, it added that there was no 'good explanation' for the delay. In particular, the fact that Mr Patel was not legally represented would not have prevented him from completing the simple form of notice of appeal. Similarly, the fact that he had been in prison did not explain the delay, given that he was assisted by his daughter who had academic qualifications in accounts and tax; and the fact that he faced bankruptcy could not be taken into account.

Next, following *Data Select*, the FTT noted that HMRC had already incurred the expense of bankruptcy proceedings, so that a late appeal would prejudice it. Finally, it did not consider it necessary to consider the substantive merits of the appeal but it expressed doubt as to the possibility of a proper appeal in circumstances where Mr Patel was not in a position to conduct an appeal without professional assistance and could not afford such assistance.

Comments – The Tribunal have set procedures and principles that need to be followed when considering the grant of a late appeal. In this case they examined the circumstances in detail but taking into account a number of cases including the two referred to above they decided against grating the late appeal even though there would be severe consequences for Mr Patel

Girish Kantilal Patel v HMRC TC5487

Injunction stopping HMRC from enforcement action

Summary - The High Court decided that it had jurisdiction to hear this case and consequently granted an injunction stopping HMRC from starting enforcement action in respect of the tax liabilities.

This was an application by three claimants for an interim injunction prohibiting HMRC from starting enforcement action against them, in respect of alleged tax liabilities that were the subject of appeal and postponement applications before the FTT. The dispute concerned the purchase and sale of property in Lancashire and the tax at stake was £10,900,000. The claimants had also applied for judicial review of several decisions of HMRC, including amendments to the company's and its directors' tax returns; the refusal to agree the postponement of the tax demanded under jeopardy amendments; and, finally, the decision to start insolvency proceedings against the company.

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Decision:

The High Court found that it had jurisdiction, despite the fact that the directors of the company were based in Scotland, as HMRC is a UK-wide body (para 41). The court then set out to apply the *American Cyanamid* principles (para 42). First, the court did not view the claimants' claims as 'totally without merit'; there was therefore a 'serious issue to be tried'. Second, damages would not be an adequate remedy in the event that HMRC took steps to enforce the unpaid tax through the Sheriff 's Court because of the adverse impact of such a judgment on the company's business. Finally, the balance of convenience pointed towards granting the injunction. If HMRC ended up being successful, it would be compensated for the delayed receipt of the tax with interest and penalties, whilst the consequences of enforcement for the claimants were far more significant.

Comments – This case is interesting as the judge has examined each of the issues highlighted in the decision and found in favour of the taxpayer. It would be a useful decision to place in an armoury of cases when considering appeals on behalf of clients on similar issues.

Biffin and others v HMRC EWHC 2926

Failure to file ATED returns

Summary - The FTT found that only one of five penalties imposed by HMRC for the late filing of the annual tax on enveloped dwellings (ATED) returns was due with 4 out of 5 being cancelled because of errors.

Chartridge Developments Ltd (Chartridge) was a property development company. As it owned UK residential property, it was, on the face of it, within the charge to ATED, although an exemption applies to property development companies.

Chartridge had not submitted its ATED returns for 2013/14 and HMRC had imposed penalties.

Decision:

The FTT found that some of the penalties should be cancelled, as the notices were invalid because they contained the wrong date for the filing of the ATED returns. This left one valid penalty notice and the issue was whether the company's reliance on its accountant had constituted a reasonable excuse under para 23 Sch 55 FA 2009. The FTT noted in para 98 of the report that para 23(2)(b) that reliance on another person could not be a reasonable excuse, unless the taxpayer had taken reasonable care to avoid the failure. Chartridge had not established that it had taken such reasonable care. Furthermore, it had always been intended that the return would be filed by Chartridge, so that an internal misunderstanding as to who had the responsibility of doing so could not amount to a reasonable excuse. Finally, it was not reasonable for the taxpayer to expect to be reminded by HMRC.

The FTT also found that there were no special circumstances justifying a reduction of the penalty. In particular, the fact that ATED was a new tax did not constitute a special circumstance, since Chartridge admitted that it had known about its obligations.

Comments – Para 1 of the report refers to the new tax - In some cases, an exemption from the charge is available but a return still has to be made in order to claim the exemption. Practitioners will be less familiar with this tax than ones where they may have years of experience. Greater care may be necessary but certain basics like having appropriate compliance checks in position should apply. Additionally checking penalty notices for correct data may produce significant dividends as demonstrated by the facts of this case.

Chartridge Developments Ltd v HMRC TC5493

Departure of director - not a reasonable excuse

Summary - The FTT found that the departure of a director did not constitute a reasonable excuse for late compliance.

Sirimi Salons Ltd was a hairdressing and beauty treatment company. Its three directors divided the administration of the business between them. One of them, Simon Boast, was responsible for accounts and staff issues, including VAT compliance. He kept the VAT files at his home. He left the business in March 2014. A bookkeeper was eventually appointed but Sirimi Salons Ltd was late in filing its VAT returns and paying its VAT.

The main issue was whether the departure of the director constituted a reasonable excuse although there was a subsidiary issue over the application of an HMRC concession.

Decision:

The FTT found that there was no reasonable excuse for the period ending 06/14. In the five months between the director leaving and the due date, there had been sufficient time to reconstruct the company's VAT affairs. The FTT thought that 'responsible directors of a business, even if they had allocated responsibility for VAT to a director who had left suddenly, would be aware that VAT was due every quarter and would have taken steps to regularise the business within five months'.

In relation to the 03/14 return, the FTT thought that the position was 'more balanced'. However, in the absence of evidence put forward by the company, reasonable excuse was not established. The FTT noted in particular that the remaining directors had not showed that they had tried to retrieve the records from the director who had left.

Comments – As will be evident from the decision the other directors did not cover themselves in glory by their inaction when Simon Boast left abruptly. With other actions they might have convinced the Tribunal that the departure would have constituted a reasonable excuse.

Sirimi Salons Ltd t/a The Red Salon v HMRC TC5453

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Lack of advice by accountant and HMRC - not a reasonable excuse

Summary - The FTT decided that the taxpayers, who had been badly advised by their accountant and had not been alerted to the need to register for VAT by HMRC, did not have a reasonable excuse.

The Appellants traded as industrial roofing and cladding contractors from premises in Spalding, Lincolnshire. On 15 January 2015, HMRC contacted the Appellants to discuss whether or not the business should be registered for VAT purposes. A questionnaire was sent with the letter, which the Appellant duly completed and returned to HMRC in February 2015. HMRC concluded that the appellants should have been registered since 2008. The appellants registered under the flat rate scheme but they were issued with failure to notify penalties against which they appealed.

Mr. Ward said that he and his brother were not businessmen and perhaps foolishly did not identify and charge out materials separately to customers, but treated the cost of materials as part of their own overheads. This had the effect of artificially increasing their turnover and unbeknown to them they had been trading significantly in excess of the VAT registration threshold. Mr. Ward said that they had "probably been fools to themselves" and lost a substantial amount of income. Having incurred input VAT on the cost of materials, instead of passing on the VAT to customers, they absorbed the input vat within their own profits along with the output VAT not charged on their labour costs.

Decision:

The FTT accepted that the taxpayers had received poor advice from their accountant and questioned why the issue of VAT registration had not been raised at a meeting with HMRC to discuss the construction industry scheme. However, the FTT considered that the appellants had not taken 'reasonable care to avoid the failure'. In particular, having considered in 2010 whether they should be registered for VAT, and having raised the point with their accountant, they had not followed it up. Any excuse would therefore have ceased to be reasonable at that time.

Comments – This case demonstrated how taxpayers with insufficient knowledge of the tax system can be badly let down both by advisers and HMRC but how that does not necessarily mean that they have a reasonable excuse. We may potentially see more cases like this when MTD comes into operation. It is clear that the minimum standards of care that the advisors should have given did not occur.

I & S Ward Roofing and Cladding v HMRC TC5461

HMRC News

Deadline Dates

1 January 2017

- Due date of payment of corporation tax liabilities for accounting periods ended 31 March 2016 for small and medium-sized companies not liable to pay by instalments.

7 January 2017

- Due date for VAT returns and payment for 30 November 2016 quarter (electronic payment).

14 January 2017

- Form CT61 to be submitted and tax paid for the quarter ended 31 December 2016 by this date.
- Due date for quarterly corporation tax instalment for large companies depending on accounting year end.

19 January 2017

- Pay PAYE, NIC, CIS and student loan liabilities for month ended 5 January 2017 if not paying electronically by this date.
- File monthly construction industry scheme return by this date.
- Payment of PAYE liability for quarter ended 5 January 2017 if average monthly liability is less than £1,500 is due by this date.

21 January 2017

- File online monthly EC sales list by this date.
- Due date of submission for supplementary Intrastat declarations for December 2016.

22 January 2017

- PAYE, NIC, CIS and student loan liabilities should have cleared into HMRC bank account by this date.

31 January 2017

- Electronic filing date for 2015-16 personal, partnership and trust self-assessment (SA) tax returns.
- Balance of 2015-16 SA liabilities is now due.
- Due date for payment of first instalment of 2016-17 SA liabilities.
- 2014-15 SA tax returns have to be amended by this date.
- Due date for Companies House to receive accounts of private companies with 30 April 2016 year ends and public limited companies with 31 July 2016 year ends.
- HMRC should have received corporation tax self-assessment returns for companies with accounting periods ended 31 January 2016 by this date.

