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Personal Tax

Pre Budget Report predictions

It is that time of year when speculation mounts at to what the Pre Budget Report (PBR) might contain. This is due to be given this autumn although no date has yet been announced. After the October 2007 'block-buster', with its radical changes to capital gains tax and residence and domicile, will this year see a quieter affair?

Here are some possible contenders for a place in the Chancellor's autumn event:

1. Income shifting - Following the decision of the House of Lords in the Arctic Systems case in 2007 (*Jones v Garnett*), the Government swiftly declared that they would effectively reverse the ruling by changing the law. A consultation document was published in December 2007 with the intention of legislation being effective from 6 April 2008. This was then deferred for further consultation but the Government remains committed to introducing a measure to take effect in April 2009.

The deferred income shifting proposal focussed on 'income shifting arrangements that make use of companies or partnerships to gain a tax advantage'. While it was aimed at preventing the transfer of dividend income or partnership profits from a person who paid tax at 40% to an individual paying a lower rate of tax, the changes were widely drafted and caught situations in which a range of connected parties had invested capital in a business (for example, businesses involving spouses, siblings and parents and children).

It is fair to say that the proposed legislation created something of an outcry, largely because it was so far-reaching and because the examples given as to how it might operate were particularly simple and did not clarify many of the situations that arise in practice.

PREDICTION: The Government will announce another consultation paper with a similar but more targeted measure than last time around.

2. Income tax - The Chancellor's May 'mini-Budget reversed elements of the disastrous 10p tax rate changes. By altering the thresholds, he was able to help many by up to £120 per year. Increasing the personal allowance had the advantage of being simple, capable of being backdated to April 2008 and relatively easy to deliver quickly. However, it was an expensive measure which will cost £2.7 billion. This is because it is not targeted, and benefits many people who had not lost out from the tax rate changes in the first place.

Also, because the measure is based on the average loss, a large number of people remained without full compensation and they will be the taxpayers on the lowest incomes. For example those with pay packets between £5,435 and £6,035 will receive less than the full £120.

Perhaps more pressing, these changes only dealt with 2008/09 and not the next tax year.

PREDICTION: The Chancellor will be obliged to tackle the '10p tax rate' issue for 2009/10.

3. Company car changes - This is a regular contender in any PBR. We may hear harsher measure to further encourage employers and employees to take up greener 'cleaner' cars.

It is likely that we may at last hear more concrete decisions on the use of Employee Car Ownership Schemes (ECOS) and around the use of Approved Mileage Allowance Payments.

PREDICTION: More news on the 'sales room' tax eluded to in the March Budget and perhaps information on changes to ECOS schemes.

4. HMRC powers - An update is likely to be given on the next steps in the powers review.

PREDICTION: We will see a further pressing ahead on changes to HMRC's powers. This may include the proposal to remove the ability to reduce penalties down to nil when a tax return is not filed on time but the tax is paid by the due date.

5. Tax rises - The economy is in poor shape. The coffers need replenishing. There are bound to be revenue raising measures. These will need to fall into the 'paletable' camp and there are plenty of suggestions that these should be targeted at those perceived as being able to pay. For example, we will get a windfall tax on oil companies? Will we see something aimed at helping those in need whilst hitting at 'city bonues'?

PREDICTION: In what ever form there will have to revenue raising measures and they need to raise a lot.

6. Foreign profits and UK competitiveness - The number of UK companies moving overseas may lead to measures aimed at competitiveness. The detailed consultation on the taxation of foreign profits appears to be drifting off into 2010 if not beyond. Will the Government take some limited action in this area?

PREDICTION: The competitiveness of the UK must be mentioned in the PBR although radical proposals do not seem to be on the agenda.

Article by Francesca Lagerberg

Lecture P496 (14.43 Minutes)

HMRC reminder about changes to basic personal income tax allowance

HMRC has issued a reminder about this month's change to the 2008–09 basic personal income tax allowance.

The change, announced by the Chancellor in May 2008, will mean most people under 65 who pay tax at the basic rate will see an extra £60 in their first pay packet on or after 7 September, and a £10 increase in their take-home pay each month after that until next April. Those paid weekly will get £53 the first time the increased allowance is used, and then receive £2·30 extra a week until April. The exact increases depend on how much tax they have already paid in 2008–09.

For most people the change is straightforward; their employer or pension provider will make all the necessary changes to their tax code. They will not have to do anything and do not need to contact HMRC.

For other groups, the following applies—

– Anyone who only pays tax through Self Assessment, such as the self-employed, will have the new allowance taken into account in their tax calculation for 2008–09;

– Individuals where HMRC does not have full information on their tax affairs will get a weekly or monthly increase from September and will get the benefit of the backdated increase once they are taxed on a normal basis or when their tax liability for 2008–09 is finally calculated after April 2009.

– Higher rate taxpayers will continue to pay the same amount of tax

– Budget 2007 significantly increased the personal allowance for those aged over 65. Therefore most individuals aged 65 are unaffected by this change. However, those individuals over 65 who did not get the full Personal Age Allowance because of the level of their income will get the benefit of the revised Personal Allowance.

Further details of how the changes affect people are available by visiting the HMRC website at www.hmrc.gov.uk and clicking the “Extra Personal Allowance for 2008–09” link.

HMRC press release 2 September 2008

Recession-proofing your clients - Personal Tax

We are always looking to place our clients in the best possible tax position. However, in turbulent markets personal tax clients are eager to find ways to keep their tax bill down and wealth plan for difficult times. The following ten tips are just some thoughts on 'recession-proofing' our individual tax clients with low-risk strategies. Many of these are items we would think about at any time; others are even more important now.

1) Using full allowances - Most tax advisers would place this idea on their end of year tax checklist. As each member of the family, even a minor, is treated as a separate taxpayer and has his or her own personal allowances and exemptions there are opportunities to spread assets and income around the family to reduce the overall tax bill.

Unwary clients can easily fall into traps such as the parent who gives capital that generates income of more than £100 a year – excluding income from child trust funds and National Savings Children's Bonus Bonds – to children under 18. In these cases the parents are then taxed on that income until the child either becomes 18 or marries before reaching that age.

It is important to look to the near future if income is being reallocated between higher and lower rate taxpayers. The Government is still committed to introduce 'income shifting' rules (linked to the *Jones v Garnett* or Arctic Systems Ltd case) from April 2009. This could affect any planning in this area.

Those who are married or in a registered civil partnership can of course transfer assets between themselves without any tax applying. This could lead to capital gains tax savings, where, for example, one spouse transfers part of a share portfolio to the other, enabling both of them to utilise their capital gains tax annual exemptions on a sale. Watch out for the targeted anti-avoidance provisions for capital loss planning (the 'TAAR' rules) if the client is looking to do something very aggressive in this area.

2) Reviewing benefits in kind and payment structures - Employees should take a close look at any benefits they receive and determine if they continue to have a value. Is the 'gas-guzzling' company car still a worthwhile perk? This can also be viewed from an employer perspective. For example, a business can claim 100% first year allowances for a new car if the car is electrically propelled or has a carbon dioxide (CO2) emissions rating not exceeding 110g/km. As the benefit in kind charge on such vehicles is also lower, this may also reduce the company's Class 1A NIC liability.

Many employers will be looking to restructure the pay and benefits package in a cost- and tax-efficient way, whilst at the same time ensuring that employees are properly remunerated and rewarded for their efforts – not just in terms of salary but via other benefits, such as flexible working, additional holidays, company cars, pensions, childcare, shares etc. Often the cost savings from restructuring the package can outweigh the savings from making a group of people redundant.

A popular idea is to make use of salary sacrifice opportunities. These require careful implementation and HMRC approval should be sought. However, they can provide useful savings. For example, if the client has children and their employer offers childcare vouchers in exchange for legally reducing their salary then £2,916 of their old salary can be received as childcare vouchers that are free from income tax and National Insurance.

3) Maximise contributions to Individual Savings Accounts (ISAs) - An ISA is a tax-efficient investment for savings. The maximum permitted contribution this year is £7,200. If ISAs form a key element of someone's savings and tax mitigation strategy, and since unused contribution allowances cannot be carried forward, it is important that they utilise their full allowance before the end of the tax year.

4) National Savings Certificates - This type of investment also offers tax-free saving. Clients can invest up to £15,000 in each issue without it affecting any other tax-free investments they have and, with interest rates fixed for the length of their chosen term, they will know how much interest they will earn each year.

5) Claim repayments quickly - If cashflow is important and the client has a tax repayment due, they should be encouraged to file as early as possible to get the money back. This may particularly affect client's who have made pension contributions or gift aid payments on which they wish to claim

higher rate tax relief or if they are due any other reliefs that they are making a claim for through their tax return.

6) Don't give 'presents' to HMRC - Ideally a client should never fall behind with tax payments and returns thus ensuring that they do not 'gift' interest and penalties to HMRC. Finance Act 2007 introduced legislation for a new penalties regime that covers inaccurate documents and under-assessments relating to a range of taxes, including income tax, corporation tax, capital gains tax, PAYE, NIC, the construction industry scheme and VAT. This regime came into force in respect of return periods commencing on or after 1 April 2008 for returns filed after 31 March 2009. Therefore, it is possible that decisions being undertaken now could affect future returns and therefore it is essential that 'reasonable care' (the new defining term) is taken when completing returns. The maximum penalty can be as much as 100% of the underpaid tax.

In difficult times it is possible that a client will simply not be able to fund their tax bill. The key here is to engage quickly with HMRC before interest and penalties rise and consider any available debt management options.

7) Rent-a-room relief - If the client is looking to make ends meet at home they could consider renting out furnished accommodation in their only or main residence. Rent-a-room relief would then allow rental income of up to £4,250 per annum to be left out of account when calculating taxable income. Taking in a lodger could help out both parties - the homeowner in meeting their mortgage repayments and for the lodger it may represent cheaper accommodation if rents are set to rise as predicted.

8) Pension contributions - Pensions remain extremely tax efficient too. Not only are contributions to a pension fund fully allowable for income tax but the assets in the fund can grow tax free. Even better, if the client can persuade their employer to make contributions to their pension, not only is that contribution in effect tax-free salary but it escapes National Insurance for the employee and employer.

Clients need to ensure that they are claiming higher rate tax relief on their pension contributions. A higher rate taxpayer making contributions to a Personal Pension scheme (including Stakeholder Pensions and Group Stakeholder / Personal Pensions) should be reclaiming the additional 20% higher rate tax relief via their tax return. Many fail to make the claim. If they are contributing £250 per month (net of basic rate tax relief) to a personal pension plan they are entitled to a further £62.50 per month tax relief if they are a higher rate taxpayer.

Some pensioners on fixed incomes may well be considering how to unlock part of their pension either by withdrawing just the tax free cash that is available and deferring drawing income or by drawing the tax free cash and the income. This can be of particular use for people who have no intentions to leave assets to their children / grandchildren as it is likely that it will reduce the value of the estate. This option is only available for the over 50's.

9) Inheritance tax planning- Clients may be less inclined to make lifetime gifts at the moment, but they should not forget sensible tips for ensuring that assets do not form part of their estate for inheritance tax purposes. For example, life assurance policies should be written in trust so that they do not form part of their estate on death and worsen the inheritance tax position. If the proceeds go directly to the beneficiaries, there is no tax to pay, but if they fall into the estate they could be charged to inheritance tax.

10) Protect personal wealth - If matters are going particularly badly for a business, the owner may be thinking about how to separate their personal wealth from the finances of the business. Lenders will be asking for security, whether that is based on a business asset or on the business owner's personal property. Business owners therefore need to be careful. They will be wanting advice about salary/dividend/bonus splits to extract funds from their business in the best way possible.

If an individuals needs to lend money to say, their company, out of personal funds, rather than putting it in as an unsecured loan, they could consider cash backing the bank's additional advance or taking security under a second charge after the bank. In this way, they could improve the prospects of recovering their funds. There may also need to be some tough decisions about throwing good money after bad.

Article by Francesca Lagerberg

Lecture P497 (12.01Minutes)

Warning for buy-to-let investors

Buy-to-let investors must keep accurate records or face inspection from the taxman's newly empowered inspectors, Grant Thornton has warned.

The company's alert follows HMRC's ramping up of its efforts to recoup lost revenue as a result of landlords either making accidental errors on their tax returns or deliberately evading the payment of levies on rental income.

As part of a new initiative to identify untaxed rental income and gains, information routinely gathered from local government authorities, letting agents and the Revenue's stamp taxes office will be 'data matched' to identify individuals who have not made the appropriate returns.

With effect from 1 April 2009, if HMRC suspect a landlord has untaxed rental income and gains, officers will have the power to inspect business records at premises. For an individual landlord this could include his or her private residence.

Phil Espin of Grant Thornton's national tax investigations team said: 'It's likely that only the most serious cases will warrant a knock on the door from the taxman, but it signals HMRC's intent to pursue persistent tax evaders'.

He added: 'Landlords need to be aware that HMRC has new inspection powers for visiting business premises to look at records and these powers are expected to take effect from next April. We encourage landlords to keep business and private records separately to avoid an Inspector seeing personal records that they have no right to.'

Grant Thornton has advised that landlords, like businesses, keep records of property income and expenses for at least six years after the tax year to which they apply.

Overseas holiday homes offer exemption

New legislation relating to holiday homes abroad purchased by UK residents through a company will enable individuals to claim exemption from the living accommodation tax charge outlined in ITEPA.

FA 2008, s 45 inserts ss 100A and 100B into ITEPA 2003, and these sections provide for an exception from the living accommodation tax charge where living accommodation outside the UK is provided by a company for a director or other officer of the company or a member of the director's family or household where all of the following apply:

- The company is wholly owned by the director or the director and other individuals (and no interest in the company is partnership property).
- The company's main or only asset is a relevant interest in the property.
- Its only activities are ones that are incidental to its ownership of that interest.

As the living accommodation tax charge was not intended to apply to these circumstances, FA 2008, s 45(2) provides that ITEPA 2003, ss 100A and 100B are to be treated as always having had effect.

This means that where the provision of living accommodation outside the UK satisfies the statutory conditions, no liability to income tax in respect of the benefit of that provision arises for any tax year.

Individuals who can show that they have paid income tax for any year before 2008-09 on the benefit of living accommodation that qualifies for exemption under s 100A should contact Michael Robinson, c/o Debbie Green, HMRC, CPPT Directors Office, 5th Floor, Trinity Bridge House, 2 Dearmans Place, Salford, Manchester M3 5DT.

The following information should be provided:

- Name, address, National Insurance number and/or unique taxpayer's reference.
- Where relevant, the agent's name and address.
- Details of the living accommodation outside the UK, i.e. address, type of property, uses made of the property.

- Details of the company through which living accommodation outside the UK is provided.
- Explanation of why the exemption applies.
- Years for which tax has been paid on the benefit of the accommodation.
- Evidence that tax has been paid: e.g. assessments, self-assessments, forms P11D, coding notices, correspondence with HMRC.

Redundant or given the sack!

An employment relationship can end for a variety of reasons. It is worth examining the most frequent of these, looking at the tax treatment of associated payments.

1. Termination by resignation

Where an employee resigns there will normally be no compensation payment in respect of the termination of the employment relationship, but the matter of notice may be in play.

If he serves his notice, all payments including wages or salary, overtime, holiday pay, bonuses, etc. will be subject to the deduction of tax and National Insurance contributions under the PAYE regime as normal.

If he does not serve out his notice period, he may either be asked to go on 'garden leave' or be paid an amount in lieu of the period, and cease employment immediately thereafter.

Garden leave: All payments to the employee remain subject to deductions under PAYE as if he had continued to attend the office.

Payment in lieu of notice**:** A PILON which flows from a term of the contract of employment will be subject to the deduction of tax and NICs as they fall within the definition of 'earnings' as prescribed by ITEPA 2003, s 62.

It is important to mention at this point that the absence of a contractual right to a PILON will not in all cases be a defence from an attack by HMRC, who have in the past sought to tax as earnings payments made on termination of employment where the employer has a 'custom and practice' of making such payments on the cessation of employment.

HMRC argue that where there is a reasonable expectation on the part of an employee that despite the absence of a contractual entitlement, he will receive a PILON instead of being allowed to work out his notice period, a contractual term will be implied and PAYE will be due on the payment.

Termination by dismissal for poor performance or gross misconduct

If the employee is served with notice to terminate the contract of employment, and they serve out their notice, then PAYE will flow as discussed above.

In reality, however, most dismissals of this nature are followed by either a period of garden leave or the making of a PILON which may or may not be taxable depending on whether or not there is a contractual right – express or implied (see above).

If a PILON clause exists and the employer does not allow the employee to serve out the notice period, a breach of contract will have occurred and any subsequent compensation payment will not be treated as earnings but will be taxed under ITEPA 2003, s 401.

In the event of gross misconduct leading to a summary dismissal, there will normally be no provision within the contract for a PILON and the employer will not be obliged to compensate the employee for the termination of the employment relationship.

Any payment made on termination will therefore be deemed to be earnings, unless there is an argument for damages related to a failure to comply with the aforementioned procedures under Employment Relations Act 2004, in which case taxation under s 401 will be triggered.

Termination by mutual agreement

In exceptional circumstances, an argument may be made for the agreement by both parties to the mutual termination of the contract of employment.

The possible reasons for this are many and varied and may be outside the scope of this article. Where these occur, any payment made on the cessation of the employment will require careful analysis before a decision is made on whether or not the payment should be treated as taxable within the scope of ITEPA 2003, s 62 or s 401.

Redundancies

Put simply, where an employment relationship is terminated by redundancy as defined by the Employment Rights Act 1996, s 139, a redundancy payment may follow.

An employee will qualify for statutory redundancy payment if he has the required minimum of two years' service (see ERA 1996, s 139). The payment will not be earnings for the purpose of ITEPA 2003, s 62 as it is exempted by ITEPA 2003, s 309, but it will be taxable under the provisions of ITEPA 2003, s 401.

Any payment in respect of restrictive covenants, holiday, terminal bonuses, et al, will remain taxable as contractual payments. Restrictive undertakings may be reinforced in any payment on termination, but this will be subject to tax under ITEPA 2003, s 225.

Tax planning opportunities

There are a number of ways in which an employer can mitigate the costs of a payment on termination of employment, as certain types of payments that might be made when an employment ends are exempt from taxation under s 401.

- ITEPA 2003, s 271. Useful in limited circumstances, this refers to the making of payments in respect of removal costs that arise as a result of a change or termination of duties.
- ITEPA 2003, s 406. Payments on death or disability
- ITEPA 2003, s 407. Payment by the employer of contributions to a tax exempt pension scheme
- ITEPA 2003, s 413. Foreign service deduction.

Conclusion

In summary, the point is made here that provided the right conditions are met, a payment made in compensation for loss of office will be taxed under ITEPA 2003, s 401 not s 62.

Attention must be paid to establish that what is being paid out is compensation for loss of office, or in lieu of serving notice.

To this end, clients are advised to consider looking at the various components of the payments that they propose making to their employees and to then analyse these to ensure that a distinction is made between payments that are prima facie taxable because they are either a contractual (express or implied) entitlement and those payments that are made in respect of compensation – whether that be damages for breach of contract, loss of employment, or payments that the employee is not entitled to receive under his contract.

Once taxation under s 401 has been established – as noted above – a number of further provisions may provide planning opportunities for tax on amounts over and above the £30,000 limit set out at ITEPA 2003, s 403(4).

From an article by Femi Ogunshakin

Non domiciled individuals – the remittance basis

Overview

The remittance basis available to non domiciled individuals in respect of both foreign income and gains will effectively be withdrawn for all but the very wealthy from 2008/09. Non domiciled individuals are taxed on their worldwide income, but income arising abroad is taxed on a remittance basis. The same rule applies to capital gains on assets situated abroad.