Other Matters

"My tax return was on my yacht…which caught fire"

Each year HMRC receives a number of unusual excuses from Self Assessment customers who didn't complete their tax return on time.
These include:

1. "My tax return was on my yacht…which caught fire"
2. "A wasp in my car caused me to have an accident and my tax return, which was inside, was destroyed"
3. "My wife helps me with my tax return, but she had a headache for ten days"
4. "My dog ate my tax return…and all of the reminders"
5. "I couldn't complete my tax return, because my husband left me and took our accountant with him. I am currently trying to find a new accountant"
6. "My child scribbled all over the tax return, so I wasn't able to send it back"
7. "I work for myself, but a colleague borrowed my tax return to photocopy it and lost it"
8. "My husband told me the deadline was the 31 March"
9. "My internet connection failed"
10. "The postman doesn't deliver to my house"

The reasons above were all used in unsuccessful appeals against HMRC penalties for late returns.

Ruth Owen, HMRC Director General of Customer Services, said:

> Blaming the postman, arguing with family members and pesky insects – it's easy to see that some excuses for not completing a tax return on time can be more questionable than others. Luckily, it's only a small minority who chance their arm.
>
> But there will always be help and support available for those who have a genuine excuse for not submitting their return on time. If you think you might miss the 31 January deadline, get in touch with us now - the earlier we're contacted, the better.
>
> The deadline for sending 2015-16 Self Assessment tax returns to HMRC, and paying any tax owed, is 31 January 2017.

Self Assessment customers can now also submit their return via their Personal Tax Account, it takes five minutes to sign up for an account: www.gov.uk/personal-tax-account

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HMRC tackles online VAT fraud in time for Christmas

New powers announced in March 2016 have seen 7,185 internet retailers come forward to register for VAT.

Online retailers selling goods in Britain have rushed to register for UK VAT, following the introduction of new powers which hold online marketplaces liable for unpaid VAT by overseas retailers.

The new powers were announced in March 2016 and this year HMRC has seen 7,185 internet retailers come forward to register for VAT – a more than ten-fold increase on 2015 when just 695 registered.

Overseas sellers used to gain an unfair advantage on UK based retailers by not charging VAT on goods sold through online marketplaces.

HMRC has seen a big rise in this activity, which currently costs the Exchequer around £1 billion each year. With a growing number of overseas sellers dominating sales of popular gifts on online marketplaces, last Christmas alone it was estimated the Exchequer lost tens of millions of pounds to VAT evasion.

Under the rules which came into force in September, HMRC can now force overseas retailers to appoint a UK-based VAT representative or provide a financial guarantee. If the overseas retailer fails to comply with HMRC's directions, then the online marketplace they use to sell their goods could be held liable.

On top of this, as these goods are often stored in UK warehouses for distributions to UK customers, warehouses will have to join a due diligence scheme by 2018 or face penalties.

Financial Secretary to the Treasury, Jane Ellison said:

> Having worked in the retail sector, I know what an important time of year this is for retailers and the millions of workers across the country who work in the sector. These new powers will mean that everyone has to play by the same rules and pay the right tax.

The new powers allow HMRC to tackle overseas traders that are not complying and take the most appropriate action including:

- making them register for VAT in the UK
- directing them to appoint a UK-established VAT representative
- requiring them to provide a financial guarantee to HMRC

Where the overseas trader does not comply with HMRC's directions HMRC will put the online marketplace on notice. It may be held liable for the VAT in respect of the overseas trader's future sales through its marketplace. The notice will also set out a period of time (normally 30 days) during which the online marketplace can take steps so it does not become liable, either by securing the VAT from the overseas business or by removing it from its marketplace. After this period of time, the online marketplace will be held liable if no such action has been taken.

The new powers along with the fulfilment house due diligence scheme in 2018 will raise £875 million in total for the Exchequer by 2021.

Even before the new powers came into force, HMRC was taking action to tackle this evasion, including, in one case, seizing goods worth more than £500,000 from a warehouse storing goods for overseas traders who had not paid their VAT.

HMRC and international regulatory colleagues meet with major money services businesses

International conference addressed issues around anti-money laundering, countering the financing of terrorism, and other financial crimes.

As the UK's representative on the International Supervisors Forum (ISF), HMRC took part in discussions last week in Washington DC with senior executives of three major international money services businesses (MSBs).

The ISF was established in 2013 by government regulatory agencies from the UK, the United States, Canada, Australia, and New Zealand to address issues pertaining to anti-money laundering and countering the financing of terrorism, and other financial crimes. It also seeks to strengthen domestic and international compliance and supervisory regimes.

As an anti-money laundering supervisor of more than 26,000 businesses in the UK, including MSBs, HMRC plays an active part in this forum.

Hosted by the Financial Crimes Enforcement Network (FinCEN), this third annual conference saw ISF agencies engage with senior executives from Western Union, MoneyGram and Ria, who conduct business in each of the ISF countries.

Discussions focused on the ISF's role and initiatives, transnational threats, information sharing, and the creation of an ongoing dialogue on prevalent compliance matters.

An HMRC spokesperson said:

> Sharing information with our international regulatory peers, and engaging with international financial institutions are obvious and important steps to pursue.
>
> The better we co-ordinate our public and private sector efforts to combat international financial criminals, the safer the global financial system will be.
>
> Transnational efforts are essential to managing the continuing and changing threats posed by international money laundering and terrorist finance networks. ISF members have been formalising agreements that will allow for information to be shared on a consistent basis.
>
> As a result, ISF members are working with their respective law enforcement agencies to share operational practices, methodologies, training, and to leverage resources to strengthen the international anti-money laundering and countering the financing of terrorism community.
>
> ISF members regulate a significant number of MSB entities that have a presence in some or all of the members' jurisdictions. Moving forward, the ISF will work to co-ordinate compliance and enforcement activities on entities within the MSB industry.

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HMRC anti-money laundering supervision goes online

Find out about online registration and renewal for HMRC's anti-money laundering supervision.

In 2017 HMRC is introducing an online, digital system for anti-money laundering supervision. When it launches, businesses will be able to register and renew online.

The online system will:

- allow all registrations, renewals, updates and payments to be made online
- reduce errors and 'rejected' applications - these will be flagged instantly by the new system, avoiding forms being returned for re-submission
- better meet customer needs - this has been possible through asking businesses to test the system and tell us how they think it should work.

Currently we ask businesses registering for the first time to complete their form online, print it off and post it to us. Businesses renewing their registration are sent a letter and asked to respond by post. We know that this causes delays.

A selection of customers have been helping us develop the system over the last year. We're still asking customers to use the system and provide feedback, helping us refine it further.

Using the system for the first time will involve a one-off completion of your details.

This is the same if you are already registered with HMRC or if you are registering with us for the first time. Don't worry if you don't have everything to hand as you'll be able to save your entries and come back to them for up to 28 days.

When you come to renew a year later, your details will be stored and the process will be quick, easy and completely paperless.

We'll be communicating with customers when the system is ready to launch.

To use the new system you'll need an online ID. If you don't have an ID, you can register at Government Gateway online.

Personal Tax Account celebrates its first birthday

HMRC's revolutionary online service marks the first year since its launch. The Personal Tax Account marks its first birthday on 14 December, and in that time, it has already revolutionised the way customers interact with HMRC.

In its first year, the Personal Tax Account already has more than seven million users and there have been millions of transactions including:

- 1.6 million Income Tax repayments, worth more than £800 million
- 1 million tax credit renewals
- 100,000 people check or update their company car details
- 1.6 million people checking their tax estimate
- 2 million people checking their state pensions.

The Personal Tax Account is designed to be a one stop shop for all customer interactions with HMRC and customers using it can:

- check their state pension
- complete and return a Self Assessment tax return
- update tax credits circumstances as they change throughout the year to prevent under and overpayments
- claim an Income Tax refund that will be paid straight into their bank account so they don't have to wait 14 days for a cheque in the post
- check and update their Marriage Allowance.

The Personal Tax Account is one aspect of HMRC's digital transformation, which aims to create the most digitally advanced tax authority in the world.

Increases to van and fuel benefits

The van benefit charge and the car and van fuel benefit charges are set to increase from 6 April 2017.

The van benefit charge will increase from £3,170 to £3,230, the car fuel benefit charge will increase from £22,200 to £22,600 and the van fuel benefit charge will increase by £12 to £610.

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Business Taxation

Treatment of cars provided to taxi drivers

Summary – The FTT decided that the cost of cars which were made available for the use of its self-employed drivers were capital purchases nor revenue purchases

The taxpayer was a mini cab, car hire and courier business based in south east London that has been trading since 1979. For a number (4 or 5) of years, it had kept a fleet of spare cars that the drivers, who were self-employed, could use when their own were off the road. Older cars were charged at £80 a week and newer ones at £100 a week. The Appellant operated this system to promote driver loyalty. The drivers paid the taxpayer £125 a week for the rent of a taxi radio and, it was asserted by HMRC, for the use of the loaned vehicle. The drivers could buy the cars once they 'ceased to have any economic value' to the taxpayer.

In its tax return for 2011-12, the taxpayer included the cost of the cars as a revenue expense. HMRC said it was a capital expense. The cars were plant and machinery and should have been treated in the accounts as capital items.

The taxpayer appealed, saying the cars were short-life assets.

Decision:

The First-tier Tribunal said the evidence showed that the drivers hired the vehicles. The cars were bought to generate profit and encourage driver loyalty. They were fixed assets subject to the capital allowance legislation and should not be included in the "cost of sales".

The taxpayer's appeal was dismissed.

Comments – At para 73 "Items of a capital nature cannot be treated as stock. The cars were bought to generate profit and encourage driver loyalty. They were fixed assets subject to the capital allowance legislation." This was a relatively simple decision for the Tribunal.

Waterloo Car Hire v HMRC TC5479

Claim for additional R & D deduction

Summary – The FTT decided that the payment had to be made IN the period to get the R&D relief for a sub-contractor payment

The taxpayer contracted with an unconnected third party for research and development (R&D) services. In its return for the accounting period ended 31 March 2013, it claimed relief for subcontracted R&D, although no payment was made to the contractor in that year.

HMRC allowed the normal corporation tax deduction, but not the enhanced one. This was only due if the taxpayer has paid the subcontractor to obtain the extra relief. Further, the taxpayer was out of time to amend the return to include any later payment.

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The taxpayer said the reason for not paying the subcontractor was lack of cash. The company disputed that sums paid after the statutory time limit for a claim did not qualify for relief. In support, the taxpayer quoted in the case at para 36 para CIRD 82100 of HMRC's *Corporate Intangibles Research and Development Manual* which states:

> 'Where the underlying legislation requires not only that there be expenditure, but also payment, this means that the amount must actually be paid. While the payment in these circumstances need not have been made by the end of the accounting period in which the expenditure is shown, it must have been made before the claim to R&D tax relief can be valid. This approach does not alter the time limits for making a claim, but it does mean that the claim cannot be accepted before payment is made.'

Decision:

The First-tier Tribunal noted that the taxpayer had made subcontractor payments in February 2015, March 2016 and June 2016. However, none was made by 31 March 2013. The judge disagreed that the payment did not have to be made by the end of the accounting period in which the expenditure was shown. At para 42 the additional deduction was given if conditions A to D in s1044 CTA 2009 were met. Condition D required qualifying expenditure deductible 'in calculating for corporation tax purposes the profits of the trade for the period'. This led to the requirement in s 1133 for 'a payment made by a company to another person'.

The judge concluded that, taken together, these gave 'a legislative requirement for a payment to be made in the accounting period for which relief is claimed'. Nothing in the legislation suggested that relief should be given for payments made after the end of the relevant accounting period.

The taxpayer's appeal was dismissed.

Comments – As many practitioners will be aware the legislation relating to R&D is highly prescriptive. The case describes many of the conditions and if the taxpayer was going to be successful they needed to be met – interpreting the legislation purposively was unlikely to be successful. It is worth noting that in paras 57 to 64 the Tribunal set out their thoughts on the HMRC interpretation … which “may be helpful if this case goes further. We emphasise that these comments are *obiter* to our conclusion above that the appeal fails.”

Gas Recovery and Recycle Ltd v HMRC TC5473

Impact of cancellation of CIS registration on taxpayer's business

Summary – The Court of Appeal has determined that the decision to cancel CIS registration does not have to take into account the economic implications for the relevant business

J P Whitter was a small family-owned and operated company. In July 2009, the company failed an annual review for the first time because of late payment of PAYE and its registration was cancelled. The company appealed and its appeal was upheld but the letter allowing the appeal gave a clear warning that the rules would be interpreted strictly in the future. Despite this warning, the Company failed its next annual review in June 2010 and its registration was again cancelled. They also failed further reviews.

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It was established that the loss of gross payment status would mean the loss of some 63% of the company's turnover and profits, as a result of the loss of its main client (United Utilities); and that even if registration was reinstated for the following 12 months, it would take the company '10 years or so' to regain its present position. The issue was therefore whether, before exercising its power of cancellation of registration under s66(1) FA 2004, HMRC was obliged, or at least entitled, to take into account the impact on the taxpayer's business of the cancellation of its registration for gross payment which was highlighted at the FTT.

Decision:

The Court of Appeal noted (para 58) that registration for gross payment was a privilege earned by demonstrating a good track record; and that provision therefore had to be made for cancellation of the privilege and reversion to the default position, if circumstances no longer warranted its continuation. The court added that a number of significant protections for the taxpayer were built into the statutory scheme, notably that HMRC was not obliged to cancel registration in the event of failure and had to give the taxpayer notice. However, there was no indication that parliament had intended HMRC to have the power, and still less a duty, to take into account matters extraneous to the CIS regime, when deciding whether or not to exercise the power of cancellation in s 66(1)(para 60). The court observed that requiring inspectors to conduct a prospective review or forecast of the potential effect of the cancellation of registration on individual businesses would place a very heavy burden on them.

The Court of Appeal considered the concept of proportionality both from a common law and a Human Rights perspective. The principle of proportionality did not assist the company. It had failed to put in place a system to ensure timely payment of PAYE, despite being warned twice about the consequences of late payment. It would therefore be 'strange' if the exercise of the s 66(1) power was subject to a wider requirement of proportionality, requiring a detailed examination of the taxpayer's present and probable future financial position in the event of cancellation. Finally, there was no scope for an argument based on a breach of human rights, in circumstances where the statutory scheme was compliant with the European Convention on Human Rights.

Comments – The first sentence in the judgement states “This appeal raises an important point of principle concerning the power of …HMRC, to cancel the registration of a taxpayer for gross payment under the legislation which governs the CIS.” It may appear unfair that HMRC are not required to assess the impact of their decision on the business but the decision is that of the Court of Appeal so this principle has been well considered.

J P Whitter (Waterwell Engineers) v HMRC EWCA

FII Group Litigation — The quantum of tax and remedies

Summary – The Court of Appeal has decided on a number of computational issues and remedies

The appeal concerned the most recent stage in the long running Franked Investment Income (FII) group litigation. The litigation arose out of the way in which, under the regime in force until 5 April 1999, advance corporation tax (ACT) and corporation tax under Sch D Case V were charged on dividends received by UK resident companies from non resident subsidiaries.

The original test claimants in the litigation were all UK resident companies in the British American Tobacco (BAT) group, but they had been joined by other companies (in the Ford and GKN groups) in respect of specific issues.

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The claimants contended as follows:

1. The way in which ACT and corporation tax had been charged on these dividends had been in breach of EU law.
2. As a result, they were entitled as a matter of EU law to a remedy, including but not limited to the repayment by HMRC of the amount of the tax wrongly paid, under the principles established by the decision of the European Court of Justice in *Amministrazione delle Finanze dello Stato v SpA San Giorgio* (Case 199/82).
3. As a matter of domestic law, such a remedy could be afforded not only by a claim based on the fact that the tax was not due (a so-called '*Woolwich* claim' — see *Woolwich Equitable Building Society v Commissioners of Inland Revenue* [1993] AC70), but also by a claim based on the fact that the tax was paid in the mistaken belief that it was due (a 'mistake-based claim' — see *Deutsche Morgan Grenfell Group plc v Inland Revenue Commissioners* [2006] UKHL 49). The result is that the extended limitation period under s32(1)(c) Limitation Act 1980 applied.

After a long judicial saga, which involved no fewer than three references to the CJEU, this appeal and cross-appeal have been brought.

Decision:

The report is a long report at 378 paragraphs. The Court of Appeal first dealt with the calculations of unlawfully levied Sch D Case V tax and unlawfully levied ACT. The court accepted the claimants' submission that a UK company receiving a dividend from an EU subsidiary paid out of profits chargeable to corporation tax in its home state was in a worse position than a UK group receiving a dividend from a UK subsidiary. The critical point was that, at the stage of receipt in the UK, the EU dividends had already borne actual foreign tax. In order to remedy the unlawful discrimination identified by the CJEU, the foreign tax should therefore be regarded as equivalent to domestic ACT, and the sum of the dividend and the foreign tax credit should be treated as equivalent to FII.

The court then considered remedies and in particular the enrichment issues, as they affected the quantification of the mistake-based claims in restitution. The issue was whether, in compensating one particular claimant in the Ford group, FCE Bank Ltd (FCE), for its overpayments of ACT, HMRC could take credit for the double taxation treaty half tax credits that it had to provide to FCE's US parents. The court found that HMRC was enriched by the full amount of the payments of ACT, even when it was required to give corresponding tax credits to the recipients of the dividends.

Comments – This case demonstrates how litigation on tax can far outlive the actual tax (which disappeared in 1999). Para 5 of the report states “The amounts at stake in the litigation are very large.

As appears below, the outcome of the test claims is that HMRC have been ordered to pay the BAT Claimants over £1.184 billion. It is not yet known what amounts will be payable, subject to this appeal, in the other FII cases; but at an earlier stage in the litigation Henderson J recorded that the total amount potentially payable was some £5 billion.” Accordingly this will be of interest to certain specialists but will not be relevant to many non-specialist CT practitioners

The test claimants in the FII group litigation v HMRC and Evonik Degussa UK Holdings and others v HMRC EWCA Civ 1180

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FRS 102: Tax effects of new finance lease definitions (Lecture B993 – 11.23 minutes)

Introduction

Under old UK GAAP, a lease would be treated as a finance lease (broadly) if the present value of the minimum lease payments was at least 90% of the fair value of the asset.