From April 2008, the remittance basis will have to be claimed by most non domiciled UK resident taxpayers, with the following consequences :

- No claim will be needed if the taxpayer has unremitted income and gains in the year of less than £2,000. The remittance basis will be automatically available, and there will be no impact on the taxation of their UK income.
- If the unremitted income and gains exceeds £2,000 in any tax year, then the taxpayer will have to make a claim to retain the benefit of the remittance basis. Such a claim will result in the loss of UK income tax allowances, including the personal allowance (including age related allowances), married allowance, blind person's allowance and tax relief on life assurance premiums, and CGT annual exempt amount.
- If the taxpayer has been resident for seven out of the previous 9 tax years, then the remittance basis will only be available to them on payment of a £30,000 tax charge on the unremitted income and gains. This is known as the remittance basis charge, and represents UK tax on selected unremitted income. This should ensure that double tax relief is available on the charge.
- The £30,000 charge will not apply to minors.

The new charge will apply **in addition** to income tax and CGT on remitted income and gains. However, the amount remitted to the UK to pay the £30,000 charge will not be regarded as remitted income.

Individuals will be permitted to choose from year to year whether they wish to claim the remittance basis or not. Careful records of remittances will be needed to ensure that the correct tax position is observed when taxpayers move from the remittance basis to the arising basis and back again.

Technical summary – legislation

Schedule 7 to FA 2008 introduces the remittance basis charge and the necessary changes to the operation of the remittance basis to ensure that the new rules are sufficiently robust. It insets into ITA Part 14 a new ChapterA1, before Chapter 1, comprising new sections 809A to 809Z7. It also makes changes to ITEPA 2003 to deal with employment related securities, by inserting new sections 41A to 41E, 700A, and replacing existing section 832 with a revised section 832 and new sections 832A & B. Changes are also made to ITTOIA, TCGA and ICTA.

Application of remittance basis

New sections 809A to 809J deal with the new applications for the remittance basis to apply.

Section 809B is the new section under which an individual who is UK resident but either not domiciled in the UK or not ordinarily resident may claim the remittance basis. It sets out reference points for time limits and procedure for claims. The time limit will be five years after 31 January following the end of the tax year until the new rules on time limits are commenced, at which point the time limit will be reduced to four years after the end of the tax year.

Section 809C then moves to long term UK resident individuals claiming the remittance basis. It provides the criteria for the charge of £30,000, namely that the individual is aged 18 or over in the tax year (i.e. by the end of the tax year) and has been UK resident in at least 7 of the 9 years preceding the year of claim, and requires a person claiming remittance basis to nominate the foreign income or gains of the year to which the charge under Section 808H(2) applies. However, they must not nominate more income and gains than would produce an additional £30,000 tax charge.

Note that when calculating periods of residence for this purpose, the split year treatment is ignored, so that if a person is resident for any part of a tax year, that year count s towards the seven years.

The £2,000 annual exemption is in new section 809D, which provides that if an individual's unremitted foreign income and gains for that year is less than £2,000 the remittance basis applies without a claim. Section 809E identifies other situations under which the remittance basis applies without a claim. These are :

- The individual is UK resident but either non domiciled or not ordinarily resident, and
- Has no UK income or gains in the year, nor remittances of relevant income and gains, and either
  - The individual has been UK resident for not more than six of the nine tax years preceding the current year, or
  - The individual is under 18 for the whole of the tax year.

For this purpose, relevant income or gains is any foreign income or gains (of the current or any preceding year) which have not been taxed in the UK as a result of the remittance basis applying.

Where the remittance basis applies to an individual for a tax year, their UK chargeable income is determined as follows :

- The relevant foreign earnings are charged in accordance with Ss 22 or 26 ITEPA 2003 (as amended by paras 14 to 19 of Sch 7)
- The relevant foreign income is charged in accordance with Section 832 ITTOIA 2005 (as amended by para 53 of Sch 7), and
- If the individual is not UK domiciled, their foreign chargeable gains are charged in accordance with Section 12 TCGA 1992 (as amended by para 60 Sch 7).

The effect on an individual's allowances of a claim to the remittance basis is in new Section 809G, and eliminates the personal allowance, blind person's allowance, married couple's and civil partners tax reductions and relief for life assurance. The loss of CGT annual exemption is dealt with by an amendment to section 3 of TCGA, made by para 55 of Sch 7, but it is cross referred to here in new Section 809G.

Remittance basis charge

New section 809H legislates for the £30,000 charge. It imposes income tax on nominated income and capital gains tax on nominated capital gains as if the remittance basis did not apply. If the additional income and capital gains tax payable is less than £30,000, then section 809H (4) deems additional income to be nominated to make the additional tax payable £30,000. However, subsection 4 cannot affect the actual amounts nominated.

Not that capping the charge at £30,000 in Section 809H is not necessary, as the remittance basis claim includes the nomination of income, which Section 809C prevents from exceeding such amount as produces an additional £30,000 tax charge.

The way the remittance basis charge is calculated means that any benefit of foreign tax credit is lost, as this is deducted before the calculation of the charge. The foreign tax credit cannot therefore be set off against the £30,000 charge.

The £30,000 is not pro rated for partial UK residence in a tax year. Therefore, if a claim is made for the remittance basis to apply and the individual has been UK resident in at least seven of the nine tax years immediately preceding that year, but is only resident for part of the current tax year, the full £30,000 is due.

If payment of the £30,000 charge is made from a foreign source, this amount will itself be treated as a remittance and liable to UK tax if it is paid into a UK bank account before payment is made to HMRC. However, if the amount is paid directly to HMRC from the foreign bank account, it is not treated as a remittance. (new section 809V)

One very important point relating to the imposition of the £30,000 charge is that s33, TMA 1970 does not apply to allow a claim for error or mistake if too much tax is paid. So if an individual claims the remittance basis in a particular year and later on discovers that his relevant foreign income and gains were less than originally calculated, thus making the payment of a £30,000 charge excessive in relation to the amount of relevant income or gains, there is no refund of any part of the £30,000 charge. It is an all-or-nothing charge. Once an individual has made a valid election for the

remittance basis to apply and he satisfies the long- term residence criterion, the £30,000 charge stands. The £30,000 is in addition to the tax due on any remitted income or gains.

Subsequent remittances

Sections 809I and J together determine how tax paid is attributed to foreign income and gains for the purposes of applying the remittance basis where the £30,000 charge has applied in any year. Where nominated income and gains are remitted, no further tax would apply on remittance. However, where untaxed foreign income and gains are remitted, the income and gains remitted need to be identified for the purpose of applying the remittance basis.

The following terms are used :

- Nominated income and gains – the amounts nominated for the current or any previous tax year under section 809C.
- Remittance basis income and gains – foreign income and gains of the current and all preceding tax years which have benefited from the remittance basis under Sections 809B, D or E apart from the nominated income and gains.

Section 809I applies if any of the individual's nominated income and gains are remitted to the UK, and there has been **no** remittance of remittance basis income and gains up to that point. Section 809J then deems the nature of the income remitted, and deems the actual income remitted not to have been so remitted.

Section 809J provides a statutory order of remittances for a tax year, and a computation of how they are taxed when remitted. The order of remittances is as follows :

- Relevant foreign earnings which are not subject to foreign tax
- Foreign specific employment income which is not subject to foreign tax
- Relevant foreign income which is not subject to foreign tax
- Foreign chargeable gains which are not subject to foreign tax
- Relevant foreign earnings subject to foreign
- Foreign specific employment income subject to foreign tax
- Relevant foreign income subject to foreign tax, and
- Foreign chargeable gains subject to foreign tax.

Relevant foreign income includes income arising outside of the United Kingdom from trading profits, property, interest, dividends, royalties, estate income, and many other forms of income not relating to earnings from employment.

Example computations : remittance basis charge

Bert is non-domiciled but has been UK resident for nine years. He has foreign income of £20,000 and foreign gains of £50,000 in 2009/10. His UK income is £10,000. He does not remit anything to the UK.

(a) No election for remittance basis

	£
UK Income	10,000
Foreign income	20,000
	30,000
Less : Personal allowance	(6,035)
Taxable income	£23,965
Income tax at 20%	4,793
Capital gains tax at 18% on £40,800	7,344
Total tax liability	**£12,137**

In this scenario, he is paying tax on the arising basis so can remit any of that income or gains to the UK with no further tax charge.

(b) Election for remittance basis

	£
UK Income	10,000
No Personal allowance	
Taxable income	£10,000
Income tax at 20%	2,000
Remittance basis charge	30,000
Total tax liability	**£32,000**

In this scenario, he has not brought anything into the UK but has a tax charge of £32,000. He can pay this from a foreign bank account direct to HMRC without it being a remittance. He can nominate the £20,000 income and £50,000 gains against the £30,000 charge and bring them into the UK free of further tax at a later date. In this example, it clearly makes sense to pay tax on the arising basis.

No consider the same facts as above, except this time the foreign income is £100,000 and the foreign gains are £300,000.

(a) No election for remittance basis

		£
UK Income		10,000
Foreign income		100,000
		110,000
Less : Personal allowance		(6,035)
Taxable income		£103,965
Income tax		
£34,800 @ 20%	6,960	
£69,165 @ 40%	27,666	
Capital gains tax at 18% on £290,800		52,344
Total tax liability		**£86,970**

(b) Election for remittance basis

	£
UK Income	10,000
No Personal allowance	
Taxable income	£10,000
Income tax at 20%	2,000
Remittance basis charge	30,000
Total tax liability	**£32,000**

In this instance it would be advisable for Bert to make an election for the remittance basis to apply. If Bert consults his adviser **before** the end of the tax year, his adviser may advise him to nominate capital gains against the £30,000 charge and to actually remit income of £24,800 during the tax year to take him up to the 40% threshold.

Practicalities

You will need to set certain measures in train now so that you can act appropriately for non domiciled individuals.

1. All non domiciled individuals will need to provide full details of their offshore income and gains for the year if there is any doubt about whether the remittance basis is available automatically or whether it is to be claimed. Those forfeiting the remittance basis and paying tax on an arising basis will also need to collate details of overseas income and gains.
2. Where the income is modest, you will then have to compare the amount of income and gains on an arising basis with the limit of £2,000, and document this detail. Where the unremitted income and gains is less than £2,000 you can utilise the remittance basis without claim and without loss of allowances in the UK. This treatment applies irrespective of how long the individual has been resident in the UK
3. If the limit of £2,000 is exceeded then there are two possible costs associated with claiming the remittance basis. All taxpayers claiming the remittance basis will lose their UK personal allowances and CGT annual exemption. There are other UK allowances which are lost, such as life assurance tax relief, but as these are rare they should not trouble the average taxpayer. If the individual has been UK resident for 7 out of the last 9 years, and is over 18 years of age, then in addition, a tax charge of £30,000 must be paid in order to retain the benefit of the remittance basis.
4. Thus you will need to compute the UK tax liability on unremitted income and gains, and after allowing for double taxation relief decide whether tax should be paid on the overseas income on an arising basis, or whether the benefit of the remittance basis should be sought.

Examples

In all of the examples below, the taxpayer is a UK resident non domiciled individual.

- Freda has been resident in the UK for 20 years. She has income in Portugal which has not been taxed in the UK, as it has not been remitted to the UK. In 2008-09 the amount of interest received is £1,200.

  Freda will not need to claim the remittance basis for that year, as she is automatically entitled to it, based on the de minimis sum of £2,000.

- Peter has been resident in the UK for 4 years. He has income arising in Dubai of £3,600, which has not been subject to tax in Dubai. He is currently a 40% taxpayer in the UK.

  Peter would not be automatically entitled to the remittance basis, as his income in 2008-09 exceeds the income limit of £2,000. His additional tax on his foreign income on an arising basis would be 40% x £3,600 = £1,440. As this is less than the loss of personal allowances – which is worth 40% x £6,035 = £2,414, he will not claim the remittance basis, and will pay UK tax on his foreign income in 2008-09. The £30,000 charge would not apply as he has not been resident in the UK for long enough.

- Luke has been UK resident for 15 years. He receives a pension which is taxed in Sweden. The gross amount is £15,000, and tax suffered is £7,000.

  Luke would be liable to the £30,000 charge on a claim to access the remittance basis, so with foreign income of £15,000 this would clearly not be worthwhile. In the event, Luke's foreign tax liability on the income far exceeds his UK liability, so being taxed on an arising basis is no issue in regard to this income stream, as double tax relief will eliminate the UK liability.

- Ian has been resident in the UK for three years. He has a substantial building business here, and sends money home regularly. He has purchased a house in Poland, which he will move

back to when he finishes his work in the UK – which he expects to be in around 4 years time; meanwhile he lives in bed and breakfast accommodation while in the UK. He has never lived in the property. He has recently sold this property, realising a cash appreciation of £20,000.

Clearly, Ian's unremitted income exceeds the £2,000 limit, and while the loss of personal allowances and CGT exemption are likely to cost him only £2,414, the actual CGT on the disposal is only £1,872. On the facts given it is unlikely that his Polish home could qualify for PPR, there is a slight possibility. It is worth examining the facts in more detail to establish whether a PPR claim would be possible in this case. Note that no details of Polish CGT have been taken into account, so the resultant tax charge may be lower when this is taken into account.

Lecture P498 (15.24 Minutes)

Lecture P499 (14.47 Minutes)

Ex gratia or not?

In 1996 the company was formed as part of the Lloyd's reconstruction and renewal plan to reinsure various long-tail liabilities of Lloyd's and it was set up with the intention of "working itself out of business". In November 1996 H, a US national, was employed by the company as director of human resources. Once it achieved its business objectives the company began to downsize and H's job changed from managing high volume staff recruitment and establishing human resources policies for the business to managing a planned headcount reduction programme over a five-year period. Thus, by 2004 H's role was very different from her original role and realising that her task had been accomplished she formally resigned on 21 July 2004. In so doing she forfeited her potential redundancy benefit, assessed to be £152,300, and outstanding long-term incentive plan awards, amounting to £122,500, she would have received had she remained. Whilst there was no provision in her employment contract under which she was entitled to an ex gratia payment, the CEO of the company decided to make her an ex gratia payment of £150,000 to compensate her for the benefits she was giving up as a result of her resignation and to recognise that she was doing the "right thing" by the company. H left the company on 17 September 2004 and returned to California. On 19 November 2004 the company made the ex gratia payment into her American bank account. The company deducted tax at the basic rate of 22 per cent from £120,000 of the payment. HMRC contended that the ex gratia payment was chargeable to tax as general income from the employment under ITEPA 2003 s 62(2)(b) and amended H's self-assessment tax return for 2005 and issued a determination on the company under the Income Tax (Pay As You Earn) Regulations 2003, SI 2003/2682, reg 80. H and the company appealed. The company argued that the ex gratia payment was not chargeable under s 62 but only under ITEPA 2003 s 401 as a payment in connection with the termination of H's employment and that on that basis it had deducted and accounted for the correct amount of tax. H submitted that (a) she was not employed by the company when the payment was made and she had no contractual or other legal entitlement to it and had the company refused to pay it there would have been no formal recourse open to her. Furthermore the payment was not paid in connection with the termination of her employment. It was a straightforward personal gift—made because she had "done the right thing" by the company in resigning—and not chargeable to tax at all; or, in the alternative, (b) if it was a termination payment within s 401, it was not subject to UK income tax because it was not "salaries, wages, and other similar remuneration derived by a resident of a Contracting State in respect of an employment" within the UK/USA Double Taxation Convention 2001, art 14; thus the payment could only be "other income" within art 22 and therefore taxable only in the USA.

The Special Commissioner found that the ex gratia payment was not earnings for the purposes of ITEPA 2003 s 62 as it was paid in recognition of the fact that H had "done the right thing" in resigning her position as human resources director with the company. On the facts the ex gratia payment was truly ex gratia. H had no contractual entitlement to it and she did nothing to earn it in the conventional sense. Whilst it was true that the company would not have paid it had she not chosen to resign her position, it was not paid in return for that resignation. However, a gratuity or gift was not removed from charge to tax as employment income by that fact alone. It was possible that had there been no financial cost to H's decision to resign voluntarily the company CEO would not have thought of making the ex gratia payment. Although companies did not usually pay

gratuities to employees who chose to leave voluntarily, they might do to recognise the personal qualities that an employee had exhibited in the course of that employment. When judges referred in that context to the payment being for “something else” they did not necessarily have in mind payment for some other (non-employment) service or asset. It might be an intangible personal quality of the individual concerned—loyalty, good humour, for being a good team player—that contributed significantly to the success of the business and therefore were appropriately recognised gratuitously. However, a payment did not lose its character as earnings because it was paid to recognise the personal qualities that the employee had exhibited in the course of rendering services. The payment remained earnings for employment services even if it purported to be for rendering the services with a smile. That was not the case, however, when the personal quality involved was recognising that the time had come to leave. H had recognised that her job was done and that she should move on to other things. The payment was made for “doing the right thing” by the company and resigning voluntarily; it was not in respect of any service that H had rendered or that she was obliged (but for short notice) to render.

The Special Commissioner found that the ex gratia payment was a termination payment within ITEPA 2003 s 401. The language of sub-s (1) was cast in the widest terms designed to catch any payment or benefit received “directly or indirectly … in consequence of, or otherwise in connection with” the termination of H's employment. The payment might have been gratuitous and for “doing the right thing” but the right thing was resigning her employment. Accordingly the payment was in consequence of or in connection with the termination of her employment.

However, the Special Commissioner found that the ex gratia payment was not within the scope of the UK/US Double Taxation Convention 200, art 14. As the ex gratia payment was a gift “for doing the right thing” it did not fall within the ordinary meaning of the words “salaries, wages and other similar remuneration”. Whilst “other similar remuneration” was capable of extending to any reward that a person derived in respect of their employment services, whatever form it took, including termination payments such as PILONs, and “remuneration” was a wider term than salary and could envisage anything that a person got for his services, remuneration still involved the concept of something that was given quid pro quo for services rendered. In the present case, the only thing which could be described as a quid pro quo was the fact that H had voluntarily resigned her position. An ex gratia payment that the company chose to make following a resignation in those circumstances could not be described as remuneration in any ordinary sense of the word. It was not solely the fact that it was ex gratia but that the payment lacked the necessary nexus with services rendered that usually characterised payments as salary, wages or other similar remuneration. Furthermore, there was nothing in the context of ITEPA 2003 or in the language of the Convention to indicate that art 14 of the Convention should be construed as encompassing anything that fell within the charge to tax under Sch E or within ITEPA. Therefore the gratuitous payment should not be treated as within the Treaty concept of “salaries, wages and other similar remuneration” just because it happened to be taxed by the UK as an amount that counted as employment income. It followed that since art 14 did not apply to the ex gratia payment, the portion of the ex gratia payment (ie £120,000) that would otherwise be charged to UK tax was nevertheless exempt by virtue of the UK/US Double Taxation Convention 2001, art 22(1). Accordingly the appeals of H and the company would be allowed.