FRS 102 has different indicators of a finance lease, including using finance lease treatment where the lease term covers the major part of the asset's expected life. 'Major part' is not defined in FRS 102 but is generally accepted as being around 75% or more.

The new definitions mean that some leases that were treated as operating leases under old UK GAAP will now be finance leases, potentially leading to restatement of figures in the accounts. This should, however, be relatively rare.

Tax treatment of leases

As many readers will know, the tax treatment of a lease generally follows the accounting treatment (e.g. for a finance lease, relief is given for the depreciation and interest costs shown in the accounts).

Finance Act 2011 requires the 'old' treatment to be maintained for tax purposes if there is a change to lease accounting standards; however, section 53 (3) says that the treatment should be revised if the new accounting treatment is equivalent to International Financial Reporting for Small and Medium Sized Entities (IFRS for SMEs). FRS 102 is equivalent to this, so it seems that any changes to lease accounting required by FRS 102 will have tax consequences.

Example – lease reclassification

Schlong Ltd is adopting FRS 102 in y/e 31 December 2016.

It had entered into a 7-year lease for some lorries on 1 January 2014 with annual lease rentals of £124,000, payable annually in arrears; and the fair value of the lorries was £755,000.

The present value of the lease rentals has been calculated as £668,272 and the lorries are expected to have a life of 9 years.

As the present value of the lease rentals is 88% of the fair value of the lorries, the company has correctly treated the lease as an operating lease under old UK GAAP and has expensed £124,000 per annum in 2014 and 2015.

Your accounts team has noted that it will need to be reclassified as a finance lease under FRS 102 (because the lease term (7 years) represents 78% of the expected economic life (9 years)). The team has provided the calculations that follow below.

Explain:

- the adjustments required to the tax expense in the 2015 and 2016 accounts, and
- the impact of the reclassification on the company's tax computations.

Assume a tax rate of 20%.

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Finance lease calculations

		Asset	Liability
2014	Inception of lease	668,272	668,272
	Depreciation	- 95,467	
	Interest @ 7%		46,779
	Rental		- 124,000
	at 31 December	572,805	591,051
2015	Depreciation	- 95,467	
	Interest @ 7%		41,374
	Rental		- 124,000
	at 31 December	477,337	508,425
2016	Depreciation	- 95,467	
	Interest @ 7%		35,590
	Rental		- 124,000
	at 31 December	381,870	420,014

Solution

On restatement as a finance lease at the transition date (1 January 2015), there is a lease asset of £572,805 and a liability of £591,051.

This gives a corresponding reduction in accumulated profits of £18,246, which will be treated as a deduction in the y/e 31 December 2016 tax computation. The tax saving @ 20% will be £3,649.

The accounting entries for this will either be an adjustment to opening reserves, or a reduction in 2016 tax expense (using deferred tax to match)).

The restatement of the y/e 31 December 2015 figures will produce a reduction in the previously stated leasing charge of £12,841 (95,467 + 41,374 – 124,000); this will reduce the 2015 current tax liability by £2,568. Again, there are different possibilities for the accounting treatment, for example:

DR 2015 DT tax asset 2,568

CR 2015 deferred tax expense 2,568

And

DR 2016 deferred tax expense 2,568 (see note)

CR 2015 DT asset (to reverse it) 2,568

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And

DR 2016 current tax liability 2,568

CR 2016 current tax expense 2,568 (see note)

Note: These two entries make the 2016 tax expense effect zero, which is what we want because the effect on accounting profits is in 2015.

Finally, there will be a normal tax deduction in 2016 for the depreciation and interest expense for that year, with the leasing payments being added back. The net adjustment of £7,057 will produce a tax saving @ 20% this year of £1,411.

Guidance: Dealing in or developing UK Land (Lecture B991/ 992 – 21.29/ 10.32 minutes)

FA 2016 introduced new provisions in respect of profits from a trade of dealing in or developing UK land. HMRC has recently issued guidance commencing at BIM60510. The guidance is set out in five chapters and there is no substitute for examining the complete guidance.

Chapter 1 BIM60515: Introduction and Overview

Chapter 2 BIM60520: Profits from a trade of dealing in or developing UK land

Chapter 3 BIM60700: Anti-avoidance provisions

Chapter 4 BIM60800: Definitions

Chapter 5 BIM60900: Notification, assessment & payment

This article concentrates on the first two chapters with illustrative examples from the guidance.

BIM60515: Overview

This guidance covers:

- Amendments to Section 5 CTA 2009, and the introduction of new Sections 5A and 5B;
- Amendments to Section 6 ITTOIA 2005, and the introduction of new Sections 6A and 6B;
- Repeal of Part 18 CTA 2010 and insertion of Part 8ZB CTA 2010: "Transactions in UK land";
- Repeal of Chapter 3 Part 13 ITA 2007; insertion of Part 9A ITA 2007: "Transactions in UK land";
- Commencement and transitional provisions (Sections 80 and 81 FA 2016);
- Notification, assessment and payment.

The amendments to Section 5 CTA 2009 and Section 6 ITTOIA 2005 extend the scope of UK taxation to profits from a trade of dealing in or developing UK land, regardless of the residence of the person making the disposal.

The transactions in land legislation is repealed and replaced by new legislation with additional provisions, including specific rules with regard to fragmentation, enveloping and anti-avoidance.

One aspect of the commencement and transitional provisions is to prevent tax avoidance between Budget Day (16 March 2016), when the changes were announced, and the introduction of the legislation.

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The legislation applies from 5 July 2016 and the anti-forestalling rules apply to transactions on or after 16 March 2016.

Who is affected?

The rules apply to resident and non-resident companies and individuals carrying on a trade of dealing in or developing UK land either directly or indirectly through, for example, holding an interest in a partnership that carries on a trade of dealing in or developing UK land.

Where the income or profits are already fully chargeable to tax as income in the UK there will be no double charge. This means there will be no impact on UK businesses if profits are already fully taxed as income in the UK.

BIM60520: Profits from a trade of dealing in or developing UK land: Overview

All profits from a trade of dealing in or developing UK land are now specifically subject to tax in the UK.

The amendments to Section 5 CTA 2009 and Section 6 ITTOIA 2005 expand the scope of the UK legislation, to include dealing in and developing UK land regardless of the residence of the company or individual, or whether that company or individual is trading in the UK through a permanent establishment.

Section 5B CTA 2009 and Section 6B ITTOIA 2005 set out what is meant by a trade of dealing in or developing UK land.

The commencement and transitional provisions set out the treatment of transactions in the period between Budget day (16 March 2016) and the introduction of the legislation on 5 July 2016 and of transactions that straddle 5 July 2016

BIM60525: Profits from a trade of dealing in or developing UK land: Expansion of territorial scope of Corporation Tax and Income tax: Overview

Prior to the changes in the Finance Act 2016 a non-resident company was chargeable to UK Corporation Tax, only to the extent that the profits were attributable to a UK Permanent Establishment. In circumstances where its arrangements met the specific conditions in Part 3 Finance Act 2015 it may have been charged to Diverted Profits Tax.

The territorial restriction has been removed for UK land transactions. Non-resident companies, and non- resident non corporates are now within the charge to corporation tax or income tax (as appropriate) on the full profit, from carrying on a trade of dealing in or developing UK land. It is not necessary for them to be trading through a permanent establishment in the UK or for them to be resident in the UK.

Example

Company X is not resident in the UK. It purchases a block of flats in the UK to develop and sell as part of a trading business. As Company X carries on a trade of developing UK land it is within the charge to UK corporation tax.

All of the profits from the trade of developing UK land will be subject to corporation tax regardless of the place of residence of the company, or the amount of profit that would be attributed to a UK PE of Company X.

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BIM60530: Profits from a trade of dealing in or developing UK land: Expansion of scope of Corporation Tax and Income tax: Trade of dealing in or developing UK land

The meaning of trade of dealing in or developing UK land is set out in Section 5B CTA 2010 and Section 6B ITTOIA 2005.

A non-UK resident's trade of dealing in or developing UK land consists of:

- dealing in UK land or developing UK land for the purpose of disposing of it, this includes redeveloping, or
- any activities which are treated as profits of a trade of dealing in or developing UK land by virtue of Part 8ZB CTA 2010 or Part 9A ITA 2007.

A trade of dealing in land exists where land and/or property is acquired or developed with a view to profit on disposal. This is in contrast to the situation where property is acquired for investment, usually rental income, but over time that property may increase in value and a profit may therefore be realised from its eventual disposal. This increase in value may arise as a result of movement in the property market or from action taken by an owner to enhance the value of the property for investment purposes.

To establish if an individual or company is trading, the facts of each case are key. The list below gives some factors which could have an impact when considering if the business is carrying on a trade or investment in respect of land.

This list is not definitive and each case will depend on its individual facts and circumstances.

- Length of time the land is owned.
- Intention at purchase date.
- Any change of intention.
- How the acquisition is funded.
- The usage of the property by the owner.
- Whether it is developed or improved (rather than repaired) before disposal.
- Whether there is a connection with an existing trade – for example a builder buying a property to renovate and sell.

The anti-fragmentation rule needs to be taken into account when considering whether a person is trading; slice of the action contracts and similar arrangements are also to be considered as trading. These have not been included in this summary.

BIM60550: Profits from a trade of dealing in or developing UK land: Transactions in UK land: Amounts treated as trading profits

The transactions in UK land provisions only apply when certain gateway conditions are satisfied.

Section 356OB CTA 2010 sets out the conditions for corporation tax, and Section 517B ITA 2007 sets out the conditions for income tax.

The conditions which must be met are:

- A person realises a profit or gain from the disposal of all or part of any UK land and
- Any one of conditions A to D apply.

Where the conditions are met the profit or gain is to be treated as a profit of a trade of dealing in or developing UK land, and arising to the chargeable company or person.

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The profit or gain will only be chargeable/ allowable if it would not already have been brought into account as income in calculating profits in another section of legislation.

The profits should be treated as arising in the period in which the profit or gain from the disposal are realised. Where there is a deemed disposal (for example, an appropriation from trading stock to investment) or write up which would be taxed under Part 3 CTA 2009 if the company was UK Resident, it will be taxed under the transactions in UK land rules.

If property is appropriated into trading stock, account must be taken of Chapter 10 of Part 3 CTA 2009 for corporation tax and Chapter 11A of Part 2 ITTOIA 2005 for income tax.

The profits should be calculated based on the amount which the stock would have realised if sold in the open market at the time of the appropriation. S161 TCGA 1992 will apply where these conditions are met.

All references to profits or gains also apply in situations where there is a loss.

BIM60555: Profits from a trade of dealing in or developing UK land: Amounts treated as profits of a trade of dealing in UK land: Conditions

The purpose of this legislation is to ensure that profits from activities which, when looked at in the round, amount to (i) a trade in land or (ii) a trade of developing land, are taxed as trading profits. It is not the purpose of these rules to alter the treatment of activity that is clearly investment.

The rules effectively look through structures or arrangements which might allow an argument, that on a strict legal analysis, the transactions in question do not amount to a trade.

These rules do not alter the treatment of or recharacterise investment activities, except where they are part of such a wider trading activity. In particular, they do not apply to transactions such as buying or repairing a property for the purpose of earning rental income, **or** as an investment to generate rental income and enjoy capital appreciation.

The legislation should always be understood in the context that it is taxing only what are, in substance, trading profits**.**

Amounts are treated as profits of a trade of dealing in or developing UK land where one or more of Conditions A to D are met. The conditions are set out in Section 356OB (4)-(7) CTA 2010 and Sections 517B (4)-(7) ITA 2007.

If **any** of the conditions are met and a person realises a profit or gain from a disposal of UK land, the profits should be treated as profits of a trade of dealing in or developing UK land.

The conditions are as follows:

> **Condition A:** the main purpose, or one of the main purposes, of acquiring the land was to realise a profit or gain from disposing of the land.
>
> **Condition B:** the main purpose, or one of the main purposes, of acquiring any property deriving its value from the land was to realise a profit or gain from disposing of the land.
>
> For example, if an individual purchases shares and the reason for acquiring the shares was to dispose of land held by the company and make a profit.
>
> **Condition C:** the land is held as trading stock.
>
> **Condition D:** (where the land has been developed) the main purpose or one of the main purposes of developing the land was to realise a profit or gain from disposing of the land.

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BIM60560: Profits from a trade of dealing in or developing UK land: Amounts treated as profits of a trade of dealing in UK land: Main purpose or one of the main purposes

Conditions A, B and D contain a test of whether the "main purpose or one of the main purposes" for acquiring or developing the land, or the property deriving its value from land, was to make a profit or gain from disposal of land. This is a test of purpose, not of benefit or expectation.

The concepts of 'the main purpose' and 'a main purpose' are used widely in UK tax law. A person may have more than one main purpose in entering into a transaction, and 'a main purpose' is a wider test than requiring something to be 'the main purpose'. It is therefore important to consider the question of trading alongside a main purpose test when considering whether or not this legislation applies, to ensure that what are genuinely non-trading transactions are not brought within its scope.

An example of a type of arrangement where a main purpose test might be invoked would be a fact pattern similar to that in Ransom v Higgs [1974] 50TC1.

If a person buys land with the intention of building on part of it to retain for their own purposes, and of building on the rest of it for sale at a profit [in a manner consistent with trading activity], it is clear that one of their main purposes is to make a trading profit from development and disposal. In this instance at the point of acquisition the precise section of the land to be disposed of and the costs relating to that section may not be known. If this is the case profits should be calculated using the original cost of the land apportioned on a just and reasonable basis, subject to the anti-fragmentation provisions.

It may be the case that an investor in UK property expects primarily to benefit from capital growth over time, in addition to obtaining rental yield. The legislation requires that a main purpose of the arrangement is to obtain a gain from disposing of the property. This condition will not be met in the case of straightforward long-term investment, where the economic benefit arising to the owner is the result of market movement from holding that asset rather than transactions that are in the nature of trading.

An owner may also seek to increase the value of their property through improving the quality and security of the property's rental income, for example by negotiating longer leases. Alternatively, they may improve the property through some form of refurbishment in order to attract higher paying tenants, or subdivision of the property to attract more tenants, which again would increase the value of the property. Rental income is often an indicator that the asset is held as an investment, although this is not conclusive - an asset held for trading purposes could produce rental income over a relatively short period, equally an asset held over a longer period may for a number of reasons not produce income but could still be seen as an investment. The facts of each case will determine whether or not one of the main purposes is to make a trading profit from development and disposal.

It is possible for the intention to change over time, at which point the main purpose test would need to be reconsidered (see examples 3, 4 and 5 below).

You should examine the following examples to appreciate the principles.

Example 1

A non-resident property investor purchases a property with the primary purpose of realising rental income from the land purchased. When the investor purchased the land one of the factors they considered was likely capital appreciation of the land. After letting out the property for 7 years they make some repairs and dispose of the land.

This is an example of an investment not trading transaction. The main purpose of the transaction is the rental income. Whilst the long term capital appreciation could be a reasonable expectation, it is clearly not a profit from a disguised trading transaction and would not therefore meet condition A.

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Example 2

A non-resident property investor purchases a property with the intention of developing then selling the property.

After developing the property they let it out for 6 months while they wait for the market to pick up. In this instance a main purpose of acquiring the land, was to realise a profit from disposing of the land and condition A would be met.

Example 3

An individual property investor acquires an old block of flats. They rent the flats out for several years then decide to build new flats on the site. They obtain planning permission for a new development which they complete and sell.

In this example there has been a change of intention and Section 517L ITA 2007 will apply. Only the profit relating to the period after the change of intention should be taxed as a trading profit. The portion relating to the period where there was an investment intention should not be included in the tax calculation.

Example 4

Company X purchases 100% of the share capital of company Y, which owns a UK property on investment account. Company X has the intention of realising a profit in a manner consistent with trading activity, by procuring company Y that sells the property.

This would fall under Condition B.

In this example there has been a change of intention and Section 356OL CTA 2010 will apply. Only the profit relating to the period after the change of intention should be taxed as a trading profit. The portion relating to the period where there was an investment intention should not be included in the tax calculation.

Example 5

An individual purchases a rundown block of flats. They intend to develop the flats into luxury apartments. After development they intend to keep 55 for rental and sell 45. In this instance a main purpose of acquiring the land was to realise a profit or gain from disposing of it so condition A would be met.

The profit relating to the 45 apartments should be taxed as trading income. Where it is not possible to specifically identify costs relating to the 45 apartments just and reasonable apportionment should be used.

Example 6

A non-resident property investor purchases an ageing block of offices in a prime location with the primary purpose of realising rental income from the land purchased. In order to achieve a higher rate of rent and a better quality of tenant, the investor redevelops the offices soon after the acquisition and then lets out the redeveloped offices for a period of 5 years. After such time they dispose of the land at a gain. In this instance the main purpose of the transaction is the rental income. Whilst the office block is redeveloped, the primary purpose for doing so is to improve the yield from the investment rather than realise a gain.

Example 7

A non-resident property investor purchases a property with a view to realising rental income from the land purchased. At the time that the investor purchased the land it anticipated holding the property for over 5 years. In fact, after 2 years, the investor suffers a liquidity event and is forced to sell the property.

The main purpose of the transaction is the rental income and the sale was motivated by a sudden unforeseen emergency. Condition A would not be met in this instance.

Example 8

A non-resident property investor purchases a property with a view to realising long term capital appreciation from the land purchased. The company will have to wait a significant number of years before the lease ends, or the tenant is prepared to surrender the lease. During the time that the property is held, the rental profits are poor, perhaps due to a rent-free period or vacancy arising from unexpected occupier insolvency. The investor sells the property after 5 years for a significant profit due to a market increase in the value of the land. This is an example of an investment and not trading transaction and condition A would not be met.

Example 9

A non-resident property investor purchases a property with a view to realising rental income from the land purchased. At the time that the investor purchased the land it anticipated holding the property for over 5 years. In fact, after 18 months, the investor sells the property early as a result of unforeseen circumstances. In this instance the main purpose of the transaction is the rental income and the sale was motivated by unforeseen circumstances so condition A would not be met.

BIM60565: Profits from a trade of dealing in or developing UK land: Amounts treated as profits of a trade of dealing in UK land: Person realising a profit or gain

The legislation applies where the person, or persons, who obtain the profit or gain meets one of the conditions in Section 356OB(2) CTA 2010 or Section 517B(2) ITA 2007.

The person must be either:

- The person acquiring, holding or developing the land.
- A person who is associated with that person, at a relevant time or
- A person who is party to, or concerned in an arrangement.