Appeals allowed

Resolute Management Services Ltd v Revenue and Customs Commissioners; Haderlein v Revenue and Customs Commissioners SpC 710

A Guarantor v Revenue and Customs Commissioners SpC 703

The appellant was a director of the company and held 5% of the issued shares. The company was in acute financial difficulty and in September 2002 it entered into a debt factoring agreement which obliged its directors to enter into personal guarantees in amounts which were proportionate to their respective shareholdings and was binding on them for a four month period after resignation from office. The appellant resigned the same month and left the company. Unfortunately, the company failed in December 2002 and the appellant's guarantee was called upon. In November 2004 the appellant paid £12,972 in respect of the guarantee. In his tax return for the year to 5 April 2005 the appellant claimed a deduction for the payment under ITEPA 2003 s 336(1). HMRC disallowed the claim and the appellant appealed contending that, as a company director, he was obliged to enter into the guarantee. The company was in financial

difficulty and he had a duty, as a director, to its creditors, employees and shareholders to maintain its solvency. If, as in the present case, there was only one available means to achieve that objective, it followed that the expenses incurred by a director when availing himself of those means were wholly and necessarily incurred in the course of his employment. HMRC submitted that (i) the expense in the present case did not fulfil any of the conditions in s 336(1)—it could not be said that every director of a company was obliged to guarantee the company's debts, indeed until September 2002 the appellant, though a director of the company, did not guarantee its debts. Since it was not the duty of a director to guarantee a company's debts, it could also not be said that the expense was necessarily incurred in the performance of his duties. It might be the case that, had the directors refused to enter into the guarantees, the company would have ceased to exist, but that was a consequence of its poor financial position; the directors could perform their duties as directors without entering into guarantees. Guaranteeing the company's debts might have enabled the company to continue to trade, and to that extent it enabled the appellant to perform his duties, but it was not something he did in the course of those duties; (ii) the appellant had incurred none of the expense for which he now claimed relief in the course of his employment. Whilst he ceased to be a director in 2002, he did not incur any expense until he made the payment in November 2004. He had no more than a contingent liability when he left office; by the time it crystallised he was no longer in that employment, and it could not be said that the expense was incurred in the course of carrying out his duties; (iii) even if all the other relevant conditions were satisfied, the expense had not been incurred wholly and exclusively for the purposes of the appellant's employment since, whatever his primary purpose and motive in entering into the guarantee, it also had the purpose of protecting his investment in the company and his own position as its director and employee; and (iv) the appellant had sought relief under the wrong provision as there was a tailor-made provision under TCGA 1992 s 253, which in itself was a clear indication that ITEPA 2003 s 336(1) was not intended to afford the relief sought.

The Special Commissioner considered that the appellant was not entitled to claim relief under ITEPA 2003 s 336(1) in respect of the payment made under the personal guarantee. It was an inescapable conclusion that the expense, as distinct from the contingent liability, was not incurred in the course of his employment, but only after it had come to an end, with the consequence that it could not be said that the expense was incurred in the course of the employment; and that the appellant gained some benefit, albeit in the event very short-lived, from the company's ability to trade. Indeed, the very fact that, by entering into the guarantee, the taxpayer discharged his duty as an officer (rather than an employee) of the company bestowed some benefit on him. It followed that the appeal would be dismissed.

Appeal dismissed.

Capital Gains Tax

Share valuations

What methodology?

In the recent Special Commissioner's decision in *Executors of Ian Campbell McArthur (deceased)* (SpC 700), dividends being paid were low compared to the net assets and so the experts for both sides had agreed that a discounted asset basis, rather than a dividend yield basis, was appropriate here

While this may have been appropriate in this instance, for other property or investment companies a dividend yield may be better where there is a very regular dividend and little prospect of a sale of the whole company.

For tax purposes, an asset-based approach is generally the most common, even though the shareholder may never see his share of the underlying assets.

What are net assets?

The net asset values were agreed in the Macarthur case between the experts before the case came before the Commissioners, so there is no judicial comment on values.

The 'information standard' which underpins a tax valuation was the subject of two recent articles in Taxation: Circumstances alter cases by Mick Ruse and Gold standard by Bruce Sutherland. It is significant that the authors disagreed with each other at the margin.

Both articles looked at the case law, and in particular the linked cases of *Caton* [1995] STC (SCD) 34 and *Clark* [1995] STC (SCD) 99, which involved the same trading company, Yorkshire Switchgear.

Each company is different and must be treated on its particular merits.

A holding of 14% is significant if it is the largest holding by some distance (as was the case in Caton [1995] STC (SCD) 34) but less so if other shares are held, say 51% and 35%.

If a company regularly sends current year trading information to its shareholders, this is information available to even the smallest shareholder.

For the valuation of a controlling interest, it is common ground that the valuation assumes full commercial due diligence, so that the purchaser has access to all the information about the company available to the directors.

For a very small and uninfluential minority interest, information is generally restricted to what is in the public domain.

For a significant minority interest, the information available is somewhere in-between.

For income tax valuations and employment related securities valuations using an income tax information standard, the information known to the specific employee or director is used.

Deferred tax

The next issue is the extent to which deferred tax should be taken into account. If there is no intention to sell the property, it is usual to take a percentage of the deferred tax into account, say 30%.

If the underlying assets are very likely to be sold, the full estimated deferred tax should be deducted.

It may still be possible to reduce this a little, as it is often possible with 'real' sales for the vendor to suffer the whole of the deferred tax less the stamp duty savings to the purchaser between buying shares and stamp duty land tax of 4% on buying assets.

What interest to value?

There was considerable debate in the McArthur judgment about the position of the convertible loans. These had a face value of £1 and the potential to convert on a one-for-one basis.

The Special Commissioner held that the loan notes should be deemed to have been converted, as their value was more than £1 each on this basis.

This increased the percentage shareholdings, with a consequent dramatic impact on discounts.

What discount?

Having established the appropriate level of new assets, it is then necessary to apply a discount to the resulting value per share, to take account of:

- the lack of liquidity of an unquoted shareholding;
- the unattractiveness of a company not paying regular dividends;
- the lack of influence over dividend policy of an interest of less than 50%; and
- the inability to push through a liquidation of an interest of less than 75%.

The general rule is that the smaller the size of the shareholding, the larger the discount. However, this needs to be considered sensibly in the context of the company, the rights of its shares under the articles of association (for an interest of less than 75%) and the situation of the directors and the other shareholders.

One further situation to note is the valuation of a shareholding that can give another shareholder control, e.g. a 2% interest in a company held 49:49:2. If one of the larger shareholders has financial ability and inclination to acquire these shares, he is a potential special purchaser and the shares will be worth very much more than normal.

Interestingly, the HMRC manuals suggest the following as a rule of thumb:

Interest	Discount
>75%	0-5%
51% - 75%	10-15%
Exact 50%	20%
>25 - 49.9%	25-40%

For a trading company, the discounts would be higher for minority interests, as these are more risky.

Summary

There are relatively few recent decisions on minority discounts, and those that have been heard have generally related to trading companies, which tend to have distinguishing features that make them hard to use as precedents.

As regards trading companies, in Caton a discount of 50% was agreed for a 14.08% interest, which was nonetheless far and away the largest shareholding in the company and in Clark a 3% interest in the same company merited a 65% discount.

In *Hawkings-Byass* [1996] STC SCD 319 where the share rights were unusual, 9% and 11% holdings merited a discount of 1/3 but for a 24% interest, with power to appoint two directors, the discount was held to be 20%.

In *Denekamp v Pearce (aka Mr Cash & Carry v HMIT)* [1998] STC 1120 the discount for a 24% interest at March 1982 was determined at 50% (with HMRC wanting 65% and the taxpayer only 10%). This case is therefore very useful to show potential non-trading company discounts.

Note that valuations and issues such as the discount to apply are questions of fact, to be determined by the Special Commissioner (or Lands Tribunal in respect of property values), and scope for appeal is limited.

From an article by Jan Ellis writing in Taxation

Pre-5 April 2008 inter-spouse transfers and indexation allowance?

A plan

While the echoes of the Pre-Budget Report were still dying in the House of Commons, stockbrokers started e-mailing me to ask whether it would be possible to crystallise indexation allowance before 6 April 2008 by making inter-spouse transfers (which should be taken, throughout what follows, to include transfers between civil partners) at a no loss/no gain (NL/NG) price, and so carry forward a higher base cost to be taxed at 18%.

Indexation was specifically included in the NL/NG price, up to 5 April 2008, by TCGA 1992, s 56(2).

FAQ!

From the information on HMRC's website, the plan appeared to work (Box 1).

Box 1. HMRC 'frequently asked question'

Q. If I make a no gain/no loss transfer on or before 5 April 2008, for instance a transfer to my husband/wife, will he/she retain the benefit of any indexation allowance due on the transfer?

A. Indexation allowance will not be stripped out when the person who acquires the asset under a no gain/no loss transfer disposes of it after 5 April 2008. For example, in the case of an inter-spousal transfer, indexation allowance will continue to be included, where applicable, in arriving at the allowable cost to the transferee spouse.
(www.hmrc.gov.uk/cgt/faqs-cgt-reform.htm#1)

Gift horse #1

There were a number of articles in the professional press celebrating HMRC's apparent generosity, in particular I love your assets by Richard Curtis and Plan B planning by Jan Ellis.

Richard raised the following suspicion about the new rules which was so devious that even I did not believe that HMRC had intended it – although I believed that the writing of careless articles in *Taxation* would surely make them take the point.

Under the pre-2008 rebasing legislation (TCGA 1992, s 35), a spouse receiving a NL/NG transfer was entitled to treat a subsequent disposal as eligible for rebasing.

That meant that the inter-spouse disposal was not rebased, but rather that this was done at original cost plus indexation. The effect was normally the same, but the crystallisation plan would not work perfectly for assets owned by one spouse on 5 April 1982 and transferred to the other spouse at any point after that – in particular between October 2007 and 6 April 2008.

The effect was still positive for assets acquired after 1982, and the plan appeared to work for many people.

Back to the first horse

There is a new TCGA 1992, s 35A which means that Richard Curtis's rebasing problem does not exist. Where someone acquired an asset on a NL/NG basis between 31 March 1982 and 5 April 2008, and disposes of it after 5 April 2008, then:

> 'It is to be assumed that s 35(2) [rebasing] did apply to the relevant disposal [the NL/NG transfer] (and that s 56(2) applied to the relevant disposal) accordingly).'

That means that the NL/NG price would be 1982 market value plus indexation, not original cost plus indexation.

The same person also pointed out that new TCGA 1992, s 52A which applies the indexation rules only to corporation tax from 6 April 2008 onwards, has cancelled the effect of s 56(3) for capital gains tax from that date.

So there is no longer any need to identify indexation in a NL/NG asset, because that indexation has become capable once again of creating or increasing a loss.

Gift horse #2

Then someone drew my attention to the Explanatory Notes to the Finance Bill, The offending item is set out in **Box 2**.

Box 2. Finance Bill 2008, Sch 2 clause 6

Where there is an existing s 104 holding at 5 April 2008, the record of the holding should distinguish between the original cost and indexed cost. It is the original cost (not the indexed cost) of an existing s 104 holding that is taken into account in computing the allowable expenditure in a 'new' s 104 holding from 6 April 2008 onwards. Where there were any additions to a s 104 holding between 30 November 1993 and 5 April 2008 under transactions (such as transfers between husband and wife) that are treated for capital gains tax purposes as giving rise to neither a gain nor a loss to the person making the disposal, the amount of the original cost will not include any element of indexation allowance. (In such cases the indexation element was added to the indexed cost of the holding separately from the original cost.)

A 's 104 holding' is the indexed pool of shares acquired between 6 April 1982 and 5 April 1998 that was prescribed by the pre-2008 legislation (TCGA 1992, s 104) and which has now become much simpler (no indexation, everything pooled).

That suggested to me that the crystallisation plan did not work for shares acquired between 1982 and 1998 (although it would still have been effective for other assets). If that was the case, the FAQ was at the very least misleading.

The right note?

So, is the Explanatory Note correct, and was the FAQ misleading?

But surely the people who write the Finance Bill Explanatory Notes usually have a reason for what they put in them. I found the apparent reason in TCGA 1992, s 110(6). Although s 110 starts 'for the purposes of corporation tax', it is applied in almost its entirety to capital gains tax for the period 6 April 1998 to 5 April 2008 by s 110A.

The effect of s 110(6) is what it says in the Note: on a NL/NG transfer of a s 104 holding, s 56(2) does not apply. Instead, the recipient acquires a s 104 holding with the cost and indexed cost separately identified. That would mean that the indexation would disappear after 5 April 2008.

The FAQ should have included a caveat. 'This plan works, except for the asset which you are most likely to use it on – share pools.'

From an article by Mike Thexton writing in Taxation

Entrepreneurs relief and reorganisations

On the assumption that the sale of a company progresses as a share sale the tax treatment of the different types of consideration is as follows:

1. Cash	Whole gain charged at the time of the sale of the company.
2. Shares	No gain chargeable at the time of the sale of the company. The base cost and capital gains history of the old shareholding becomes the base cost and history of the new shares.

The sale of the new shares in the future will be taxed at 18% on the gain – subject to entrepreneurs relief.

If you feel the new shares are unlikely to qualify for entrepreneurs relief (eg less than 5%) you can elect out of the share for share rules and pay tax on original disposal - subject to entrepreneurs relief.

3. QCB Loan notes

Qualifying corporate bond (QCB) loan notes are non-convertible sterling bonds issued on normal commercial terms.

Where QCBs are issued as part of the consideration for the acquisition of a company the gain is computed on that portion of the consideration in the same way as cash but the gain is deferred until the bond is redeemed or disposed of.

The chargeable gain is frozen after entrepreneurs relief.

For share disposals pre 6 April 2008 the gain was frozen pre taper where QCBs were involved – hence taper is now lost. Entrepreneurs relief will however be available if the original disposal would have qualified for entrepreneurs relief.

4. Non-QCB loan notes

Such loan notes would typically be issued in, or convertible into a foreign currency.

Where these are issued as part of the consideration the treatment is the same as shares, i.e. there is no gain chargeable at the time but the loan notes take over the base cost and history of the old shares.

5. Deferred consideration

Many deals are structured such that part of the consideration is only payable on the satisfaction of some condition such as the achievement of a certain level of profits. Where the amount payable is fixed in advance, or payable in cash the gain on that portion is charged at the time of the deal.

6. “Earn – out”

An earn-out is where the amount of additional consideration is calculated according to a formula.

Typically this will be linked to the future profits and as such is conditional and uncertain. Where the future sum is payable in cash an estimate of the future amount receivable is charged at the time of the deal. However where the additional consideration is in the form of shares or loan notes the right to future paper is treated as a security acquired at the time of the deal and the treatment follows 2 to 4 above.

Lecture B498 (14.42 Minutes)

Entrepreneurs relief and business property

Overview

Section 9 refers us immediately to Schedule 3 for the detail of Entrepreneurs' Relief.

The relief is very largely modelled on retirement relief, which was available for many years up to the late 1990's and was effectively replaced by Taper Relief. However the relief is much broader and much simpler than retirement relief, and is therefore likely to be more widely applicable. It should be remembered, however, that both retirement relief, and now entrepreneurs' relief is designed for the disposal of a business rather than an asset.

The legislative change is achieved by inserting new Sections 169H to 169S into TCGA.

Material disposal of business assets

Section 169H being an introduction to the relief in the style of the tax law rewrite, providing a summary of the structure of the legislation, Section 169I commences with the detail of the relief by defining a material disposal, to which relief will apply.

The main form of relief is where an individual makes a material disposal of business assets. This is defined as a disposal of business assets by an individual, which meets the conditions for a material disposal.

A disposal of business assets is defined as :

- A disposal of the whole or part of a business (including an interest in a partnership),
- A disposal of (or of interests in) one or more assets which were in use in a business at the time the business ceased, or
- A disposal of shares or securities in a company.

The interpretation section (Section 169S) states that a business is any trade profession or vocation which is conducted on a commercial basis with a view to the realisation of profits. This is extended by para 3 of Schedule 2 to include furnished holiday lettings.

The criteria for a disposal to be a material disposal place further qualifications on each type of asset listed above.

- Where the disposal is of the whole or part of the business, the disposal is a material disposal if the business was owned by the individual disposing of it for the whole of the year ending with the date of disposal.
- Where the disposal is of an asset used in a business which has ceased, the business must have been owned by the individual throughout the year ending on the dare the business ceased, and that date must be within three years ending on the date of disposal.
- Where the disposal is of shares or securities in a company, either condition A or B must be met :
    - Condition A – throughout the one year ending on the date of disposal the company was the individual's personal company and is either a trading company or holding company of a trading group, and the individual is an officer or employee of the company or of one or more companies which are members of the same trading group.
    - Condition B – The same conditions are met as for condition A throughout the one year ending on the date on which the company ceases to be a trading company without continuing to be or becoming a member of a trading group, or ceases to be a member of a trading group without continuing to be or becoming a trading company.

Section 169S provides the definition of personal company. It is a company in which at least 5% of the ordinary share capital is held by the individual, and at least 5% of the votes are exercisable by the individual by virtue of that holding. Where shares are jointly held, then the individual is regarded as

entitled to a pro rata proportion. Trading company, holding company and trading groups are defined in the new Section 165A, which takes the old activity based definition from taper relief, including the "to no substantial extent" test.

Individuals who trade through a partnership are dealt with by Section 169I(8). This provides that the disposal of assets on entering into a partnership and the disposal of all or part of an individual's interest in the assets of a partnership are the disposal of a business, and are therefore treated the same as the disposal of a business by an individual trader.

What does not qualify

By a process of elimination, it is possible to identify major disposal which do not qualify for relief. The sale of assets without the sale of the business, or the cessation of trade will not qualify for relief. This will affect farmers who sell off parcels of land, which previously qualified for BATR, but do not attract relief after 5 April 2008. It would also be an issue where a property used by the owner's personal trading company is sold either to the company or to a third party without the sale of the shares.

Commercial properties which are let on the open market, while previously qualifying for BATR will never qualify for ER under any circumstances.

Disposal of trust business assets

Entrepreneur's relief can also apply to the disposal of assets by trustees, and Section 169J sets out the basic conditions for a disposal to qualify.

There is a disposal of trust business assets within this relief when :

- The trustees of a settlement dispose of settlement business assets
- There is an individual who is a qualifying beneficiary, and
- The relevant condition is met.

Settlement business assets are shares or securities of a company and assets used or previously used for the purposes of a business which are settlement assets.

An individual is a qualifying beneficiary if under the settlement he has an interest in possession in either the whole of the settled property, or that part of it which comprises the settlement business assets disposed of.

The relevant conditions are :

- In relation to a disposal of shares or securities that throughout a period of one year ending not more than three years before the date of disposal, the company is the qualifying beneficiary's personal company, and is either a trading company or holding company of a trading group and the qualifying beneficiary is either an officer or employee of the company or another company in the same trading group.
- In relation to a disposal of assets, that the settlement business assets are used for the purpose of the business carried on by the qualifying beneficiary (alone or in partnership) throughout the period of one year ended within three years of the date of disposal and the beneficiary (or partnership) ceases to carry on the business (or the beneficiary ceases to be a member of the partnership) on the date of disposal or within three years before that date.

Associated disposal

Section 169K deals with associated disposals. An associated disposal is a disposal associated with a material disposal of business assets (a relevant material disposal) if the following three conditions are met :

- Condition A – an individual makes a material disposal of business assets that consists of the whole or part of an individuals interest in the assets of a partnership, or the disposal of shares or securities in a company.
- Condition B – the individual makes the disposal as part of his withdrawal from participation in the business of the partnership or company
- Condition C – throughout the period of one year ended with the earlier of :

- o The date of the material disposal of business assets, or
- o The cessation of the business of the partnership or company

the assets which are disposed of are in use for the purposes of the business.

Relevant business assets

Section 169L restricts relief to relevant business assets. This applies where the material disposal is of assets other than shares or securities, and denies relief unless the assets disposed of are relevant business assets. These are defined as assets used for the purposes of a business carried on by the individual or partnership, with a parallel provision for trusts, or if it is an associated disposal, assets used for the purposes of the business of the company or partnership. There follows in Section 169L(4) excluded assets which are shares and securities and other assets held as investments.

Claims

Entrepreneurs' relief is only available on a claim, which is made jointly by the trustees, or by the individual making the disposal. The time limit for claim is twelve months after 31 January following the year of disposal. (Section 169M).

Amount of relief

The **net** gains on the disposal of business assets must be computed, so that losses on disposal of business assets are netted off before relief is given on the net gain. The net gain is subject to a deduction of 4/9 of the gain, unless the net gains exceed £1 million, in which case only the first £1 million of net gains attract relief. Thus, if gross gains exceed £1 million, relief will still be given on the net gains, which is less advantageous than allowing relief against the gross gains, leaving the losses to be deducted in full. (Mathematically any losses are therefore also subject to a 4/9 deduction when set off against relieved gains).