An arrangement is covered by Section 356OB(3) CTA 2010 or Section 517B(3) ITA 2007, if it is carried out with respect to all or part of the land, and enables a profit or gain to be realised by an indirect method or a series of transactions.

Any number of transactions can be a single arrangement where they have a common purpose or there is sufficient evidence of a common purpose.

BIM60575: Profits from a trade of dealing in or developing UK land: Disposals of property deriving its value from land

It is possible to realise profits from the disposal of any property that derives its value from land rather than from the land itself. There are rules in the legislation to ensure the right amount of tax is paid where any property that derives its value from land is disposed of.

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Example

A new company is setup to acquire land which will be developed. The intention is to sell the shares in the company when the land is developed rather than the land itself. If all of the conditions are met the rules will apply to tax the profit on disposal of the shares.

BIM60580: Profits from a trade of dealing in or developing UK land: Disposals of property deriving its value from land

Section 356OD CTA 2010 and Section 517D ITA 2007 set out the conditions which, if met, mean profits on the disposal of property which derives its value from land should be treated as trading profits. Section 356OD CTA 2010 and Section 517D ITA 2007 differ from condition B which applies where it is the land which is disposed of not the property which derives its value from the land.

All of the following conditions must be met for Section 356OD CTA 2010 and Section 517D ITA 2007 to apply:

- A person realises a profit or gain from a disposal of any property which (at the time of the disposal) derives at least 50% of its value from land in the United Kingdom, and
- The person is a party to, or concerned in, an arrangement concerning some or all of the project land, and
- The main purpose or one of the main purposes of the arrangement, is to deal in or develop the project land and realise a profit or gain from a disposal of property deriving the whole or part of its value from that land.

Property deriving its value from land is widely defined and is set out at Section 356OR CTA 2010 and Section 517S ITA 2007.

Where a company or individual are charged by virtue of S356OD CTA 2010 or Section 517D ITA 2007, they may not have started a trade prior to the point of disposal. If this is the case the obligation to notify will arise when the shares are disposed of.

Example 1

Company X owns 100% of Company Y. Company Y purchases a piece of UK land and carries out the development of a block of flats. Company Y has no other substantial assets so over 50% of the company's value relates to the land. The intention of Company X is for Company Y to develop the land and to immediately dispose of their shares in Company Y when the land is developed. When the development is completed Company X sells the shares in Company Y to a third party.

In this example the disposal meets the conditions and is a disposal of property deriving its value from land. The profits should be treated as trading profits of Company X.

Example 2

Company X purchases 100% of the share capital of Company Y, whose only asset is a dated office block that is held on investment account. Company X purchased the shares in company Y to hold as an investment and yield income.

After a period of rental there is a change of intention and a decision to redevelop and sell the office block. To carry out this disposal it is agreed Company X will dispose of its shares in company Y when the redevelopment is complete.

In this example there has been a change of intention and Section 356OL CTA 2010 will apply. Only the profit relating to the period after the change of intention should be taxed as a trading profit. The portion relating to the period where there was an investment intention should not be included in the tax calculation.

BIM60590: Profits from a trade of dealing in or developing UK land: Relevant amount and relevant assets

Under the rules covering disposals of property deriving its value from land it is the 'relevant amount' which is subject to UK taxation. Section 356OE (5) CTA 2010 and Section 517E (5) ITA 2007 set out how to compute the relevant amount.

The 'relevant amount' is – on a just and reasonable apportionment – the amount of the profit or gain which is attributable to the relevant UK assets.

A 'relevant UK asset' is any UK land from which the property derives its value.

In all calculations, a just and reasonable basis should be used for apportionment.

Example 1

A company disposes of its shareholding in a company. The shares were purchased with the intention of dealing in the project land and making a profit from disposing of the shares which derives their value from the land. The shares are worth £10m, £6m of the value relates to a block of flats based in the UK and £4m to a housing development outside the UK. In this instance, and assuming that the acquisition costs of the shares is nil, the block of flats is the relevant UK asset and the relevant amount is £6m. If consideration paid for the shares was £5m, and 60% of that cost related to the UK development, the relevant amount would be £3m (£6m less 60% of £5m).

Example 2

An individual purchases shares in a company which is developing a large housing estate. The shares were valued at £10m and the value is derived entirely from UK Land. When the individual purchased the shares they intended to dispose of 40% of the shares to an individual who wished to purchase the land after development and hold on to the remaining 60% for the capital appreciation. In this instance the relevant UK assets are the £4m of land. The remaining £6m are investment assets, and not subject to the new legislation.

BIM60660: Pre-trading expenses – Overview

The normal rules apply when determining if a company has started to trade. This means a company is treated as starting to carry on a trade when it starts to be within the charge to corporation tax (S41 CTA 2009). To determine if the company has started to trade the same factors should be considered as would be considered with a UK resident company.

Where there are write-downs in the value of a property before 5th July 2016 - and the company then falls within the new charge - the opening value of the property would follow UK GAAP or IFRS. Subsequently, the opening value of the property would take into account the write-down, but the costs represented by the write-downs are to be treated as pre-trading expenses if incurred in the seven years prior to the deemed commencement of a trade. To the extent that the write-down is reversed, there should be a corresponding adjustment to the value of pre-trading expenses.

Expenditure may have been incurred prior to this date and in most instances relief for pre trading expenditure will be obtained under the normal rules in S57 Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005) or S61 Corporation Tax Act 2009 (CTA 2009)).

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Where a company was already within the charge to corporation tax as a result of carrying on the **relevant trade** through a permanent establishment in the UK, a deduction would not have been given to any element of expenditure which was not related to the UK PE. Without the introduction of specific rules no relief would be given under the pre trading rules as the trade would have already commenced.

Specific rules have been introduced in Section 80 of FA 2016 to ensure Section 61 will apply provide relief for this expenditure.

Where the conditions listed below are met, Section 61 CTA 2009 will apply as if the company had started to carry on the relevant trade at the point the company is first within the charge to corporation tax.

The following conditions must be met:

- No deduction would otherwise be available for the expenses in question.
- The company would have been eligible for a deduction under Section 41 or 61 of CTA 2009, if it had not been carrying on a relevant trade before coming within the charge to corporation tax as a consequence of dealing in or developing UK land.
- No relief can have been obtained for these expenses under the law of any other country other than the UK. HMRC consider relief to have been given where there is any reduction in the tax payable in any country other than the UK.

For the purposes of this legislation 'The relevant trade' means the trade of dealing in or developing UK land – see Section 5(2) and Section 5B of CTA 2009.

Example

Company A has been developing land in the UK for many years through a UK permanent establishment.

In 2014, Company A commenced 'Project X' in the UK. Company A incurred employee expenses of

£2m in respect of Project X in 2014, none of which were attributable to the UK permanent establishment. Company A disposes of Project X in August 2016.

Because Company A already had a UK permanent establishment, it fell within the charge to corporation tax. Because Company A was trading prior to the introduction of the new legislation on 5 July 2016, the £2m employee expenses would not be 'pre-trading expenditure' were it not for special provisions.

So long as relief has not already been given, Company A can have relief for the £2m, to be taken into account as pre-trading expenditure under the assumption that Company A had first started trading in the UK from the commencement date of the new legislation (5 July 2016).

BIM60665: Commencement and transitional provisions: Overview

The commencement and transitional rules are in Section 80 of FA 2016 for corporation tax and Section 81 of FA 2016 for income tax.

The commencement and transitional provisions contain Targeted Anti-Avoidance Rules which prevent avoidance between the date the legislation was announced (16 March 2016) and the date the legislation was introduced (5th July 2016).

The anti-forestalling provisions apply where a person disposes of a relevant asset to an associated person between 16th March 2016 and 5th July 2016 and the company obtains a relevant tax advantage as a result of the disposal.

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For the rules to apply the person must be associated at the relevant time. The relevant time is the time period which begins when the activities of the project begin and ends 6 months after the disposal.

For example, Company A makes a contract on 1 April 2016 to dispose of development property to a related party, Company B, with a view to crystallising the profit inherent in the development project before the new rules come into force. Company A will be charged on this disposal to its related party, under the transitional rules. When the property is ultimately disposed of to a third party on or after 5 July 2016, there is another disposal, and Company B will be charged under Section 5(2A) on any additional profit.

For corporation tax purposes a relevant tax advantage is a tax advantage in relation to the tax which would have been chargeable as a result of Section 5(2A) CTA 2009, which also includes profits charged as a result of Part 8ZB CTA 2010.

For income tax purposes a relevant tax advantage is a tax advantage in relation to the tax which would have been chargeable as a result of Section 6(1A) ITTOIA 2005, which also includes profits charged as a result of Part 9A ITA 2007.

Where the commencement and transitional rules apply, if a property is disposed of under a contract, the date for disposal should be treated as the date the contract was made and not the date of the property transfer. This includes conditional contracts.

Where there is a tax advantage the advantage should be counteracted by means of adjustments.
The adjustments can be made by way of an assessment, the modification of an assessment or disallowance of a claim or otherwise.

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VAT

Mixed commercial and residential property sale

Summary – The FTT replaced the 90:10 apportionment by HMRC with 2/3:1/3

The taxpayers bought a public house that had a residential first-floor flat comprising three rooms and a bathroom. They made an option to tax election on the property, so charged VAT on the rent to a tenant. But he failed to pay the rent and left the property. The taxpayers sold the building for £52,500.

The sale was treated as VAT exempt on the basis that the pub had no commercial value and £52,500 was a reasonable price for a residential property in the area. HMRC said that a correct outcome would be for 90% of the proceeds to be standard rated as relevant to the commercial part of the property. This was in accordance with an agreement reached between HMRC and the Brewers Society (effective from 1 August 1989 and explained in *VAT Notice 700/57*) that related to input tax issues on a mixed building but could also apply to output tax apportionment.

Decision:

The First-tier Tribunal decided that the 90:10 split was not appropriate because the pub was not tenanted or trading. It said that any split based on rental yields or separate selling prices would not be feasible because of a lack of information and expert opinion about the region and potential yields.

However, neither did the tribunal accept the taxpayer's argument that the whole sale should be VAT-exempt. It concluded that a floor area split would be the most accurate basis of calculation. Given that the pub element included a beer garden and beer cellar, a reasonable split would be two-thirds commercial and one-third residential.

The taxpayer's appeal was allowed in part.

Comments - Neil Warren, independent VAT consultant, commented: 'The 90:10 split between commercial and residential use of a public house has been mainly unchallenged for the past 27 years. The split has no force of law and the taxpayer's view that the flat was worth more than £5,250 was accepted by the tribunal. A floor area split seems to have been the most sensible way of apportioning the sale proceeds.'

DJ Matthews; PE Matthews v HMRC TC5426

Input tax on legal fees incurred in an MBO

Summary – The FTT found in favour of the taxpayer allowing recoverability of input tax on legal fees for an MBO.

Heating Plumbing Supplies distributed domestic heating and plumbing appliances. Its board decided to look into an MBO and it engaged two firms, EMW Law LLP and Grant Thornton, for that purpose. As part of the MBO, the company was acquired by a new holding company (HPSGL), which was owned by the management and staff. Heating Plumbing Supplies' VAT registration was cancelled and replaced by a group registration. The issue was whether input tax incurred on the services provided by the two firms was recoverable.

HMRC cited the decision in *BAA* in the Court of Appeal in 2013 as authority for the proposition that costs associated with the takeover, by a holding company, of the shares in a company that itself made taxable supplies, were not costs of that underlying business.

Decision:

However, the FTT noted that the MBO had been implemented for the purpose of expanding the appellant's business (para 69). The FTT therefore found that this case differed from *BAA*; as, in *BAA*, the purchasing company had not undertaken any economic activity beyond the mere holding of shares.

The FTT did note that some of the services had been provided before the insertion of the holding company, as they had related to the consideration of and appropriate structure for an MBO. However, there was a direct and immediate link between the services and the appellant's business; and, since the appellant's business consisted wholly of the making of taxable supplies, the relevant input tax was recoverable by the appellant.

Comments – Para 65 states "To be recoverable, input tax must be incurred by a taxable person in the course of an economic activity and there must be a direct and immediate link between the goods or services supplied (to which the tax relates) and the taxable supplies made by the taxable person". Para 67 states "Had the Services been provided solely to facilitate the acquisition of shares with a view to receiving a dividend (as in *BAA*) there would have been no direct and immediate link with taxable supplies made by the Appellant. However, in this case, the Services were provided for the direct benefit of the Appellant's business and as such can be viewed as overheads of it." This case may be a useful decision to refer to where restructuring is involved.

Heating Plumbing Supplies Ltd v HMRC TC5480

Late VAT registration – tax saving tips for first return (Lecture B994 – 15.06 minutes)

Introduction

HMRC have the power to correct a late VAT registration up to 20 years back in time. This is a much longer time period than the four-year window that applies for correcting errors on past VAT returns.

A business is liable to be registered in two main situations:

- Its taxable sales have exceeded the relevant VAT threshold on a rolling 12-month basis. In such cases, the liability to register and charge VAT takes effect on the first day of the second month after the limit has been exceeded

  Example – a business exceeds the threshold on 31 October 2016 – it will need to register and charge VAT from 1 December 2016.

- It expects its taxable sales in the next 30 days to exceed the registration threshold. In such cases, the date of registration is the beginning of the 30 day period. This clause aims to ensure that all large businesses trading in the UK need to VAT register from their first day of trading.

Note – the registration threshold has been £83,000 since 1 April 2016.

I will consider this subject by introducing a simple case study:

John the computer consultant exceeded the registration threshold for the first time on 30 November 2010. His date of registration will be 1 January 2011. He notified HMRC of his liability to register on 1 October 2016 ie he has to submit and pay a late return covering five years and nine months.

Tax saving tips

Sales are VAT inclusive for late period

The first good news is that John will treat all standard rated sales made in the late period as inclusive of VAT ie his output tax liability will be 1/6 of total sales rather than 20%. This will not only reduce his VAT bill on the first return but also the potential late registration penalty, which is based on the net VAT payable in the late period.

VAT only invoices?

The next challenge for John will be to issue a VAT only invoice to each of his customers since 1 January 2011. He will be able to do this if either his customers can claim input tax (so the VAT charge is not a cost) or his contract gives scope for him to belatedly charge 20% VAT if historic sales become subject to tax. This particular clause is common with many commercial property deals.

The VAT only invoices will have a current date and if they are issued after 30 September 2016 (when John has received his VAT number from HMRC), then he will pay the difference between 1/6 and 20% of the total sales value on his second VAT return ending 31 December 2016.

Example 1

John's sales with 'Customer A' were £24,000 between January 2011 and September 2016. He issued a VAT only invoice for £4,800 on 15 October 2016. John will pay output tax of £4,000 on his late period return ending September 2016 (£24,000 x 1/6) and £800 on his next return ending December 2016 (ie £4,800 - £4,000).

It is not a problem that some of John's sales were made more than four years ago as far as the customer claiming input tax is concerned. This is because the first opportunity for the customer to claim input tax will be the date he receives the VAT only invoice from John ie this is the date when the four-year error correction clock starts ticking.

Identify non-VATable sales

If John has provided computer consultancy services to EU business customers outside the UK, or any customer outside the EU, these sales are outside the scope of VAT and therefore not subject to output tax. The same situation will apply if any sales are zero-rated or exempt from VAT (unlikely for John but relevant for many SMEs).

Flat rate scheme

An eligible business can join the flat rate scheme (FRS) at the beginning of the next VAT period after the application has been received by HMRC (VAT Notice 733, para 5.5). However, HMRC will allow a retrospective application in most cases as long as the VAT return for the period in question is still outstanding. So John might save tax by joining the scheme form 1 January 2011 but his annual taxable sales must be less than the scheme threshold of £150,000 excluding VAT.

Note – because John is late registering for VAT, he will not benefit from the 1% discount available to scheme users in their first year of VAT registration.

Input tax

John will be able to claim input tax on all costs relevant to the late period if he does not use the FRS (subject to usual rules), and can also claim pre-registration input tax ie the six month window for services and four years for goods used in the business since they were purchased and that are still owned on his first day of registration.

A potential challenge could be that certain purchase invoices might be missing for the late period. In such cases, advisers should be aware that HMRC will allow alternative evidence to claim input tax in the absence of an invoice. (VAT Regulations 1995, SI1995/2518, Reg 29/2).

Exception to being registered

If John can show that he exceeded the threshold on 30 November 2010 because of an unexpected increase in his turnover due to say a one-off good sale that won't be repeated, he might be able to ask HMRC for an exception to being registered. He must be able to show that on this date, he knew that his taxable sales in the following 12 months to 30 November 2011 would be less than the deregistration threshold that applied on that date (VAT Notice 700/1, para 3.7).

Final tip – beware payments to overseas suppliers

Don't forget that if an unregistered business in the UK pays overseas suppliers for services which would be subject to the reverse charge if it was registered, then it must treat the payments to these suppliers as part of the registration threshold.

Example 2

Jill is a self-employed accountant earning £60,000 each year and is not VAT registered. She subcontracts all of her bookkeeping work to a business in India for an annual fee of £30,000. Jill's taxable sales as far as the registration threshold is concerned are £90,000 rather than £60,000 so she has exceeded the £83,000 threshold.

Contributed by Neil Warren

New limited cost trader category for flat rate scheme (Lecture B995 – 14.54 minutes)

Introduction

The Autumn Statement produced a shock announcement that a new flat rate scheme (FRS) category will be introduced on 1 April 2017 for a business that does not spend more than 2% of its gross sales (or £250 in a quarter if greater) on buying goods. The category of a limited cost trader will have a rate of 16.5% and will mean a higher VAT bill for all users caught by the new category. This is because the highest existing rate is 14.5% although many schemer users currently adopt a flat rate percentage of 12% or 14%. As a specific example, a business with gross sales of £200,000 including VAT will see its annual VAT bill increase by £9,000 if its rate increases from 12% to 16.5%.

The FRS has been an important part of the VAT system since April 2002, and has saved thousands of pounds of tax for many SMEs compared to normal VAT accounting. It has also simplified accounting systems and therefore saved time and money for users, and reduced the risk of VAT errors being made.

But that outcome will change on 1 April because an estimated 123,000 out of 411,000 existing scheme users will be classed as limited cost traders. The aim of the new rate is to supposedly tackle aggressive abuse of the scheme by labour-only agency workers but it will affect all users who have low spending on goods ie including the honest traders.