<u>Example</u>
Sarah sells her trading business and realises gains of £450,000 (before Entrepreneurs' Relief). She has made no other claims to the relief, and the whole of the gains are eligible for relief. If she claims the relief the gains of £450,000 will be reduced by 4/9ths (£200,000) and £250,000 of the gains will be liable to CGT (subject to deduction of any allowable losses and the annual exempt amount).

The £1 million is a lifetime limit, so if any previous disposals have attracted Entrepreneurs' relief, then the limit is reduced accordingly. Where the disposal is by an individual, previous disposals by that individual, and disposals of trust business assets for which he was the qualifying beneficiary are taken into account. Where the disposal is of trust business assets, previous disposals by the trust in respect of which the same qualifying beneficiary has an interest and disposals by that individual are taken into account.

Where there is more than one beneficiary interested in the assets disposed of by a trust, then relief is only available on the proportion of the gain relating to the qualifying beneficiary. This proportion is arrived at by taking the interest of the qualifying beneficiary in the income of the shares or securities disposed of in relation to the interest in that income of all of the beneficiaries who have interests in possession in the settled property. The time period used for this computation is the period of one year ended not earlier than three years before the date of disposal during which the relevant conditions are met.

The amount of relief for an associated disposal may be further restricted under Section 169P. The gain attracting relief is restricted to an amount which is just and reasonable, taking into account the following factors :

- The asset disposed of has been in use in the business for only part of the period of ownership by the individual
- Only part of the asset has been in use for the business for the period during which they are owned by the individual
- The individual has only been involved in the business for only part of the time he has owned the asset, or
- The asset has been provided to the business in return for rent.

These restrictions seem to apply for the entire period during which the property was owned. In determining what is a fair and reasonable proportion of the gain to which relief should apply, regard should be had to the length of time during which the assets are used in the business, or the proportion of the asset used in the business, the length of time the individual is involved in the business, and the proportion of market rent which has been charged for use of the asset.

The transitional rules at para 6 of Sch 3 restrict the consideration of rent charged to periods after 6 April 2008 only. This was a late amendment at the request of ICAEW Tax Faculty.

In Taxation in May 2008 Kevin Slevin published his views on how property interacts with entrepreneurs relief. His views and examples provide useful analysis of the issues that will affect sellers of businesses going forward.

Since the publication of the article the government have amended the rental provisions which Kevin highlights as being inequitable.

John — a sole trader

Entrepreneurs' relief arises to sole traders who make 'qualifying business disposals' within s 169H.

Let us assume that John has been a sole trader for several years trading from Unit B6, a building owned by him. In recent years, John has outsourced the manufacturing side of his business and this has freed up approximately 40% of Unit B6 which he has let on a short lease to a third party.

Say, in January 2009, John decides to retire and sell the business as a going concern. He immediately finds a buyer and the buyer is happy to let the tenant continue in occupation until his lease expires.

On the disposal of the business the following capital gains arise:

Asset	Gain (£)
Goodwill	600,000
Sale of Unit B6	400,000

John has read in the financial pages of his Sunday newspaper that, because the gain amounts to not more than £1 million he will not pay tax of more than 10%. John reports the transaction to his taxation adviser only after the disposal has been made. His adviser starts to consider the issues.

Is there a reduction in relief?

The main question which arises is to what extent may John's gain on the disposal of Unit B6 be reduced by entrepreneurs' relief? Is there a restriction because of the letting of 40% of the building for a period of time?

Section 169H(1), (2) and s 169I(1), (2)(a) and (3) combine to require John to demonstrate that he has disposed of a business (or part of a business) which has been owned by him for a period of at least one year ending with the date of disposal. In so doing, John can demonstrate that he has made a qualifying business disposal, being a material disposal of business assets falling within s 169I. These requirements are clearly met. However, John's adviser is also worried about s 169H(3) which contains a further requirement. It reads as follows.

'But in the case of certain qualifying business disposals, entrepreneurs' relief is given only in respect of disposals of relevant business assets comprised in the qualifying business disposal: see s 169L.'

Broadly speaking, s 169L has effect so that, where the asset disposed of is used in a trade carried on by a sole tradership or a partnership, it is necessary for the assets comprised in the qualifying business disposal referred to above to be 'relevant business assets'.

What is a relevant business asset?

Subject to one important proviso (see below), in the case of a disposal of a sole tradership, a relevant business asset is an asset used for the purpose of a business carried on by the individual (s 169L(3)). There is no requirement in the legislation for the asset to be *fully* used in the business. It must be in use in the business at the time the business is disposed of and, because this was the case in John's situation, his £400,000 gain on the property disposal is potentially eligible to be reduced by entrepreneurs' relief.

Turning to the proviso in s 169L referred to above, it is provided that certain assets are to be considered as 'excluded assets' and the gains thereon cannot be reduced by entrepreneurs' relief. Section 169L(4) reads as follows:

'The following are excluded assets:

(a) shares and securities; and

(b) assets, other than shares or securities, which are held as investments.'

Clearly, John's interest in the building is neither a share nor a security, but the question is whether the property could be regarded as an investment asset by HMRC. In the author's opinion, an asset purchased by a trader to provide himself with a place from where to carry on business operated as a sole tradership is not to be regarded as an investment asset, whether or not it is subsequently let as described.

Therefore, John's claim to entrepreneurs' relief would not be restricted. If John has made no other disposal attracting relief, he will reduce the aggregate of his capital gains arising on his two relevant business assets by 4/9ths; i.e. from £1 million to £555,555.

Letting an investment asset

Of course, little in tax is that straightforward. Let's now say that John had originally acquired the premises to let it out to third parties. Only subsequently had he installed himself as a part user of the building, occupying say 25% for his sole tradership. Here, entrepreneurs' relief could well be restricted as HMRC could argue that the asset had remained an investment asset throughout and, as such, then assess the full gain (not just 75% of it) as an 'excluded asset' under s 169L(4) (see above). The reality is likely to be that John occupying 60% would be accepted, but if John only occupied 10% he would have to argue his case — with some considerable difficulty. HMRC might perceive his occupation as driven by entrepreneurs' relief planning!

Fred and business cessation

The next scenario also involves a sole trader. In March 2009, Fred, who has owned his business for many years, disposes of the goodwill of his business and ceases to carry on his trade. The goodwill disposal crystallises a capital gain of £400,000 which is reduced by 4/9ths to £222,222. Fred owned the premises from where his former business was operated. He has viewed this asset as his 'pension fund' and he has let it to the new owner of the business at a full market rent.

After two years, the new owner of the business goes bankrupt and Fred regains vacant possession. Thirty months after ceasing to trade, Fred sells the building to a developer realising a capital gain of £1 million. The question is, can Fred claim the balance of his £1 million lifetime entrepreneurs' relief?

The answer here is that s 169I((2)(b) and subsection (4) thereof combine to allow the post-cessation disposal of an asset to, nevertheless, be treated as a material disposal of a business asset. This is so even though the asset has been leased to a third party.

Provided the post-cessation asset disposal takes place not more than three years after the business ceases (and the chargeable asset was in use in the business when the business was disposed of), entrepreneurs' relief can be claimed. Use during the post cessation of business period (maximum three year period) is not a factor taken into account.

In this scenario, Fred's £1 million gain would be taxed as :

	(£)	(£)
Gain on disposal of building		1,000,000
Maximum gain eligible		
(£1 m - previous goodwill gain £400,000)		600,000
Part of gain not eligible to		400,000
Part of gain eligible for relief	600,000	
Entrepreneurs' relief 4/9ths	266,667	
Taxable at 18%		333,333
Gain as reduced by relief		733,333
Less: Annual exemption (say)		10,000
Assessable at 18%:		723,333

Associated disposals

The position regarding an associated disposal, i.e. the disposal of assets owned by an individual and provided either (i) for use in a trade of partnership of which he is a member, or (ii) for use by the owner's 'personal company' in its trade, which is provided for in s 169K, is not so generous.

In the case of such use by a partnership or a personal company (broadly, a company where the asset owner is either an employee or officer thereof and owns at least 5% of the ordinary shares and controls at least 5% of the voting rights by virtue of the shares held) there is a restriction to be made when calculating the availability of entrepreneurs' relief. Put simply, if the asset has been provided in consideration for the payment of rent or other consideration, the relief available is restricted. Where the rent paid is at the level of a full market rent, the relief is reduced to nil. Where the rent paid is less than market rent, the relief is restricted on a 'just and reasonable' basis (s 169P(2)).

Accordingly, if, say, Simon had let a factory to his personal company throughout the period he owned the asset at 50% of the market rent and he makes a capital gain on its disposal (which must, inter alia, be linked to a disposal of his shares in the company in question if it is to be an associated disposal (see s 169K(3)) his entrepreneurs' relief would be restricted as shown:

	(£)	(£)
Say, gain on sale of factory		1,000,000
Less: 50%		500,000
not eligible for relief		
		500,000
Gain eligible for relief	£500,000	
Less: entrepreneurs'	222,223	
relief (4/9ths)		
Balance		277,777
Assessable		777,777

The £500,000 balance of Simon's £1 million lifetime limit will be available against the gain arising on the disposal of shares in his personal company with which the property disposal is associated.

Partners and associated disposals

As regards associated disposals involving an asset previously provided by one or more partners in a partnership, there is a particular point to note.

This concerns the precise wording of the rent restriction operating in associated disposal situations. The restriction is found in s 169P(4)(d) and applies where 'for the whole or any part of the period for which the assets which (or interests in which) are disposed of are in use for the purposes of the business, their availability is dependent on the payment of rent'.

The question which arises is what constitutes 'rent'? What is the position if, say, an asset is owned jointly by two partners, A and B, out of a total of six equity partners and under the partnership arrangements there is an agreement that A and B will receive the first tranche of profits, being £50,000, to reflect the level of rent which would be payable for a similar property if the two partners were not making the property available? Does this arrangement constitute the payment of consideration which is to be regarded as rent? At first sight, an unwelcome answer for many partners (possibly putting a smile on the faces of their colleagues) is found in s 169S(5) which defines rent as including 'any form of consideration given for the use of the asset'. From this it would not be unreasonable to say that the profit-sharing arrangements do constitute consideration given for the use of the asset and for the entrepreneurs' relief to be restricted.

However, it is understood that, in most instances HMRC will not take this view, the motive behind the extended meaning of rent is to catch other payments dressed up to be something other than rent.

An iniquitous situation?

As regards associated disposals and the payment of rent, etc. a government minister has indicated (at the Report stage of the Finance Bill) that the Treasury will look again at the iniquitous situation currently found in the provision relating to past rents.

The pre-6 April taper relief provisions do not penalise a taxpayer for letting an asset to his personal company or to a partnership, but those same lettings *will* restrict entrepreneurs' relief — even if such rents were to cease with effect from 6 April 2008. The legislation requires entrepreneurs' relief to be restricted where at any time during the period of ownership of the asset it was in use in the partnership or the personal company. If the rent were to be waived from 6 April 2008, a restriction in the level of entrepreneurs' relief available will still apply as regards the previous rental payments.

Following consistent lobbying on this point the government have now relaxed this provision. Provisions in FA 2008 ensure that it is only the post 5 April 2008 rentals which restrict the relief.

What does this mean for business owners?

For some taxpayers the Entrepreneurs' Relief will be a very helpful extension to the proposed CGT rules and will mean they will retain the ability to be taxed effectively at 10% if they fulfill the relevant qualifying criteria.

For clients making gains in excess of £1m, then the relief will be of limited benefit (although better than nothing). Those who are losing the benefit of indexation will be hit particularly hard, particularly if they have seen increase in asset values, such as farmers. Prior to 6 April 2008 traders might have wanted to trigger a gain to bank their indexation and taper – full value incorporations were popular especially when combined with an SDLT mitigation scheme.

The question arises whether the vehicle they choose would benefit from the Entrepreneurs' Relief. Planning after 5 April 2008 is likely to focus around trying to use multiple limits.

Lecture B499 (12.13 Minutes)

Inheritance Tax and Trusts

Will trusts - are they still worth it?

Discretionary will trusts

The use of Discretionary Will Trusts (DWTs) in Will planning can be effectively used in conjunction with the newly available enhanced nil rate band (now £312,000 for 2008/09). This can double the amount of the joint estate of couples and civil partners that escapes an inheritance tax (IHT) charge.

IHT considerations should be an essential part of Will and succession planning, the aim of which is often to preserve as much wealth as possible for future generations of a client's family. However, in today's modern age, the nuclear family is far from the norm, and unusual or convoluted family structures are part and parcel of life in the UK today.

Major issue

One major issue that can have a significant impact on planning is the increased incidence of remarriage and of step-families. The use of carefully drafted Will trusts can, of course, help ensure the desired succession of assets, but what about assets that do not pass under a Will? Assets owned jointly, if owned under the legal tenet of joint tenants, will not pass according to instructions detailed in a Will, as they will automatically pass to the other joint owner(s) under the rule of survivorship. Property that is commonly owned as joint tenants includes bank accounts, joint life policies, and, of course, the family home, which is often the most valuable asset.

Example

Consider the following scenario, a couple jointly own a substantial property worth approximately £700,000. Mr X's Will directs that his half share is to pass to the couple's four children in equal shares. At the time of his death, Mrs X's will includes similar provisions, meaning that, on the death of both parents, the children could anticipate 25% each. Under the joint tenancy, Mr X's share will automatically pass to Mrs X rather than the children, so that she owns the whole property. Assuming a status quo, the children will, eventually obtain their 25% on the death of Mrs X. The value of the property will be wholly covered by two nil rate bands (assumed £350,000), so they will inherit free of tax.

But, consider if Mrs X, after a suitable period of mourning, is swept off her feet by a dashing bounder. He is young, wealthy, attractive and fertile, and has numerous children from a previous marriage. Mrs X remarries to become Mrs Y, sells the original family home to buy a country mansion with her new husband. Her children are concerned, but she shows them her redrafted will which specifies that her share of the property is to go to her four children. However, Mrs Y soon falls ill, and on her death, Mr Y becomes sole owner of the property. On his death, the whole property is split between the beneficiaries of his will, namely his 17 illegitimate children. Mr X's children will receive nothing.

Alternatively, Mrs X marries Mr Z, who is some years her senior and who owns company shares which do not qualify for Business Property Relief (BPR)?, but which produce a good income. He dies a couple of years after their marriage and leaves Mrs Z the shares worth £700,000 absolutely. Mrs Z is of good moral standing, and amends her will to ensure that the shares will pass to members of Mr Z's family and the original property will still pass to her own children. However, on her death, the maximum enhanced nil rate band she is entitled to is 200% of the current rate, assumed to be £350,000 x 2 = £700,000. She will inherit assets from both husbands free of tax, due to inter-spouse exemption, but on her death, she owns assets worth £1.4m, but only has £700,000 nil rate band available. Her children will therefore suffer tax at 40% on half of the value of their share, an effective 20% reduction in the value they receive.

Jointly owned assets

The issue of jointly owned assets can be simply addressed, and should always be done as part of an overall review of IHT and will planning requirements. Careful planning around second or subsequent marriages can avoid such potentially damaging pitfalls, particularly following the death of a former spouse.

There are also very effective tax planning measures that can be utilised in the situation where one spouse is anticipated to survive more than six months, but less than seven years, as in the case of the unfortunate Mr Z, which can retain more wealth for family succession.

Overall, the introduction of the enhanced nil rate band provides help to many but does not remove the need to think about Will planning.

Article by Francesca Lagerberg

Lecture P500 (7.22 Minutes)

Taylor and another v Revenue and Customs Commissioners SpC 704

The deceased lived with K in London. She had no children but she had a sister, M, who married P and had two daughters, S and PT. The daughters both married and had five children ("the grandchildren"). While he was alive K made it clear that he wanted the grandchildren to benefit when he died. K died in July 1996 and left all his real and personal property, including two building society accounts, to the deceased absolutely and appointed her to be the sole executrix of his will. Before her death on 27 December 2004 the deceased put the two building society accounts into the joint names of herself and P. The operating instructions for both the accounts were that any one signature was required and that, on a death, the whole account would pass to the survivor. Tax deduction certificates were issued to the deceased and P showing her as the first named account holder and P as a joint investor/beneficiary. Between May 1998 and April 2003 nine withdrawals were made from the accounts, mainly by the deceased. It was widely known within the family at that time that the monies in the building society accounts would at some point be for the benefit of the grandchildren. Under her will the deceased left all her property on trust for sale for the benefit of S and PT absolutely. At the time of her death the amounts in the accounts were £54,284·64 and £1,092·98 respectively. No inheritance tax was paid on those amounts. On 31 December 2004 P closed both accounts using the money therein to pay the deceased's debts and funeral expenses and £15,000 was given to S and PT for the benefit of their children and £3,000 was given to PT's eldest son. In December 2005 S wrote to HMRC asserting that K had wanted P to have his savings and had informed the deceased accordingly, and that P had agreed that the building society accounts should be in the joint names of himself and the deceased so that she would have access to the money at any time, although it belonged to him. On 18 June 2007 HMRC issued two notices of determination to P and S, the sole executrix of the deceased's will, which stated (1) the deceased was to be treated as beneficially entitled to the whole money in the joint accounts at the date of death; or, alternatively, (2) having regard to the provisions of FA 1986 s 102(1), (2) and (3), the disposal was a gift of property subject to a reservation and was deemed to be property to which the deceased was beneficially entitled immediately before her death. P and S appealed contending the monies in the two building society accounts belonged to P who had the power at any time to enjoy the monies or to withdraw them and close the accounts. HMRC argued (a) that the deceased had not held the accounts as trustee; (b) that as she had had a general power which enabled her to dispose of the whole of the accounts within the meaning of IHTA 1984 s 5(2) she was to be treated as beneficially entitled to the whole of the accounts; or, alternatively, (c) that if she had disposed of the whole accounts by way of gift to P, the accounts had not been enjoyed by P to the entire exclusion of her, and for that reason also the accounts were property to which the deceased was beneficially entitled immediately before her death.

The Special Commissioner found that the deceased did not hold the accounts as trustee. On the facts K left all his property to the deceased absolutely and there was no evidence of the establishment of any formal trust in favour of P. Nor was there any evidence that K had established a secret trust under which the deceased was to act as trustee for P, and had given K an undertaking that the accounts would be applied for the benefit of P or, at least, that there was an understanding to that effect between her and K. The evidence was that, while he was alive, K expressed the view that he

wanted the children and grandchildren of M and P to benefit when he died. There was nothing more certain than that. There was certainly no evidence that P was to benefit from the accounts. It was also relevant that after K's death and before her own death, the deceased did not apply all the money in the accounts for the benefit of the children or grandchildren, and at that time P did not benefit from the accounts. After the deceased's death the accounts were used partly to pay her debts and funeral expenses and partly to benefit the grandchildren. Thus the evidence did not support the assertions made in the letter of 2 December 2005 that M had wanted P to have his savings and had informed the deceased of that. Furthermore whilst there may have been some moral obligation, there was nothing amounting to a legally enforceable duty on the deceased to use the accounts to benefit the grandchildren.

The Special Commissioner found that the deceased had a general power which enabled her to dispose of the whole of the accounts within the meaning of IHTA 1984 s 5(2). The present case was not a case where the deceased retained ownership of the funds and P could have withdrawn money when he wished for the following reasons—the operating instructions were that any one signature was required and that on a death the whole of the accounts would pass to the survivor; the income tax deduction certificates were sent to both accounts holders; and, before her death, most withdrawals were made by the deceased. Neither was the present case where the deceased and P owned separate shares as tenants in common as it was clear that, if P had died first, the whole of the accounts would have belonged to the deceased. On the facts it was a joint account held as joint tenants beneficially. It was also clear that the deceased was able to dispose of the whole balance for the time being in the accounts. It followed that she was to be treated as beneficially entitled to the whole of the money in the accounts at the date of her death. It followed that the appeal would be dismissed.

Appeal dismissed.

Administration

ZXCV Ltd and others v Revenue and Customs Commissioners SpC 706

Between 13 September 2004 and 4 January 2005 R, a chartered accountant who had previously qualified and worked as a vet both in the United Kingdom and abroad, incorporated the 500 appellant companies with the intention of selling them as ready-to-go shelf companies with bank accounts and PAYE registrations to Australian veterinary locums coming to work in the UK. R's wife was the sole shareholder, and director, of each of the 500 companies and R was the secretary.