Basic rules of FRS

To set the scene, the FRS means that a business never claims input tax unless an expense relates to capital goods costing more than £2,000 including VAT. A newly registered business can also claim input tax on pre-registration expenses in the same way as a non-scheme user if it uses the FRS for its first VAT period. The VAT payable is based on a flat rate percentage being applied to gross business income (but not outside the scope income), with the relevant rate depending on its trading activity. There are 55 different categories, including two 12% sweep up categories for 'any other activity that is not listed elsewhere' and 'business services that are not listed elsewhere'. These categories are relevant for a business that does not have an exact DNA match with any of the other categories.

What is a limited cost trader?

Let us invent an imaginary company that offers consultancy services to government bodies in the child care sector. It adopts the FRS category of 12% for 'business services that are not listed elsewhere' and all income is standard rated. The 12% category is correct because there is no specific category for child care consultants. However, the directors will need to consider if the company is a limited cost trader with effect from 1 April 2017, carrying out a check on each occasion that a VAT return is completed.

Here is a summary of the new rules:

The company must identify if less than 2% of its gross sales is spent on buying 'relevant goods' for the VAT quarter in question. The phrase 'relevant goods' excludes vehicles, road fuel and motor parts, as well as food, drink and capital items. Supplies of gas and electricity are included in the calculations because they are goods, whereas rent, telephone and Internet charges are services, and so are excluded. As an extra twist, the draft legislation confirms that only expenses that are wholly business are included in the calculations. This means, for example, that a gas or electricity bill with part business and part private use must be excluded completely.

Note – if the company was a transport business using the FRS category for 'Transport or storage, including couriers, freight, removals and taxis', it would be able to include spending on vehicles, road fuel and motor parts in the calculations as long as the company owned or leased a vehicle in its business.

The company will also be classed as a limited cost trader if its spending on goods is more than 2% of gross sales but less than £250 for the quarter (£1,000 is the annual figure in the draft legislation and would be relevant if a business uses the annual accounting scheme). See Limited cost trader calculation

Limited cost trader calculation

Child Care Ltd trades as a consultant in child care services, and for VAT quarter ending 30 June 2017, the company's gross sales were £10,000 including VAT. The VAT inclusive spending on relevant goods for the same period was £240 (see main article for what items are included and excluded as relevant goods).

The business must adopt the 16.5% rate and pay £1,650 of VAT if the £240 spending on goods is:

Less than 2% of sales (£10,000 in my example ie £200); and

Less than £1,000 a year ie £250 in a quarter.

So a total goods figure of £240 including VAT passes the first bullet test but not the second – so the 16.5% rate must be adopted.

Impact of the proposed changes

HMRC issued a policy paper on 23 November 2016 titled "VAT: tackling aggressive abuse of the Flat Rate Scheme".

This paper recognises that “the new 16.5% rate will remove the cash advantage for those businesses with limited costs”, i.e. all businesses are affected and not just the supposed tax avoiders. It also revealed some interesting statistics:

- The new limited cost trader category will increase the annual tax yield by £130m
- Two thirds of FRS users are registered for VAT on a voluntary basis (annual taxable sales are less than £83,000) and HMRC anticipate that the new category will mean that “many of them may decide to deregister”
- The limited credit for input tax that is evident with the 16.5% rate means that an estimated 4,000 FRS users will revert to normal VAT accounting, ie output tax less input tax.
- HMRC quote an average figure of £390 in cost savings for a business that chooses to deregister after 1 April 2017

Options for clients

Deregistration – the new 16.5% rate gives minimal credit for input tax – effectively £10 for every £1,000 of output tax (for a business with only standard rated sales). If taxable sales of the business are expected to be less than £81,000 in the next 12 months, the owner might decide to deregister, especially if some customers are not VAT registered and cannot claim input tax. This will also avoid the business having to work out whether it is a limited cost trader each quarter.

Leave the FRS – a business only needs to have input tax of more than £10 per £1,000 of output tax to be better off with normal VAT accounting ie output tax less input tax. This decision should take into account the time saving benefits of the FRS – is it worth paying more tax to retain these benefits? A business must notify HMRC of its decision to leave the scheme (Notice 733, para 12.1).

Revise strategy for spending on goods – if Child Care Services Ltd in my example of Limited cost trader calculation spends £240 on goods each quarter and has income of £10,000 including VAT each quarter, it would be sensible for the company to buy all of its goods evenly in three VAT periods if possible, and none in the fourth period. This is because the company would only be classed as a limited cost trader in one of the four periods ie retaining the 12% rate for the other three periods.

Calculation - £960 annual spend on goods would be £320 in three quarters and nil in the fourth quarter. The quarterly figure of £320 exceeds both £250 and 2% of gross income of £10,000 so the company is not a limited cost trader in these three periods.

Can the new limited cost trader category be avoided?

As soon as new legislation is announced that will increase tax bills, an initial thought of many clients (and some advisers) will be: how can we get around the new rules?

We are all in agreement that the new 16.5% category will not assist the ‘simplification’ aims of the FRS so is it possible to reduce or avoid the impact of the new rate?

- My example with Child Care Services Ltd illustrated how a change in spending patterns might avert the business from being a limited cost trader in some VAT periods. This approach is sensible VAT planning.

- Many advisers have correctly identified that stationery items such as paper and print cartridges are the main 'goods' bought by FRS users who are likely to be affected by the new 16.5% rate. So is there scope for business owners to go online before the end of each VAT quarter and spend 2% of their gross sales (or £250 if higher) on envelopes, paper clips or print cartridges? This might make commercial sense with discounts usually being available for bulk purchases, and the discount savings could also give the opportunity for future sales to be made to business friends and colleagues and make some profit as well. The disadvantage is that you will need a bit of surplus storage space to handle the extra stock.

- Is it possible for a scheme user to introduce a new business activity of selling goods so that it will meet the 2% target? As an example, one of my scheme user clients has a lady friend who loves buying and reading books. Could he buy all of her books from Amazon through his business and sell them to her for a small profit in order to avoid being a limited cost trader? This is a controversial suggestion but the draft legislation states that the goods must be "used or to be used…..exclusively for the purpose of the trader's business." Applying this phrase to both the stationery buying and sale of goods option, it certainly meets this condition.

Final tips

HMRC have confirmed that an online tool will enable current and prospective FRS users to determine whether they are limited cost traders, which is very welcome. But I suspect that most users will either deregister or revert to normal VAT accounting.

This article is based on the draft secondary legislation published on 5 December 2016 – HMRC confirmed an eight-week period from this date for affected businesses to make comments. So it is possible that the draft Statutory Instrument might be amended before it becomes law.

A business that is already in the scheme does not need to leave until its annual VAT inclusive sales have exceeded £230,000 on the anniversary date of when it first joined the scheme (VAT Notice 733, para 12.2). So a business moving from the 12% to 16.5% category and trading at the scheme limit will pay an extra £10,350 of VAT each year ie £230,000 x 4.5%. This is a massive amount of money and illustrates why advisers will need to consider the interests of each FRS client on an individual basis.

Contributed by Neil Warren

Place of supply of services provided at a fair

Summary - The Court of Appeal decided that services provided at a Farnborough air show enclosure did not constitute 'advertising services', so that the place of supply of the services was the UK.

Finmeccanica Global Services (FGS), part of a group of mainly Italian companies, is a supplier of aeronautical equipment. It sets up displays to promote its products at major events, including the Farnborough air show. The Farnborough air show provides space and an opportunity for aircraft and aerospace manufacturers to showcase their products; and provides meeting rooms and hospitality for would-be customers, the press and other selected invitees. At most, a negligible part of the FGS enclosure was open to the general public.

The FGS enclosure cost was about €14m in 2010 and FGS was responsible for arranging it. FGS invoiced the other companies of the group for its services. The issue was whether the supplies by FGS were made in the UK, as UK VAT would not be recoverable under the Refund Directive (Council Directive 2008/91EC).

Decision:

The Court of Appeal noted that although the relevant provisions had changed during the period at issue, the deemed place of supply was the place where the services were supplied, or (after 1 January 2010) the place where the activities were carried out. However, there was an exception to the general rule for 'cultural, artistic, sporting, scientific, educational, entertainment or similar activities' or 'advertising services', contained in the Sixth Directive art 9(2) (c) and 9(2)(e) (replaced by the Principal VAT Directive art 53 and 59(b)); the issue was whether this exception applied.

The Court of Appeal observed that the only relevant services were those supplied out of or in connection with the FGS enclosure, and not the Farnborough air show as a whole. It also noted that the categories of art 9 were mutually exclusive and that 'the essential purpose of the supplies must be identified'. Although promotional, the activities of FGS were a specific event; FGS provided bespoke services. Additionally, applying *Commission v France* (Case C-68/92), 'the further one moves away from conventional advertising as such, the more marginal the case may be for treating the supplies as falling within art 9(2)(e)'.

In the court's view, applying *Inter-Mark* (Case C-530/09), the services provided by FGS were ancillary to the group's primary activity.

Comments – The law relating to the place of supply is a fundamental set of rules. They try to resolve the issue of which Member state is entitled to the VAT payable and if there is a refund who is liable to refund input tax. The issues have been complicated by changes in the rules in the relevant periods. This is an area of particular complexity so advice should be sought on the relevant facts from a VAT specialist.

Finmeccanica Global Services spa v HMRC EWCA