Bank accounts for 26 companies were opened, but applications for the remainder were refused because of concerns regarding money laundering legislation. None of the companies traded during the relevant period.

On 1 March 2005, according to the 500 petty cash sheets compiled by the wife, the "Cash In" columns for each appellant company had an entry of £1, detailed as "cash received"; and on 6 March 2005 the "Cash Out" column had 78p entered as "directors' remuneration", and 22p as "IR-PAYE".

The 22p of PAYE tax for each company was paid on 6 April 2005 out of R and the wife's bank account. On 6 March 2005 a "P35" for each of the 500 companies for the tax year 2004–05 was submitted online and R applied for incentive payments of £250 for each company under the Income Tax (Incentive Payments for Voluntary Electronic Communications of PAYE Incentive Returns) Regulations 2003, SI 2003/2495, as a "small employer". Regulation 1(4) defines a "small employer" as a person "treated as paying PAYE income to 49 or fewer recipients at the specified date", and a person would be so treated if "(a) he was required by the PAYE Regulations [the Income Tax (Employments) Regulations 1993, SI 1993/744] to prepare or maintain a deductions working sheet in respect of the recipient". HMRC made 33 incentive payments, 26 of which were paid to the companies with bank accounts and the rest were made to R personally. In December 2005 R advertised the companies, the value of which included the right to the £250 incentive payment, in the Australian Veterinary Journal, and the advert stated—"Start locuming before April 2006 using your own UK limited company and Her Majesty's Inland Revenue will give you $600 …" R sold 24 of the companies.

For the tax year 2005–06 tax year exactly the same details appeared in the 500 petty cash sheets—the date and amount of the "Cash In" were 1 March 2006 and £1 respectively and the date and the amount of the "Cash Out" were 6 March 2006 (78p) and 24 April 2006 (22p) respectively. R also filed "P35" returns electronically in respect of all 500 companies and again claimed incentive payments under the 2003 Regulations.

HMRC refused the remaining incentive payments on the grounds

(1) there was no evidence that the emoluments had been paid to the wife or that, if paid, they had been paid on 6 March 2005; or that there had been any authorisation of a payment to a director; and

(2) the companies had been established for an "impermissible purpose", within the meaning of reg 4(2B)(b)(ii), which—together with reg 2(2A)—was inserted into the 2003 Regulations by the Income Tax (Incentive Payments for Voluntary Electronic Communication of PAYE Returns) (Amendment) Regulations 2005, SI 2005/826, and came into force 19 March 2005.

Regulation 4(2A) states that an incentive payment would not be made where a small employer

(a) has been established,

(b) employs employees, or

(c) makes payments of PAYE income (within the meaning of section 683 of ITEPA 2003), wholly or mainly for an impermissible purpose."

And, under reg 4(2B)(b), a “a small employer is established for an impermissible purpose if it is established for the purpose of— … (ii) obtaining an incentive under these Regulations …”..

The companies appealed. R accepted that no cash had come in to the appellant companies in question and no cash had gone out, but he argued that the entries represented accruals of credits and debits, so that the wife became a loan creditor in respect of the 78p.

The companies contended

(a) they were each a small employer because they were required to prepare and maintain a deductions working sheet in respect of the wife;

(b) they were required to prepare and maintain such a development working sheet because the PAYE Regulations required the 78p and 22p for each year to be recorded as relevant payments and tax; and

(c) the 78p was a relevant payment for the years of assessment because they were earnings from the wife's employment with the company in question which had been credited in that year to her in the company accounts or records.

The wife did not give evidence. HMRC contended

(1) there was no evidence to support the companies' claim;

(2) even if such payments had in fact been made, they were not emoluments from employment with the company in question. For that reason the company in question did not qualify as a small employer because at the relevant date, it had not been required to complete or maintain working sheets, and there was no reason to pay PAYE income to the wife; and

(3) the companies were established for an “impermissible purpose” within the meaning of reg 4(2B)(b)(ii).

The Special Commissioner found that, for the purposes of the Income Tax (Incentive Payments for Voluntary Electronic Communication of PAYE Returns) Regulations 2003, reg 1(4)(a), the appellant companies were not “required by the PAYE Regulations” to prepare or maintain a deductions working sheet in respect of the wife. Rather it was R's project that artificially and voluntarily created a state of affairs designed to engage the requirements for each of the 500 appellant companies to maintain deductions working sheets. The reality was that any tasks the wife performed were carried out, not for any particular appellant company, but to advance R's project. On the facts there was no evidence that any of the appellant companies paid the wife the “cash out” amounts, or that the petty cash sheets recorded the wife as having been credited with the “cash out” amount as a loan creditor or at all. Nothing was ever paid out to the wife because the company in question had no money with which to make any payment. As the wife did not give evidence no findings of fact as to when the petty cash sheets were compiled could be made. Therefore the entries in the petty cash signified nothing—no money came in to the company in question and none went out. The petty cash sheets were compiled as an attempt to conjure up a movement of money when none existed. It followed therefore that there were, as regards each appellant company, no amounts that the PAYE Regulations required to be entered in their deductions working sheets. That conclusion was reinforced by the fact that there was no evidence that the wife had any earnings from any employments with any of the companies. She was a director, but that did not make the 78p, spread over the 500 companies, emoluments of hers (even if they had been paid or credited to her). Had the wife given evidence there would have been an opportunity to test her involvement as director of each of the 500 appellant companies; but as she had not there was no evidence that the wife earned anything by way of emoluments. As none of the companies had made out a claim for incentive payments for any of the years in question, the appeals would be dismissed.

The Special Commissioner considered that the expression “impermissible purpose” in the Income Tax (Incentive Payments for Voluntary Electronic Communication of PAYE Returns) Regulations 2003, reg 4(2A), as amended connoted some purpose which was alien to the evident purpose behind those Regulations. They were concerned with existing employers who, as the law stood, were not required to file their year end returns electronically but chose to do so voluntarily. The Regulations, with and without the insertions made in 2005, were not concerned with situations created to enable the likes of R to help himself to a free lunch.

Appeals dismissed.

Self assessment tax return—service companies question

The guidance relating to the service companies question on page TR4 of the 2007-08 Self Assessment tax return for individuals has been revised.

We acknowledge that with hindsight the question on the tax return and original guidance were unclear, for which we apologise.

Since concerns were first raised, HM Revenue & Customs (HMRC) has been working closely with representatives of the Institute of Chartered Accountants in England and Wales (ICAEW) and the Chartered Institute of Taxation (CIOT) to make the text of the question and the guidance clearer. We are pleased to announce that as a result of that collaboration we have now developed—

– clearer guidance in the tax return guide which should be read when completing the 2007-08 Self Assessment tax return and tax returns for future years; and

– revised wording for the service company question, which will first appear on the 2008-09 Self Assessment tax return.

The amended guidance is reproduced below. HMRC will shortly update the 2007-08 tax return guide (SA150) on the Self Assessment returns part of our website to reflect the new text.

The text of the revised question for 2008-09 is also reproduced below for information.

If you have already submitted your 2007-08 Self Assessment return

If you have already submitted your 2007-08 Self Assessment tax return, you do not need to take any action as a result of these changes. There will be no adverse consequences simply because you completed (or left blank) the question in a return filed prior to today's date.

Record keeping

It is not necessary to keep any additional records to determine whether more than half of the company's income was derived from services performed by the shareholders personally. Where the level of income derived from services performed by the shareholders personally is not readily discernable from existing records, best judgement should be used.

Updated guidance for 2007-08 onwards

SERVICE COMPANIES

Complete this box if you provided your services through a service company. You provided your services through a service company if—

– you performed services (intellectual, manual or a mixture of the two) for a client (or clients);

– the services were provided under a contract between the client(s) and a company of which you were, at any time during the tax year, a shareholder; and

– the company's income was, at any time during the tax year, derived wholly or mainly (that is, more than half of it) from services performed by the shareholders personally.

Do not complete this box if all the income you derived from the company was employment income.

Example

Services are provided through a service company as described above—

Salary received from the service company (before tax)		£15,000
from the service company		
Dividends received from UK companies (including tax credit)		
from the service company	£50,000	
from a shares portfolio	£ 5,000	£55,000
Total		£70,000
Amount to be entered (excluding the shares portfolio dividends) in the service companies box (box 1 on page TR4)		£65,000

Text of the revised question to be included on the 2008-09 Self Assessment tax return

If you provided your services through a service company (a company which provides your personal services to third parties), enter the total of the dividends (including the tax credit) and salary (before tax was taken off) you withdrew from the company in the tax year.

New guidance for letters of engagement

The main tax and accounting bodies have released a new guidance on letters of engagement for tax practitioners.

This replaces the guidelines issued in 2001, and it was the result of a major redrafting exercise.

It is designed to be user-friendly and more in line with commercial practices, and it is intended to be easily adopted with minimal modification by small practices.

The chairman of the joint organisations' working party that undertook the rewrite, Mark Lee, said: 'The professional bodies are confident that the updated guidance and engagement letter will be a practical and helpful tool for tax practitioners and their clients'.

A three-step approach has been adopted for the rewritten guidance and its accompanying draft letters:

1. Identification of the client and whose instructions will be accepted when, for example, acting for a couple, a family, a group or a partnership. There is also a summary of the basis on which fees will be charged, including any estimate or fee quote, and an indication of who is responsible for fees.

2. A schedule that sets out the practitioner's standard terms and conditions.

3. Further schedules that detail the nature and scope of the services to be carried out and the responsibilities of each party. The draft letters' schedules of service cover the most common recurring compliance work: personal tax for individuals, sole traders and couples; trusts and estates, partnerships, limited liability partnerships, corporation tax, payroll services, benefits in kind returns and payments of Class 1A NIC, VAT and other indirect taxes.
(A schedule for tax credit work will follow. There are also two schedules for non–recurring services: HMRC enquiries and ad hoc tax advice.)

Practitioners should not need to replace their existing engagement letters immediately. However, they are encouraged to review them annually and update as appropriate.

In case in which practitioners use the engagement letter and schedules developed by the joint bodies, they should adapt them to suit their practice.

Guidance on the practical effect of the Demibourne case

Background

The Special Commissioner's decision in the case of *Demibourne Ltd v HMRC* [2005] STC (SCD) 667 highlighted a number of tax issues for employers and their employees which can arise as a consequence of an employer's failure to operate Pay As You Earn (PAYE).

The Demibourne case confirmed that—

- Where an employment relationship exists, the employer is responsible for deducting tax from payments made to the employee in accordance with the PAYE Regulations.
- Prior to the amendment to the PAYE Regulations, HMRC did not have the discretion to choose whether to collect tax from the employer or the employee unless there has been a Direction to transfer PAYE to the employee under either Regulation 72 or Regulation 81 of the PAYE regulations.
- An employee is always entitled under Regulation 185 of the PAYE Regulations, to treat as deducted any tax that the employer was liable to deduct whether or not that tax was actually deducted. However Regulation 185(5) provides a restriction on the amount of credit so that the credit cannot generate a repayment out of tax actually deducted.

The decision meant that HMRC had to seek recovery of PAYE from the employer even if tax had already been paid by (or on behalf of) the employee under Self Assessment (SA).

The Income Tax (Pay As You earn) (Amendment) Regulations 2008 SI 2008/782

These Regulations are effective from 6 April 2008 and extend the limited circumstances where HMRC may make a direction to transfer an outstanding PAYE liability from an employer to an employee in circumstances where—

- the employee received a payment from which the employer should have deducted or accounted for tax under PAYE and failed to do so;
- tax on that payment has been included in the employee's SA;
- no SA has been made but tax has been paid as SA payments on account; or
- tax has been deducted as a sub-contactor deduction.

The process outlined in this guidance must be followed in all cases.

Considering a direction

In order to make a direction and transfer liability to the employee the conditions of regulation 72E must apply. These conditions include an employee having received a payment (including a notional payment) on which PAYE should have been operated and one of the following conditions having applied:

Condition A – it appears that the amount which the employer was liable to deduct under PAYE from the relevant payment (or in the case of a notional payment, from other relevant payments) exceeds the amount actually deducted.

Condition B – it appears that the amount for which the employer was required to account under regulation 62(5) (notional payments) in respect of the relevant payment exceeds the amount actually accounted for.

Condition C – tax on the relevant payment was included in a determination under Regulation 80 (determination of unpaid tax and appeal against determination) and the full amount of the determination is not paid within 30 days from the date on which the determination became final and conclusive.

In what circumstances would HMRC consider a direction

The guidance gives a number of examples where HMRC would and would not consider a direction.

for those years.

Action to be taken by HMRC where a Regulation 72F direction may be appropriate

Once it has been established that a PAYE failure has occurred, HMRC will consider whether a Regulation 72F direction is required. The employer is not obliged to formally apply for a direction.

HMRC will calculate the gross amounts of the additional liability.

HMRC will decide whether the conditions for making a direction apply. They will determine whether an amount intended to represent tax on the relevant payment—

- has been included in the employees SA as Income tax;
- has not yet been included in the employee's SA but has been paid as a SA payment on account of Income tax; or
- as a sub-contactor deduction.

Unless the tax is self-assessed by an individual under Section 9, the tax cannot be directed – this will exclude Corporation Tax as that can never be included in an individual's self-assessment.

HMRC may need to exercise best judgment in making a direction as the PAYE due figures will not necessarily equate to the amount of tax self assessed or paid by the employee under SA.

Trigger Letter of Offer (72E – Trigger Events -5(d))

Once HMRC have agreed the gross PAYE tax liability with the employer they will consider whether there may be scope to make a direction to relieve some or all of the liability. If HMRC consider there is scope to make a direction they will point out to the employer that even if a direction is made, the employee has a right of appeal against the direction but that the employer has no such right.

Due to confidentiality HMRC will not disclose to the employer any details of the individuals' self-assessment.

Effect of a direction on an individual employee

The main effect of the direction as far as the employee is concerned will be to restrict the employee's ability to claim a PAYE credit by an amount equal to the amount of tax specified in the direction. The changes to the PAYE Regulations from 6 April 2008 include a change to Regulation 185 to ensure that tax which is subject to a direction under Regulation 72F cannot be included in an adjustment for tax treated as deducted in a self assessment.

Making a Direction

A direction must be made in writing as a notice to both the employer and the employee stating—

- the date the notice was issued;
- the amount (or amounts) within regulation 72E(1)(b) to which it relates; and
- in the notice to the employee, which of conditions A, B and C in Regulation 72E are met.

Appeals

Employers have no right to appeal despite the fact that they are served notice of the 72F direction.

An employee has the right of appeal against a direction on the grounds that—

- they did not receive a relevant payment;
- the tax specified in the direction is incorrect because an amount of tax in respect of the relevant payment or payments in question has not been assessed in a SA, or paid on account towards a SA, or deducted as a sub-contractor deduction;

- a trigger event occurred before 6 April 2008; and
- no trigger event has occurred on or after 6 April 2008.

National Insurance Contributions

There are no corresponding amendments required to the National Insurance contributions Regulations as HMRC already have the legal authority to set off wrongly paid Class 2 and 4 contributions against Class 1 (employee) contributions properly payable. Below is the process for dealing with Class 4/ Class 2 NICS.

Directions under Reg. 72(5)

A Regulation 72F direction should be considered to avoid the situation where HMRC are seeking recovery from the employer when the employee has received a relevant payment and it appears that an amount intended to represent tax on the payment has been self-assessed or has not been self-assessed but payments on account have been made. A direction under Regulation 72(5) or Regulation 81(4) applies in different circumstances. A Regulation 72F direction must be considered before a Regulation 72(5) or 81(4) direction.

Cases where the employer is not responsible for operating PAYE

An employer without a UK “tax presence” is not responsible for the operation of PAYE.

Section 689 ITEPA, provides measures which enable HMRC to require someone who is not the employer of an employee, but for whom the employee works, to account for PAYE on that employee's earnings.

This requirement applies automatically if the PAYE regulations do not apply to both the actual employer and, if different, the person who pays the employee (unless the payer operates PAYE regardless).

Although an individual must always include employment income on the relevant pages of his SA return he has no entitlement under Regulation 185 unless his employer or the entity for which he works was required to operate PAYE.

Earnings paid to someone other than the employee

Where earnings were paid to someone other than the employee, for example a limited company, then unless Extra Statutory Concession A37 applies, the tax and NICs must be recovered from the employer in full.

A direction cannot be made against a limited company. One can only be made if an individual has self-assessed the relevant income under Section 9 of TMA (personal return).

Value Added Tax

Where an individual has been registered for VAT and is subsequently re-categorised as an employee then, unless the individual is otherwise in business, the registration becomes an invalid registration.

If the registration is invalid the registration should be cancelled following the procedure in V1 – 28 Part 1 section 39 “Invalid Registration”.

The VAT account can be cleared by, either—

- A refund to the trader, subject to the defence of unjust enrichment where appropriate.
- Recovery of an amount from the trader.

Business Tax

CIS – an update

New de minimis Regulations

Regulations have been released to change the construction industry compliance requirements by introducing a de minimis of £100. The effect of this is to permit contractors to meet the compliance conditions even where there have been late payments of tax, provided the amounts paid late do not exceed £100. This will alleviate the position for contractors who have paid tax very slightly late (but within the tolerance allowed by the compliance rules) and incurred a small interest charge which has remained unpaid for some time. This would cause the contractor to lose gross payment status, but the new rules allow this to be ignored.

New compliance checking process

In order for the subcontractor to be registered for gross payment he must meet a number of conditions. The conditions are set out in detail in Schedule 11 to the Finance Act 2004.

Essentially Schedule 11 falls into three parts :

- Part 1 sets out the conditions applying to individuals;
- Part 2 sets out the conditions applying to firms (the individual partners will also have to satisfy either Part 1 or Part 3 depending on their status), and
- Part 3 sets out the conditions applying to companies.

Thus a company which is a member of a partnership would have to satisfy Part 3, and the firm as a whole would also have to satisfy Part 2. However, the individual qualifying tests in this case are the compliance test only.

Registration for Gross payment will only be made when the applicant has satisfied HMRC that they have maintained compliance with all aspects of tax obligations for a specified period of time. The "qualifying period" was reduced to the period of 12 months ending on the date of the application by the new scheme, implemented in April 2007. In summary the compliance test requires that :

"4 (1) The applicant must, subject to sub-paragraphs (3) and (4), have complied with—

> (a) all obligations imposed on him in the qualifying period by or under the Tax Acts or the Taxes Management Act 1970, and
>
> (b) all requests made in the qualifying period to supply to the Inland Revenue accounts of, or other information about, any business of his."

(Para 4 Sch 11 FA 2004)

Permitted breaches

The legislation allows for some breaches to be ignored in determining whether the compliance conditions have been met during the relevant period. When a subcontractor's compliance record is reviewed for a period of 12 months, the following breaches will be overlooked. The criteria are specified in the legislation :

Table 3

1. Prescribed obligations	*2. Prescribed circumstances*
Obligation to submit monthly contractor return within the required period.	(1) Return is submitted not later than 28 days after the due date, and (2) the applicant or company— (a) has not otherwise failed to comply with this obligation within the previous 12 months, or (b) has failed to comply with this obligation on not more than two occasions within the previous 12 months.
Obligation to pay— (a) the amount liable to be deducted under section 61 of the Act from payments made during that tax period, (b) tax liable to be deducted under the PAYE Regulations.	(1) Payment is made not later than 14 days after the due date, and (2) the applicant or company— (a) has not otherwise failed to comply with this obligation within the previous 12 months, or (b) has failed to comply with this obligation on not more than two occasions within the previous 12 months.
Obligation to pay income tax	(1) Payment is made not later than 28 days after the due date, and (2) the applicant has not otherwise failed to comply with this obligation within the previous 12 months.
Obligation to submit a return under regulation 73, 74 and 85 of the PAYE Regulations (annual returns) within the required period.	Return is submitted after the due date.
Obligation to pay corporation tax for which the applicant or company is liable	(1) Payment is made not later than 28 days after the due date, and (2)any shortfall in that payment has incurred an interest charge but no penalty.
Obligation to submit a self-assessment return within the required period.	Return is submitted after the due date.
Obligations and requests referred to in paragraphs 4(1), 8(1) and 12(1) of Schedule 11 to the Act.	The failure to comply occurred before the appointed day and was within section 562(10), 564(4) or 565(4) of ICTA (conditions to be satisfied: minor and technical failures).

A subcontractor may also be excused a breach if he can show that he has a reasonable excuse for the failure :

"(4) An applicant or company that has failed to comply with such an obligation or request as is referred to in sub-paragraph (1) is to be treated as satisfying the condition in that sub-paragraph as regards that obligation or request if the Commissioners for Her Majesty's Revenue and Customs are of the opinion that—

(a) the applicant or company had a reasonable excuse for the failure to comply, and

(b) if the excuse ceased, he or it complied with the obligation or request without unreasonable delay after the excuse had ceased."

The rules are better described in Fact Sheet 343 (which is available in a number of foreign languages, including Polish) :

"To pass the compliance test, you and any business partners (or your company and each of its directors) must, during the 12 months up to the date of the application, have done all of the following.

- Completed and returned all tax returns sent to you.
- Supplied any information to do with your tax that we may have requested.
- Paid by the due dates
  - all tax due from yourself or the business
  - all your own National Insurance contributions (NICs)
  - any PAYE tax and NICs due from you as an employer
  - any deductions due from you as a contractor in the construction industry."

"When considering whether you have passed the compliance test, we will disregard, during the same 12 month period, any or all of the following:

- Three late submissions of the monthly return – up to 28 days late.
- Three late payments of CIS/PAYE deductions – up to 14 days late.
- One late payment of Self Assessment tax – up to 28 days late.
- Any employer's end of year return made late.
- Any late payments of Corporation Tax – up to 28 days late, including where any shortfall in the payment has incurred an interest charge but no penalty.
- Any Self Assessment return made late.
- Any failures classed as 'minor and technical' in relation to your obligations under the old Scheme, where these fall within the 12-month period up to your application."

Cancellation of registration for gross payment

This provision is contained in Section 66 of FA 2004. HMRC may at any time make a determination cancelling the registration for gross payment if it appears that:

(Sub section (1))

- If an application were made for gross payment at that time it would be refused,
- He has made an incorrect return or provided incorrect information under this legislation or any related regulations, or
- He has failed to comply with any provisions under this legislation.

(Sub section (3))

- He became registered on the basis of false information
- He has fraudulently made an incorrect return or provided incorrect information under this legislation, or

- He has knowingly failed to comply with any provision under this legislation.

The registration will then be cancelled with effect from the end of the prescribed period (which is set by Regulation 26 as 90 days from the date of the notice) after the making of the determination for sub section (1) and with immediate effect under sub section (3).

Where a gross payment registration is cancelled under sub section (1) the person will automatically be registered for payment under deduction, and thus obtain the benefit of the lower rate of deduction. Where the cancellation is under sub section (3) the Board **may** register the person for payment under deduction if it thinks fit. Otherwise the person will be liable to deduction at the higher rate.

Once the registration for gross payment has been cancelled, the former holder cannot re-apply for gross payment registration for a period of one year after cancellation takes effect.

Practical application – the Tax Treatment Qualification Test (TTQT)

There is no longer a requirement for subcontractors to renew their registration for gross payment periodically. This is because HMRC will review their compliance record at least once a year to check that they have met the compliance conditions. If they have breached the conditions beyond the permitted exceptions listed in Table 3, then Section 66 allows the officer to issue a determination removing the subcontractor from gross payment status – he will then be subject to tax on any payments ha receives after the period allowed for appeal.

This periodic review process was implemented in October 2007, and is known as the Tax Treatment Qualification Test or TTQT.

Under this process, in the first week 1/52 of gross registered subcontractors were selected for scrutiny at random. Their tax compliance over the previous 12 months (the shorter period introduced under the new Scheme) is then looked at and if they have unacceptable breaches they receive a determination moving them to net status and notice of right of appeal.

In the following week a further sample of 1/51 of the remainder are checked and so on until all gross registered subcontractors have been checked over the course of a year.

The process then starts again with a random sample of one twelfth. So every gross registered subcontractor gets looked at every year, but it is not necessarily a year between compliance checks – it is anything from one month to two years. That way, nobody knows when they are being (or will be) checked.

The breaches of tax compliance can arise in almost any area but not VAT, oddly, as the legislation was written when the Inland Revenue was still separate from Customs and Excise. Looking at this, you will see immediately that if your client was one of the businesses which failed to send in any new monthly CIS returns at all by the end of September 2007, then as soon as his "number comes up" for TTQT he will be reclassified as net, for submitting at least 5 late returns. Many subcontractors are also contractors, so this is a real risk.

This is where the £100 de minimis comes in. For example, a subcontractor may pay his self assessment tax one day late. That breach is within the exceptions, so it will not cause him to lose gross payment status. However, the resulting small interest charge would not be chased for payment by HMRC as it is too small. HMRC's policy would be to collect that amount when the next tax instalment falls due. However, as this amount of maybe a few pounds is then paid more than 28 days late – and indeed is technically the second late payment of self assessment tax, this will trigger loss of gross payment status for the subcontractor.

Appeal

The grounds of appeal is that the subcontractor has "reasonable excuse" for his failure, unless you can show that there has not been a failure. To establish this you will need to know exactly what breach is the fatal one so that you can consider whether he has sufficient grounds of appeal. You will need to lodge this within 30 days and the change in tax status does not take effect until after the period allowed has expired or the appeal has been determined.

Mitigation

For those who lose their gross payment status, the cash flow impact can be a disaster, and may even bring the business down. Are there any other mitigating steps you might consider? You might improve things by incorporating the client, provided he has some staff or subcontractors of his own.

In this case, the CIS tax suffered can be set off against CIS or PAYE / NIC due each month, thus eroding the loss of cash flow. For an unincorporated business no such set off is possible, as the tax suffered is set against the eventual liability for the year, so he must wait for the credit. However, this will not save everyone.

Any business facing making gross subcontractor payments out of net receipts is quite clearly in serious financial trouble. There is good evidence to suggest that this issue will become quite widespread as time goes on.

Article by Rebecca Benneyworth

Taxpayer loses in *Dragonfly Consultancy* - what does it mean?

Employment status continues to be an issue that fills up court time. The case of *Dragonfly Consultancy v HMRC* received a lot of publicity when it was heard at the Special Commissioners and in itself was a good case to read if you wanted to get up to date on recent employment status cases, plus older ones that still have a relevance (see SpC 655). The facts were based around the controversial IR35 (intermediaries legislation) rules. The case has now reached the High Court [2008] EWHC 2113 (Ch). although once again the taxpayer has lost.

The facts

Dragonfly Consultancy Ltd employed its owner, an IT consultant. Dragonfly contracted with an agency, which in turn had a contract to supply workers to an end client (the AA). The Special Commissioners held that had the consultant been in a direct contractual relationship with that client it would have been an employment relationship. Therefore IR35 applied. Dragonfly appealed.

In dismissing the appeal the Court made some interesting comments. Firstly, it found that the Special Commissioners were entitled to find that the substitution clause in the consultant's notional contract with the client would not have been such as to preclude an employment relationship. The substitution clause retained the right for the client to reject substitutes. The High Court also held that the Special Commissioners were entitled on the facts to hold that the degree of control exercised by the end client equated to that under an employment contract and the taxpayer had not provided sufficient evidence otherwise. Dragonfly Consulting is left facing a tax bill for £99,000.

Analysis

This case has been long awaited and there are strong views on either side about the facts. Some would argue that there was limited evidence that the taxpayer was really working on his 'own account' and others contend that he was patently distanced from the AA and working for himself. However, what is clear is that the facts as brought out failed to convince the Special Commissioners and the High Court that the taxpayer was outside of IR35.

One element of this was the inability of the taxpayer to show that he had a genuine substitution clause and it once again shows that although it is not technically essential, it certainly helps if those with such a clause in their contract use it on at least one occasion to show that it is capable of being used.

At the Special Commissioners decision in *Dragonfly Consulting Ltd* the following were the types of issue that may be relevant in determining IR35 questions:

(a) does the taxpayer provide his or her own equipment?

(b) does the taxpayer hire his or her own helpers?

(c) what degree of financial risk does the taxpayer bare and what opportunity for profit does the taxpayer have?

(d) what degree of responsibility for investment and management does the taxpayer have?

(e) is the taxpayer part and parcel of his or her 'employer's' organisation (see *Hall v Lorimer*);

(f) the **degree** of control to which the taxpayer is subject (rather than the mere existence of a right of `control');

(g) termination provisions – termination on notice may be a pointer towards employment in some cases (it was found to be so in *Morren v Swinton* (1965) 1 WLR 576 but found to be neutral in *McManus v Griffiths* 1997 70 TC 218);

(h) the intention of the parties.

Article by Francesca Lagerberg

Lecture B496 (10.02 Minutes)

Peter Eley Partnership v Revenue and Customs Commissioners SpC 705

The appellant appealed on behalf of the partnership against amendments to the partnership accounts for the years 2001-02 and 2002-03 on the basis that his three grandchildren, aged ten, nine and two during the 2001-02 tax year, were partners in the partnership. In his statement of case the appellant stated that the partnership bankers were informed by telephone that the grandchildren were partners, and the amount owed to creditors was small. In notes of a meeting the appellant also stated that the two older children worked one to four hours per week. At a directions hearing on 28 December 1997 the Special Commissioner directed that as the appellant had failed to provide witness statements, no witness evidence would be permitted without the leave of the tribunal. A week before the appeal, the appellant informed the tribunal that he was proposing to withdraw his appeal. However, he did not withdraw, or appear at, the appeal. At the hearing HMRC contended that (a) there was no evidence that the grandchildren were partners; (b) that penalties for breach of the directions should be imposed on the appellant, on the ground that he never provided any witness statement or skeleton argument; or (c) the tribunal should impose costs under the Special Commissioners (Jurisdiction and Procedure) Regulations 1994, SI 1944/1811, reg 21(1), on the basis that the appellant had acted "wholly unreasonably in connection with the hearing".

The Special Commissioner found that there was no evidence to support the contention that the grandchildren were partners in the partnership. Their names were not on the partnership notepaper which listed the adults only, the partnership bankers were not aware that they were partners, nor were any of the partnership creditors, there was no partnership agreement and there was no evidence that the grandchildren acted as partners. Only the accounts and tax returns showed them as partners. That fell far short of evidence that that they were partners. The appeal would be dismissed.

The Special Commissioner considered in the circumstances that he should not award any penalty which would be mainly for failure to provide skeleton arguments.

The Special Commissioner considered that he was minded to award the costs of the whole proceedings and, unless the appellant provided an explanation of why he neither withdrew his appeal or appeared at the hearing, to find that he had behaved wholly unreasonably in connection with the hearing. There was a suspicion that the appellant, having provided his statement of case, never intended to take any further action. If that was the case, he should have withdrawn the appeal. The failure to attend the appeal was disruptive both to HMRC and to the tribunal. The appellant had seven days from the release of the decision to make written representations against the making of a costs order in favour of HMRC, following which a decision on the award of costs would be made.

Appeal dismissed.

Corporation Tax

Recession-proofing clients: cash conservation for corporates/businesses

In tighter economic times, clients will be more focussed on cash flow and ways of holding on to their cash for longer, or getting it in quicker. Below are some basic tax ideas for improving cash flows.

As ever there are other considerations to think about. For example, if the action gives rise to a repayment, the new Finance Act 2008 rules that allow set off between different taxes must be considered as the client may not receive the cash expected and may simply have the refund set off against another tax liability. Also some of these ideas may depend on the accounting treatment being appropriate and so clients will need to know sooner rather than later if there is an impact on the accounts.

So here is an aide memoire of issues that you may want to talk to your clients about:

Research & Development (R&D) tax relief

Extension of small and medium sized enterprise (SME) definition, makes enhanced deductions and payable credits available to larger companies, ie

- fewer than 500 employees
- annual turnover not exceeding €100m **and/or** balance sheets not exceeding €86m

Share schemes

Pay rises in equity - Enterprise Management Incentives (EMI) or Joint Share Ownership Plan (JSOP) if not EMI qualifying.

If a company does not qualify for EMI (eg controlling corporate/Venture Capital investor, > 250 employees or individual) then consider other options eg

- flowering share scheme - private companies
- JSOP - public companies.

Review payments on account (POA) and quarterly instalment payments (QIPs)

Detailed profit calculations to minimise POA

Repayments may be available if profits turn into losses

Avoid being caught in the QIPs regime - ideas include:

- change accounting periods (SI 1998/3(6)(b)) and lengthen 'grace periods'
- post acquisition review hive up strategy to ensure activities moved do not push recipient companies in to QIPs
- 'manage' profits to keep company out of QIPs (bonuses, capital allowances, specific provisions, transfer pricing).

Interest to foreign parent deductible on accruals basis

Consider interim changes to late interest rules in order to claim deductions earlier

Tax favoured capital allowances (CAs)

Enhanced CAs on energy saving and water saving equipment (plus claim payable credits for loss making companies)

- R&D allowances on equipment used for R&D at 100%
- Consider timing of capital expenditure to maximise availability of the Annual Investment Allowance

Long life assets v standard CAs	Review expenditure and accounting to maximise 20% allowances and minimise long life assets at 10%
Short life asset elections	Accelerate tax deductions
VAT - cash flow planning	Manage VAT payments, think about accruals and VAT grouping.
Transfer pricing (TP)	Move cash within the group through appropriate TP Manage tax rates through appropriate TP
Provisions - FRS12	Ensure provisions are compliant with FRS12 to get a tax deduction - often the client struggles to provide sufficient information.
Decontamination costs	150% relief for costs of decontamination, especially developers of brownfield sites
Bonus provisions paid within 9 months	Defer bonuses by up to 9 months post year end - to ensure deductions, pay within 9 months
Loss carry-back	If the current year is loss making then submit returns as soon as possible to generate a repayment of tax Any scope for provisional repayments if management accounts showing loss in current year?
Employee remuneration packages	It should be possible to restructure the pay and benefits package in a cost and tax-efficient way, while at the same time ensuring that employees are properly remunerated and rewarded for their efforts – not just in terms of salary but via other benefits, such as flexible working and additional holidays
Online filing and payment of PAYE and VAT	Online filing and payment of VAT and PAYE can extend the deadline for payment by a few days

Article by Francesca Lagerberg

Lecture B497 (8.30 Minutes)

Tax implications when a company lends money to a director

Directors have commonly 'borrowed' funds from their companies. What are the various tax implications of loans to directors?

Company law

To give an overview – it is not possible for a company to make a loan to a director or indeed to provide a guarantee or security in respect of a loan without approval by way of a resolution from the members of the company.

Naturally there are a number of exceptions, for example providing funds to the director to enable him to meet expenditure incurred by the company where that expenditure does not exceed £50,000.

Consequences of loans to directors

Both the director and the company suffer tax consequences of loans being made or indeed written off. The relevant provisions relating to the director's tax position are contained in the 'benefits code' and for the company within TA 1988, s 419 to s 422.

The director's tax position

Where a director obtains an 'employment related loan' and that loan is a 'taxable cheap loan', the cash equivalent of the loan is treated as earnings for that year subject to a number of exceptions.

These provisions do not apply to a loan in any tax year where the loan itself would have been a qualifying loan.

The rules apply equally to an overdrawn director's loan account.

To cover the position of smaller loans there is a de minimis exemption where the amount is not treated as earnings, provided the loan does not exceed £5,000 at any time during the tax year.

Additionally, expense advances are ignored provided the maximum amount outstanding does not exceed £1,000, the advances are spent within six months and the employee makes regular accounts to his employer evidencing the expenditure.

Calculation of the interest

There are two methods of calculation permitted, the 'normal averaging method' and the 'alternative precise method'. The normal averaging method is used except where HMRC require the alternative method or the individual concerned elects to use it. Notice must be given within twelve months of the self assessment filing date for the particular tax year concerned.

The benefit is reportable on the employer's form P11D for the year and Class 1A National Insurance contributions are payable by the employer at 12.8% on the cash equivalent with the director paying tax through his self assessment.

Loans subsequently written off

A loan ceases to be outstanding on the death of the director, but what of the situation where the employer decides to write the loan off?

Where a loan is written off, the director is no longer obliged to repay this and a tax charge will arise irrespective of the terms of the loan that has been written off.

Generally, any of the amount written off is taxable as income of the employment in the year it is written off; but for controlling director/shareholders special rules apply preventing the company from having a deduction against tax and treating the amount written off as a distribution.

National Insurance contributions should operate on the amount written off even if it is a shareholder loan.

The company's tax position

Additionally, there are tax implications for the company if it is a close company and the director is a 'participator' or associate of a participator.

Where such a loan is made, the company must notify HMRC within twelve months of the accounting period end in which the loan is made and must pay a 25% tax charge on the amount of the loan or indeed the balance of the overdrawn loan account if one exists.

Any tax found to be assessable is payable nine months after the end of the accounting period in which the loan is advanced unless the loan is repaid prior to this date.

It is possible for companies to claim a repayment of this s 419 tax if the loan has been repaid before the tax payment date, or by set off if the loan is repaid before the nine-month payment date.

However, if the loan is not paid by the repayment date, it will not be recoverable until nine months after the end of the period in which it is repaid.

Overdrawn loan accounts

It is often the case that a director's loan account is overdrawn and the company has an obligation in accordance with UK by the year end to pay further remuneration which will eventually be used to clear the balance.

The accounting entries will show 'debit director's remuneration and employer's National Insurance contributions' and 'credit accruals' provided the relevant accounting standards requirements are met for a valid liability to be recorded.

This additional remuneration is not, however, available to the director in accounting or tax terms at this stage and is not a credit to the director's loan account. If we assume that the accounts are prepared within the next three months and the quantum of the bonus then ascertained followed by a board meeting affirming the bonus, it will be at that point that the remuneration will be available and hence subjected to PAYE in the hands of the director and the credit recorded.

Paid and available

The misconception that remuneration is credited against the loan account, in this example, at the year end rather than when available can lead to significantly incorrect calculations of beneficial loans, s 419 tax and PAYE deductions.

It would also be best advice to have a board meeting with actions formally minuted before the year end evidencing the intention to pay a bonus, otherwise HMRC may argue that remuneration may not be deductible in calculating the taxable profit for the period.

If the board's actions make the additional remuneration available to the director, it should also allow earlier credit to the director's loan account, but will hasten the payment of PAYE.

For completeness sake, it should be noted that it may also be possible to clear a director's loan account by voting a dividend rather than paying remuneration, provided the company has sufficient distributable reserves to do so.

From an article by Penny Bates

Interest treated as a distribution—deduction of tax at source

This Brief sets out our policy on deduction of tax at source from interest that is treated as a distribution under ICTA 1988 s 209(2). It will be relevant to companies that issue securities, and their professional advisers.

ICTA 1988 s 209(2) sets out particular circumstances in which all or part of the interest paid by the issuer of a security is treated as a distribution for Corporation Tax purposes. The company cannot claim a tax deduction for interest that comes within the statutory provisions concerned. In the hands of a UK recipient, it is taxed as if it were a company dividend – not as interest.

A company paying yearly interest may be required by ITA 2007 s 874 to deduct income tax at source from the payment. Deduction of tax at source is not, however, required in respect of any interest that is treated as a distribution.

Some commentators have suggested that when ICTA 1988 s 349 – the previous statutory provision dealing with deduction of tax at source – was rewritten as ITA 2007 s 874, there was a change in the law. Section 349(2) previously referred to yearly interest "which falls with ITTOIA 2005, Pt 4, Ch 2 ... or which is chargeable to corporation tax under Case III of Schedule D ...". Concern has been expressed that the absence of any corresponding words in s 874 means that the requirement to deduct tax at source has now been extended to all yearly interest – even where it is treated as a distribution and therefore does not fall within the taxing provisions that deal with interest.

This is not our view. The question of whether the words in ICTA 1988 s 349(2) were necessary was discussed as part of consultation on drafts of what is now s 874. The conclusion reached, in conjunction with consultees, was that they were not.

The purpose of s 874, like its predecessor legislation, is to require income tax to be withheld from payments that have the character of interest – in other words, which fall to be treated under the UK tax rules as interest. Once ICTA 1988 s 209(2) treats a payment as a distribution, it no longer has that required character—it is not "yearly interest" to which s 874 applies. No withholding is therefore required.

Thus, in our view, the law operates as it has always done, and there is no requirement to deduct tax at source under ITA 2007 s 874 from interest that is treated as a distribution

HMRC Brief 47/2008 26 September 2008

Enquiry window changes – dealing with large and medium-sized groups

FA 2007 changed the rules about when HMRC can open an enquiry into individuals' and companies' self assessment tax returns (the "enquiry window"). The general effect of the changes is that where a return is delivered early, the enquiry window will close sooner – 12 months after the date of delivery, rather than 12 months after the statutory filing date.

This change was recommended by Lord Carter of Coles, in his March 2006 "Review of HMRC Online Services". The intention is to remove a disincentive to early filing. It is hoped that the change will result in more taxpayers delivering their tax returns before the statutory filing date. For more information, see "Enquiries into Company Tax Returns" on the HMRC website – www.hmrc.gov.uk/ctsa/enquiry.htm.

The rest of this note relates to corporation tax only, not to Income Tax Self Assessment. Specifically, it sets out an operational practice HMRC will adopt in relation to groups of companies.

Companies that are members of a group which is not a "small group" in Companies Act terms are excluded from the change to the enquiry window mentioned above. So by law, HMRC will still be able to open an enquiry into the company tax return of any member of a large or medium-sized group up to the anniversary of the statutory filing date, however early the return is delivered.

However, HMRC is keen to encourage these larger companies to file early where it is possible for them to do so. We have discussed this with consultative groups and representative bodies, who have told us that it would encourage earlier filing if HMRC were able to offer an operational practice on the lines explained in this note.

More Detailed Background

Best practice in all areas of HMRC is to carry out any risk review of returns, and to open formal enquiries, where it is appropriate to do so, as early as possible within the resource and other constraints applying, and subject to programmes of work on particular sectors and compliance issues. However, while the statutory time limit for giving notice of enquiry should not normally determine when a compliance intervention is started, it gives the assurance that a company's tax affairs are normally settled once the date is passed.

FA 2007 s 96(3), (4) and (6) amends FA 1998, Sch 18, para 24 ("Para.24"). The effect is that for most companies which file their company tax return before the statutory filing date, the enquiry window will close sooner so they will benefit from earlier certainty about their tax liability. For returns relating to accounting periods ending after 31 March 2008, HMRC will have to decide within 12 months of the date of delivery of the return whether to exercise its power to enquire into the return, instead of having until the anniversary of the statutory filing date. There is more detailed information about this in the HMRC Enquiry Manual at EM1510/1511 – www.hmrc.gov.uk/manuals/emmanual/EM1510.htm. You can access this guidance on the HMRC web site.

However, this change does not apply to any company which is a member of a group that is not a "small group" by the definition in CA 2006 s 383. So Para.24 still allows HMRC up to 12 months from the statutory filing date to give notice of enquiry into a company tax return for a period ending after 31 March 2008, where the company is a member, during the return period, of a group which meets two of the following three criteria—

- The group's aggregate turnover is greater than £5.6 Million net or £6.72 Million gross.
- The group's aggregate balance sheet total is more than £2.8 Million net or £3.36 Million gross.
- The group's aggregate number of employees is more than 50.

The CT600 return form requires companies to self assess whether they are within this category or not. Where the company is a member of a large or a medium-sized group, it is required to put a tick in the "Company part of a group that is not small" box on page 1 of the return form.

HMRC's risk assessment of any company's return must take account of the economic realities of the company's activities. Larger groups of companies present particular tax compliance issues, which mean that we often need to review the affairs of the group as a whole. We are also able to offer better customer service by dealing with group issues together. Discussions with business and its agents have confirmed that it is helpful to all sides if risk appraisal and assurance work is coordinated across the group, and that a common enquiry window across the group facilitates this. Consultation also suggested that few larger groups are likely to be in a position to file their returns much before the statutory filing date.

Nevertheless, discussions with representative bodies have confirmed that it would be helpful to all sides if HMRC were able to put processes in place to encourage these larger groups to file early, where they are able to do so. HMRC has therefore agreed the following guidelines. Compliance assurance staff in those parts of HMRC which deal with these sorts of businesses have been told about these guidelines, and will bring them into effect in relation to relevant company tax returns.

Operational Guidelines

Where it is practical to do so, our aim is to open all enquiries into a group's returns within 12 months of the delivery of the last individual company tax return from any member of that group. In the rest of this note, this is referred to as "the group anniversary target".

EXAMPLE

A Ltd, B Ltd and C Ltd are the members of a group. They all have the year to 31 December 2008 as an accounting period. Their joint turnover for 2008 is £23 Million. The group's balance sheet value is £10 Million. So irrespective of the number of employees, the group is not a "small group" in Companies Act terms.

The companies deliver their company tax returns on the following dates—

- A Ltd 23 September 2009
- B Ltd 14 August 2009
- C Ltd 9 October 2009

The statutory filing date for each company is 31 December 2009. So Para.24 allows HMRC until 31 December 2010 to give notice of enquiry into any of these returns. But if it is practical to do so, we will aim to meet the group anniversary target and open any enquiries into any of these company tax returns no later than 9 October 2010.

It will not always be possible for HMRC to meet the group anniversary target. Where it is not, we will continue to open enquiries as necessary, within the statutory deadline. And it remains our aim to open enquiries as early as we can and not to wait for either the Para.24 time limit or the group anniversary target.

The extent to which we are able to meet the group anniversary target in relation to a particular group will necessarily depend upon our internal organisation, and where the group's corporation tax affairs are dealt with. Our aim is as follows—

Large Business Service

Our Large Business Service deals with the tax affairs of the very largest companies. All such companies are allocated a dedicated Customer Relationship Manager.

Customer Relationship Managers (CRMs) will in any case seek to agree a timetable with the group tax manager for compliance assurance activities. As part of that exercise, they will seek to agree a timetable for the delivery of the group's returns, the handling of any risks identified and the opening

of any formal enquiries. Where it is practical to do so, CRMs will seek to agree a timetable that meets the group anniversary target.

Local Compliance – Large and Complex Customer Group

Our Local Compliance Large and Complex customer group handles the tax affairs of the largest companies outside the Large Business Service. We have appointed Customer Managers (CM) to coordinate our dealings with the very largest and most complex members of this customer group.

– Where a Customer Manager is in place

As part of their role, CMs will want to agree a timetable for the delivery of the group's returns, the handling of any risks identified and the opening of any formal enquiries. Where it is practical to do so, CMs will seek to agree a timetable that meets the group anniversary target.

Where the group's affairs are dealt with in more than one location, or it would help for other reasons, CMs will discuss with the group whether it will aim to deliver its returns significantly before the statutory filing date. Where this is the case, they will ask the group to write to the CM when the last group member's return is delivered, on the lines of the Annex to this note. Unless there are over-riding reasons not to do so, the CM will agree to open any enquiries into the relevant company tax returns within the group anniversary target.

– Where no CM is in place

Where no CM is in place, HMRC still provides some degree of co-ordination in dealing with larger groups. We are in the process of providing—

- A Single Point of Contact (SPoC) to handle incoming queries, outside of the enquiry framework, from businesses and their agents and advisors.
- Points of Responsibility (PsoR) in relation to our review of information about the group, the completion of a risk assessment and action plan, the co-ordination of subsequent intervention activity and contact with the business relating to any enquiry.

These officers will seek to facilitate meeting the group anniversary target wherever possible. We will discuss with the group whether it aims to deliver its returns significantly before the statutory filing date. Where this is the case, we will ask the group to write to us when the last group member's return is delivered, on the lines of the Annex to this note. Unless there are overriding reasons not to do so, we will agree to open any enquiries into the relevant company tax returns within the group anniversary target.

Local Compliance – outside the Large and Complex customer group

The remaining large and medium-sized groups are dealt with in much the same way as smaller companies, in our local offices. HMRC is not able to offer the necessary degree of co-ordination across such groups to undertake to meet the group anniversary target in these cases.

Other Considerations

All parties should be clear that the group anniversary target is an operational practice, not a legal requirement. HMRC reserve the right to fall back on the statutory time limit.

On the other hand, HMRC is committed to showing good faith by honouring any agreed timetable, and will make every effort to provide the necessary degree of assurance to encourage larger groups to file early where they can. An agreement cannot fetter our legal powers, but we will make every effort to meet the group anniversary target where we have agreed to do so. It should only be necessary to open enquiries after that where the group fails to honour any agreed conditions, or where material new information comes to light that was not available when the original agreement was reached.

For groups where no agreement is made to meet the group anniversary target, the statutory position will apply. This is likely to be the case for the time being for the majority of companies in groups that are not “Large” by EU definitions. That is not a matter of policy, but of operational reality—HMRC is not able to offer the necessary degree of co-ordination across such groups to undertake to meet the group anniversary target.

Value Added Tax

VAT disclosures practice made lawful

HMRC currently do not charge default interest on net errors of £2,000 or less separately notified to them (see paragraph 2.4 of Notice 700/43 (Default Interest) and note 4 on form VAT 652).

However, the decision in *R (on the application of Wilkinson) v CIR* [2006] STC 270, means that this practice is not considered lawful, said HMRC in a recently published brief, and it will be withdrawn on 1 September 2008.

All error notifications (previously known as voluntary disclosures) requiring an assessment may therefore be subject to a default interest charge, irrespective of the amount involved.

However, as before, de minimis net errors can continue to be corrected on a VAT return and will not attract interest.

Putting this change into perspective, independent VAT consultant Neil Warren explains that the new voluntary disclosure rules introduced for VAT periods beginning on or after 1 July added an extra condition to the existing rules, i.e. that an adjustment can be made by larger businesses on their VAT returns (without disclosure and therefore an interest charge) if the net amount of the errors is less than 1% of their box 6 turnover for the quarter.

There is an error ceiling of £50,000. For smaller businesses, the ceiling is £10,000. The previous rules just had a monetary ceiling of £2,000.

In the past, HMRC have always allowed a business to notify errors of less than £2,000 as a disclosure (although normal practice is to include it on the next VAT return submitted by the business), and never charged interest.

However, the problem, says Neil, with the new rules is that if a taxpayer makes a disclosure to HMRC between £10,000 and £50,000 at the beginning of its VAT period, then HMRC will not know at this point if it is less than 1% of the total turnover for the business until the VAT return has actually been submitted, which could be four months later.

This is where he believes that the *Wilkinson* case comes into play, because in most cases HMRC could guess whether the error will be less than 1% of turnover for that particular business (based on its past trading history), but they cannot be sure.

So for them to guess could create an issue of unequal treatment to taxpayers, which is the theme of the *Wilkinson* case.

In effect, HMRC have dealt with this potential unequal treatment problem by saying that any disclosure notified to them will attract interest (unless it is an error type that avoids an interest charge i.e. the separate box in the return is ticked), and to avoid the charge, it is up to the taxpayer to include errors within the limits on his next VAT return.

In terms of the implications of the brief for the taxpayer, Neil does not see any great problem.

He says he has ‘always encouraged businesses to adjust errors on VAT returns if the value of the errors is within the disclosure limits’ and does not see ‘the reason for going through the administrative exercise of notifying an underpayment if it can be legitimately adjusted in box 1 of the next VAT return’.

VAT change raises hospital fears

Concerns have again been raised about the change in tax legislation that will allow employment agencies to charge VAT.

The withdrawal of HMRC’s staff hire concession has caused hospital finance managers to fear that the cost of taking on temporary doctors and other medical professionals will sharply increase.

Currently, medical staffing agencies only charge VAT on the commission element of their invoices and not on the salary element, but with effect from 1 April 2009 the tax will be charged on the total cost, including salary.

The change comes on top of the general review that the Revenue has been conducting of the whole area of recovery of VAT on the provision of agency employees.

The VAT charge on all temporary medical staff is estimated to cost the NHS up to £10 million a year, and this is expected dramatically increase following the policy withdrawal of the concession.

In response, the Public Sector Tax Forum is putting together a report on the impact of agency costs, and is to make the case to HMRC for universal recovery of VAT on medical service fees.

The forum is composed of NHS Trust finance directors and senior managers, and provides an avenue for high-level consultation on tax policy issues between trusts and the Government. It believes that the further limiting of the categories of staff on which VAT can be reclaimed is also under consideration.

Earlier this month, the Recruitment and Employment Confederation criticised the withdrawal of the staff hire concession, claiming it will lead to an increase of as much as £400 million in the cost of supplying temporary workers to sectors such as charity, education, social housing and financial services.

R&C Commissioners v Isle of Wight Council and others (C-288/07)

[2008] All ER (D) 82 (Sep)

Summary

in the course of proceedings between the commissioners and the four defendant local authorities, namely the Isle of Wight Council, Mid-Suffolk District Council, South Tyneside Metropolitan Borough Council and West Berkshire District Council, regarding their treatment as taxable persons for the purposes of value added tax on the provision of off-street car-parking facilities, the national court stayed the proceedings and referred to the Court of Justice of the European Communities questions for a preliminary ruling which concerned the interpretation of the second subparagraph of art 4(5) of the Sixth Council Directive (EEC) 77/388 (on the harmonisation of the laws of the member states relating to turnover taxes – Common system of value added tax—uniform basis of assessment).

By its questions, the national court asked—(i) whether the expression "distortions of competition" was to be ascertained on a public body by public body basis such that, in the context of the present case, it should be determined by reference to the area or areas where the particular body in question provided off-street parking or by reference to the totality of the national territory of the member state; (ii) what was meant by the expression "would lead to" in art 4(5) of the Sixth Directive, in particular, what degree of probability or level of certainty was required for that condition to be satisfied; and (iii) what was meant by the word "significant", in particular, whether it mean an effect on competition that was more than trivial or de minimis, a "material" effect or an "exceptional" effect.

The court ruled—Article 4(5) of Sixth Directive was to be interpreted as meaning that the significant distortions of competition, to which the treatment as non-taxable persons of bodies governed by private law acting as public authorities would lead, had to be evaluated by reference to the activity in question, as such, without such evaluation relating to any local market in particular. The expression "would lead to", for the purposes of the second subparagraph of art 4(5) of the Sixth Directive, had to be interpreted as encompassing not only actual competition, but also potential competition, provided that the possibility of a private operator entering the relevant market was real, and not purely hypothetical. The word "significant" was, for the purposes of the second subparagraph of art 4(5) of Sixth Directive 77/388, to be understood as meaning that the actual or potential distortions of competition had to be more than negligible.

Leisure Pass Group Ltd v Revenue and Customs Commissioners

[2008] EWHC 2158 (Ch)

Paragraph 1(1) of Sch 10A to the Value Added Tax Act 1994 provides—"In this Schedule 'face-value voucher' means a token, stamp or voucher (whether in physical or electronic form) that represents a right to receive goods or services to the value of an amount stated on it or recorded in it."

The taxpayer sold a product which it called the "London Pass" (the Pass), and which was principally aimed at the tourist market. The Pass was a voucher the size of a credit card containing a micorchip. It was sold to visitors to London and entitled the holder, during the period of its validity (anywhere between one and six days), to visit without payment any of about 55 attractions comprising places of interest, historic houses, museums, galleries, tours and cruises and leisure activities (the attractions). A particular attraction could only be visited once during the validity of the Pass. The taxpayer contracted with the operator of each of the attractions to allow the Passholder entry without further payment. For each entry with a Pass, the taxpayer paid a fee to the attraction which was between 20 and 40% below the gate price. An issue arose as to whether the taxpayer was liable to account to the Revenue for VAT on the receipts which it obtained on sales of the Passes, or whether no VAT was payable at that stage by virtue of the provisions of Sch 10A to the Value Added Tax Act 1994 relating to "face-value vouchers". In a decision letter dated 16 August 2006, the Revenue gave notice of its conclusion that Sch 10A did not apply and that the sale of the Passes attracted VAT at the standard rate. The taxpayer appealed to the VAT and Duties Tribunal. The tribunal dismissed the appeal holding, inter alia, that the statutory definition of face-value voucher did not apply on the facts of the instant case. The taxpayer appealed.

The principal issue that fell to be determined was whether the Pass fell within the definition of face-value voucher for the purposes of para 1(1) of Sch 10A to the 1994 Act.

Held—The definition of "face-value" voucher in para 1(1) of Sch 10A to the 1994 Act contained two elements, namely—(i) a requirement that there had to be an amount to the value of which the voucher conferred on the holder and a right to services; and (ii) a requirement that the amount be stated or recorded on the voucher. The clear inference from the requirement that to be a face-value voucher, a voucher had to state or record the amount "to" which the holder was entitled to receive goods or services, was that Sch 10A dealt with—and only with—vouchers in the case of which the holder could run out of the money represented by them.

While there were limits on the use of the Pass, they were not monetary limits; and so they were not limits by reference to an amount. The effective limit was a limit of date. The Pass never expired because the holder had exhausted the monetary amount on it. It expired either because the attached time limit had expired or because it had already been used at all the relevant attractions. Accordingly, the tribunal had been right to hold that the Pass did not fall within the exception contained within para 1(1) of Sch 10A to the 1994 Act.

The appeal would be dismissed.

Chancery Division Sir Andrew Park ***11 September 2008***

Nectar case

The House of Lords has given HMRC leave to appeal the decision of the Court of Appeal in *CRC v Loyalty Management (UK) Ltd* [2007] STC 59.

In the meantime, HMRC have published interim guidance, pending the outcome of their appeal, for those businesses affected by this decision.

The case concerned the Nectar loyalty scheme. The Court of Appeal found that, on the facts of the case, there is a taxable supply of redemption services by redeemers to Loyalty Management in respect of which it is entitled to input tax credit.

The payment made to the redeemer by the taxpayer company was held to be consideration for those services. The court confirmed that all such payments to redeemers were consideration for fully standard-rated supplies (redemption services).

The matter has been referred to the European Court of Justice but, at the moment, the Court of Appeal decision represents the law as it currently stands.

Therefore, redeemers, although not party to the litigation, are nonetheless affected by it. Redeemers need to ensure that the treatment of the service charge accords with that decision, and that Loyalty Management can benefit from the decision.

HMRC say that they will proceed on the basis of their view of the law in relation to all parties, including Loyalty Management, until the outcome of their appeal is known.

Redeemers are obliged to account for output tax due on the value of the full consideration received from Loyalty Management. Where this is not done, HMRC will assess the amounts of output tax due, subject to the usual time limits.

HMRC suggest that redeemers thus affected may wish to make protective claims for the additional VAT due, in the event that HMRC's appeal is ultimately successful.

Loyalty Management is entitled to reclaim input tax on output tax charged to it by redeemers to the extent that such claims are supported by the proper evidence, in which case HMRC say they will ensure assessments are in place to protect their position pending the outcome of our appeal.

Since the consideration paid by Loyalty Management is currently seen to be for redemption services, rewards are being supplied by redeemers to collectors without consideration or, where the collector pays cash in addition to points, for partial consideration.

The court's view was that when payment for the reward was partly cash (from the collector) and partly points, the supply was to the collector to the extent he paid for it. Therefore, the decision does not affect supplies of rewards by redeemers to collectors for partial consideration.

However, HMRC's view is that, where the supply by a redeemer of a reward of goods is made wholly for points, and the redeemer is entitled to input tax deduction, the redeemer is making a supply of those goods (under VATA 1994, Sch 4(5)). VAT will be due, subject to the normal business gift rules.

Where redeemers have not and/or do not account for output tax due on these gifts, HMRC will protectively assess for any output tax arising subject to the usual time limits pending the outcome of the litigation. Where redeemers do, or have, accounted for output tax due on these gifts, they may wish to make protective claims in the event that HMRC's appeal is successful.

With regard to other cases, HMRC say that until the current litigation is concluded, it is not clear on what basis other schemes might be seen as materially similar for VAT purposes, so they will continue to look at claims for similarity on a case-by-case basis.

Info Sheet 07/2008: Partial Exemption adjustments when builders let dwellings

This information sheet sets out HMRC policy on the VAT implications when house builders decide to temporarily let their dwellings before selling them making them a partially exempt trader.

When is a house builder affected by partial exemption?

Many house builders are fully taxable businesses that can recover all of their input tax because for VAT purposes, the sale or first grant of a major interest in a dwelling is a taxable supply.

However, the letting of a dwelling is an exempt supply and input tax on related costs might not be recoverable.

Due to the current slowdown in the residential property market some house builders are deferring their intended sales of dwellings and temporarily letting instead, and so becoming partly exempt.

A partly exempt house builder might have to:

- adjust the VAT previously recovered on his submitted VAT returns
- restrict the VAT to be recovered on current and future VAT returns
- both adjust VAT previously recovered and restrict current and future VAT recovery

For many house builders the amount of 'exempt input tax' related to their temporarily lets is small (known as de minimis) and as a result they can continue to recover all of their input tax; but they must check to avoid VAT mistakes.

De minimis?

Like any business, a house builder checks for de minimis by applying his partial exemption method.

Exceptionally, HMRC will allow a builder that does not currently operate a partial exemption method, to adopt instead a 'simple check for de minimis'.

This simple check is based on the expected time period he will let his building as a proportion of the economic life of that building, which for VAT purposes is ten years.

His exempt input tax is determined by applying the proportion to his total input tax. Provided his exempt input tax does not exceed £625 per month on average (up to £7,500 per year), and is not more than half of his total input tax, then his exempt input tax is de minimis and he can recover it in full.

Adjusting previously recovered input tax

When a business changes its plans for making a taxable supply, by forming a new intention to make an exempt supply and then a taxable supply sometime later, it may have to reduce the amount of input tax that it had originally recovered.

This is known as a clawback adjustment and was the subject of the High Court decision in Curtis Henderson.

Remember a business does not make a clawback adjustment if it satisfies the test for de minimis.

Making a clawback adjustment

A house builder makes a clawback adjustment as soon as his actual or intended use of a property differs from his original plans against which input tax was recovered.

A clawback adjustment is a one-off event and a house builder would only make a second adjustment if the building was never let.

There is no need to amend the adjustment if the actual period of letting proved to be longer or shorter than anticipated.

HMRC may ask for evidence to show that the adjustment calculation is reasonable.

Restricting recovery of current and future VAT

A house builder that expects to continue to incur exempt input tax in his current or future VAT periods would need to adopt a partial exemption method. If he is not already partly exempt (most smaller-sized builders are not), then he must either apply the standard method or seek HMRC approval to apply a special method.

Questions and answers

- The information sheet contains a number of useful answers to common questions including:
- How is a clawback adjustment accounted for?
- Can a house builder base his clawback adjustment on 'years'?
- How should a house builder determine the 'values' for his clawback adjustment?
- What happens if a house builder changes his intention from making a short let followed by a sale to simply making a sale?
- What happens to costs that relate directly to the letting or sale of the new dwelling?
- What happens if buildings fall under the Capital Goods Scheme?
- Where can I find more information on 'major interests'?

VAT Option to tax: technical note

This article reviews the changes which have been made recently to the option to tax, as well as examining a recent House of Lords decision on the effectiveness of the rules.

Rule changes

New Schedule 10

The new Schedule 10 has now been issued and takes effect from 1 June 2008. The following important changes are included.

Terminology

The legislation has always previously used the expression "election to waive exemption". It will now allow for the fact that everyone else uses "option to tax".

Demolition and construction

Under the previous rules, an option could lapse if a building was demolished or a new building was constructed, so that a new option needed to be made and notified over the new building.

The default will in future be that the option to tax continues, although owners may be able to revoke an option where a new building is constructed. This change applies to most existing options to tax.

Dwellings etc.

The option has never applied to dwellings and other residential accommodation, but issues have sometimes arisen where a change of use is planned. The case of *SEH Holdings* illustrated the main problem: a company purchased a pub over which the vendor had exercised the option, paying VAT, and then sold it to someone who wanted to convert it into residential accommodation. The company did not opt to tax the sale, but would have been unable to charge VAT even if they had – while the option was not disapplied on their purchase, because they did not themselves intend to carry out the conversion work.

In future, a purchaser or tenant who intends to convert a non-residential building for residential use will need to certify this intention to the seller or landlord. This will have to be done within a set timescale, or alternatively will need the agreement of the seller or landlord. Other changes concern cases where the conversion will be undertaken by a subsequent purchaser or tenant, and with situations where the parties are content for the option to tax to apply (e.g. where the purchaser will in due course make a zero-rated grant).

In some cases the option cannot apply to a sale or lease to a housing association or registered social landlord. There are new rules about how and when the association needs to certify its intended use of the property.

Opting on multiple properties

The option generally applies property-by-property, but this can be inconvenient for businesses with a large property portfolio. If a business wants to opt on everything, HMRC have historically accepted "global" options to deal with this. This will now be replaced by new formal arrangements, referred to as a Real Estate Election or "REE", from 1 June. HMRC have confirmed that they will continue to accept options covering a whole geographical area, such as the City of London or Wales, but this will cause difficulties with revoking an option because it is not clear when the option takes effect in respect of any individual property.

Permission to opt

An option to tax requires HMRC's prior permission in cases where there have previously been exempt supplies made with the property. In some circumstances the permission is automatically granted, and in other cases specific consent is required. Where permission has to be applied for specifically, the granting of permission is not the same as accepting an option to tax – it allows the option to be made, but separate notification is then needed. From 1 June:

- permission will not be required if the exempt lettings were more than ten years earlier;

- where HMRC give permission, the option can take effect from when permission was sought, or from any later date, and there will be no need to send HMRC a further notification;
- refusal of permission will be appealable to the VAT Tribunal;
- HMRC will be able to set the permission rules aside and to treat options made without permission as valid;
- the rules about obtaining permission will be tightened up and given statutory backing.

Duration of the option

The option was originally permanent and irrevocable. In 1995 the rules were changed to allow revocation within a "cooling off period" or after 20 years. The "cooling off period" allows an option to be revoked in the first three months so long as no supplies have been made of the property in that time. It will be subject to fewer conditions and will be extended to six months. In many cases it will no longer require HMRC's consent.

An option will automatically lapse once the business has not held an interest in the property for six years.

The legislation also deals in more detail with the facility to revoke the option after 20 years, which will be available from 1 August 2009.

Groups of companies

All members of a VAT group registration are bound by an option made over a property by any member of the group. It is not entirely clear what happens if a company A leaves one group and joins another, and a different company B in the second group then buys an opted property from a different company C in the first group.

The "relevant associate" rules for VAT groups will be amended so that A and B's new group will not be bound by an option over property in which A had no interest in the old group.

Anti-avoidance rules

Changes here will:

- reinforce HMRC's view that the provisions can apply where an occupier's use of a property is less than 80 per cent in taxable activities – the legislation previously referred to "wholly or mainly for eligible purposes", which suggested that 51% taxable should have been enough, and the 80% figure was only in Customs' guidance. The guidance will now be given the force of law.
- provide that banks etc. are no longer regarded as occupying a building merely on account of an ATM.

The new legislation has been introduced by Statutory Instrument, and HMRC have issued an Information Sheet and Revenue & Customs Brief to explain some of the main changes. This is reproduced below as it contains a great deal of useful detail which is beyond the scope of this lecture.

SI 2008/1146; Information Sheet 03/2008; R&C Brief 24/08

There is also a new Notice 742A *Opting to tax land and buildings*. A number of items in it have the force of law. It lists the changes from the previous edition as:

- new rules providing that an option to tax affects land and buildings on the same site, with transitional rules, and ability to exclude new buildings from the scope of an option to tax (section 2).
- new certificate for buildings to be converted to dwellings etc and new ability for intermediaries to disapply the option to tax (section 3)
- new certificate for land sold to housing associations (section 3)
- new rules for ceasing to be a relevant associate of an opter (section 6)
- extension to the 'cooling off' period for revoking an option to tax (section 8)

- introduction of automatic revocation of the option to tax where no interest has been held for 6 years (section 8)
- introduction of rules governing the revocation of an option to tax after 20 years (section 8)
- revised definition of occupation for the anti-avoidance test including new exclusion for automatic teller machines (section 13)
- introduction of a new way to opt to tax (a real estate election) (section 14).

Notice 742A, Revenue & Customs Brief 28/08

Revoking an option

There is an article by Neil Warren about the rules for revoking an option in *Taxation*, 29 May 2008.

Taxation 29 May 2008

Information Sheet 03/2008

Issue Date

22 April 2008

This Information Sheet introduces changes to the legislation governing the option to tax. It includes an annex containing tertiary legislation having the force of law that will appear in Public Notice 742A in due course.

This Information Sheet should be read in conjunction with: Revenue & Customs Brief 24/08

1. Introduction

1.1 What is this Information Sheet about?

It introduces changes to legislation governing the option to tax, Schedule 10 of the VAT Act 1994 and contains tertiary legislation that will have the force of law.

1.2 Why do we need to change Schedule 10 of the VAT Act 1994?

This is perhaps the most complex part of the VAT Act having had a succession of anti-avoidance measures added to it. The proposed legislation including the tertiary is intended to be simpler to follow and understand as it has been re-ordered and written in a more modern manner.

1.3 When do these changes come into effect?

The new Schedule 10 will become effective from 1 June 2008. The first revocation of an option to tax after 20 years will become possible from 1 August 2009 as the option to tax was introduced in August 1989.

1.4 What is tertiary legislation and where can I find it?

Tertiary legislation are elements of the guidance which have the force of law and appear in a Public Notice or Information Sheet. The tertiary legislation being introduced with the new Schedule 10 of the VAT Act 1994 can be found in Annex 1 of this Information Sheet together with accompanying guidance. The tertiary legislation consists of Boxes A to K and the outlined forms, (which will be made available on our website from 1 June 2008).

1.5 How can I compare the old Schedule 10 to the new Schedule 10 of the VAT Act 1994?

Destination and Derivation tables are also included with this Information Sheet and will assist with navigation around the changes.

1.6 Will the public notices and HM Revenue & Customs (HMRC) books of guidance be amended?

The existing public notices and HMRC books of guidance will not be immediately updated. We plan to consult business this year about all our VAT property notices and guidance with a view to bringing out new versions in 2009. Because the content of large parts of the notices and guidance will remain unchanged, we have decided not to withdraw the notices before they are rewritten. Where we can, we intend to indicate within the notices where there are changes. It is important that business always relies on the Information Sheet if the information in the notice or guidance differs.

1.7 Are we changing the rules concerning the operation of Schedule 10 and the option to tax?

There are a few minor changes at the margins as well as the introduction of the conditions for revoking an option to tax and the introduction of a Real Estate Elections. The greater majority of the legislation remains unchanged. It has merely been reordered and written in a more consistent modern manner.

1.8 What are the changes?

The following areas have changed or are new:

- new rules for relevant associates
- introduction of certificates to disapply an option to tax for buildings to be converted into dwellings and land supplied to housing associations
- introduction of disapplication of the option to tax for intermediaries supplying buildings to be converted into dwellings etc
- revised definition of occupation including new exclusion for automatic teller machines
- introduction of a new way to opt to tax (a real estate election) which does not require individual notifications of each option
- extension and changes to the cooling off period
- automatic revocation of an option to tax after six years if no property interest has been held during that time
- introduction of rules governing the revocation of an option to tax after 20 years
- provision that in future, an option to tax applies to land and buildings on the same site – with a special transitional rule for existing options
- a new ability to exclude a new building and land within its curtilage from an option to tax
- new appeal rights
- repeal of legislation concerning Developer's Self Supply charge, Developmental Tenancies (Schedule 9(1)(b) of the VAT Act 1994 and Co-owners of land (section 51A of the VAT 1994)

2. Changes to legislation governing the option to tax, Schedule 10 to the VAT Act 1994

2.1 Please see Annex 1 for the tertiary legislation, including an outline of the forms to be used as well as guidance.

2.2 Please see the Destination and Derivation Tables at pages 37 and 39 respectively.

3. Who can I contact for further information?

If you have a query for which you have been unable to find the answer within this VAT Information Sheet please contact our National Advice Service on 0845 010 9000 (+44 208 929 0152 for International Enquiries).

The National Advice Service is open from 8.00 am to 8.00 pm, Monday to Friday, and will be able to answer both general queries and deal with enquiries relating to the Special Scheme.

If you have hearing difficulties, please ring the Textphone service on Tel 0845 000 0200.

Alternatively, international enquirers may email VAT on e-Services.

Annex 1 to Information Sheet 03/08

Changes to legislation governing the option to tax, Schedule 10 to the VAT Act 1994 as from 1June 2008

Force of law

Please note that the following have the force of law:

All boxed text

All forms – these are still being designed but an outline of each form is attached. All forms will be available from our website by 1 June 2008.

Index

Section	Title
1	Conditions for a body corporate to cease to be treated as a relevant associate of an opter
2	Exclusions from the effects of an option to tax
3	Definition of "occupation" of land for eligible purposes
4	Real estate elections
5	Revocation of an option to tax during the "cooling-off" period
6	Revoking an option where no interest has been held for more than 6 years
7	Revocation of an option where more than 20 years have elapsed since it first had effect
8	Changes to the option to tax
9	Excluding the effects of an option on a new building
10	Obtaining prior permission from HMRC before exercising an option to tax where exempt grants have already been made
Annex 1	Notification by a body corporate ceasing to be a relevant associate
Annex 2	Disapplication certificates
Annex 3	Notification of a real estate election
Annex 4	Revocation of an option to tax during the "cooling- off" period
Annex 5	Revocation of an option to tax after 20 years have passed since the option to tax had effec
Annex 6	Exclusion from the effects of an option to tax – New Buildings
Annex 7	Application for prior permission from the Commissioners to opt to tax

Section 1 – Conditions for a body corporate to cease to be treated as a relevant associate of an opter

1.1.1 A body corporate is a relevant associate of an opter if the body corporate meets one of these conditions:

- it is treated as a member of the same VAT group (see Notice 700/2, Group and Divisional Registration) as the opter, at the time an option to tax any property within the VAT Group first has effect;
- it has been treated as a member of the same VAT group as the opter at a later time when the opter held a relevant interest in the opted property.

- it has been treated as a member of the same VAT group as the opter, or a relevant associate of the opter at a time when either of them have held a relevant interest in an opted property.

A relevant interest in an opted property is an interest in, right over or licence to occupy the property (or any part of it).

1.1.2 A body corporate can cease to be a relevant associate of an opter in one of three ways, explained below:

a) by meeting the basic conditions of paragraph 3(4) of Schedule 10 to the VAT Act 1994;

b) by meeting the conditions specified in this notice under paragraph 3(5)(a) of Schedule 10 to the VAT Act 1994 and notifying HMRC in accordance with paragraph 4 of Schedule 10 to the VAT Act 1994; or

c) by obtaining the prior permission of HMRC, in accordance with paragraphs 3(5)(b) and 4 of Schedule 10 to the VAT Act 1994.

(a) Basic Conditions – paragraph 3(4) of Schedule 10 to the VAT Act 1994

1.2. A body corporate ceases to be a relevant associate of an opter if it meets all the conditions set out in paragraph 3(4) of Schedule 10 to the VAT Act 1994. These are that:

- it has no relevant interest in the building or land
- it is NOT now a member of the same VAT group as the opter; and
- it is no longer connected with any person who has a relevant interest in the building or land and is the opter or another relevant associate of the opter. (See paragraph 1.3 below for the meaning of ‘connected’).

When do Customs consider a person to be connected with another?

1.3 We use the test in section 839 of the Income and Corporation Taxes Act 1988 to determine whether people are connected. Examples of persons who are connected to you include:

- your husband or wife;
- your relatives;
- your husband’s or wife’s relatives;
- your business partners and their husbands, wives and relatives;
- a company that you control, either by yourself or with any of the persons listed above; or
- the trustees of a settlement of which you are a settlor, or of which a person who is still alive and who is connected with you is a settlor.

Relative means a brother, sister, ancestor or lineal descendant. It does not include nephews, nieces, uncles and aunts.

(b) Specified conditions for a body corporate to cease to be a relevant associate of the opter

1.4 If the conditions under paragraph 3(4) of Schedule 10 to the VAT Act 1994 are not met (see paragraph 1.2 above), a body corporate will cease to be a relevant associate if it meets the conditions set out in Box A below and notifies the Commissioners using a form to be made available from 1 June 2008 (currently outlined at Annex 1 below).

Box A

<table>
<tr><td colspan="2">Conditions for a body corporate to cease to be treated as a relevant associate of an opter (for the purpose of paragraph 3(5)(a) of Schedule 10 to the Value Added Tax Act 1994 (“the VAT Act 1994“)).</td></tr>
<tr><td colspan="2">A body corporate ceases to be a relevant associate of an opter at the time when it meets all of the following conditions:</td></tr>
<tr><td>1</td><td>The grouping condition</td></tr>
</table>

	The body corporate has ceased to be treated as a member of the VAT group (see section 43 of the VAT Act 1994) by virtue of which it became a relevant associate of the opter.
2.	The 20 year condition The body corporate has: • held any relevant interest in the building or land acquired whilst a member of that VAT group for a period of at least 20 years; and • been treated as a relevant associate of the opter for a period of at least 20 years.
3.	The capital item condition Any land or building that is subject to the option is not, in relation to the body corporate, subject to input tax adjustment as a capital item under the capital goods scheme.
4.	The valuation condition The body corporate, or a person connected with it, has not, within a period of ten years, made a supply of a relevant interest in the building or land that is subject to the option that: • was for a consideration that was less than the open market value of that supply; or • arose from a relevant grant.
5	The pre-payment condition No supply of goods or services has been made for a consideration to the body corporate (or to a person connected with it) which will be wholly or partly attributable to a supply or other use of the land or buildings made by that body (or by a person connected with it) more than 12 months later.
Explanatory Note 1 Relevant interest in the building or land" means an interest in, right over or licence to occupy the building or land (or any part of it).	
Explanatory Note 2 "Relevant grant" means a grant that the grantor intends or expects will give rise to a supply for a consideration significantly greater than any consideration for any earlier supply arising from the grant (except as a result of a rent review determined according to normal commercial practice).	

(c) Prior permission

1.5.1 If a body corporate does not meet all the conditions of paragraph 3(4) of Schedule 10 to the VAT Act 1994 (see paragraph 1.2) or all the conditions set out in Box A above, it may apply to the Commissioners for permission to cease to be a relevant associate. The application must be made using a form to be made available from 1 June 2008, (currently outlined at Annex 1).

1.5.2 Permission will not be given unless both conditions 1 and 2 set out in Box A above are met.

1.5.3 The Commissioners will only give permission in relation to those of the other automatic permission conditions above that have not been met. The body corporate will need to certify that all the remaining automatic permission conditions have been met. In deciding whether or not to give permission, the Commissioners will give particular consideration to whether or not the relevant associate has received a VAT benefit or, as a result of the relevant associate's action, a third party has received a VAT benefit.

1.5.4 For example, a case could arise where, one year before applying for permission to cease to be treated as a relevant associate, a taxpayer pre-paid for the next three years' cleaning services and because of that intention, the taxpayer only deducted one third of the input tax charged. While the taxpayer failed to meet the pre-payment condition specified in this notice as the pre-payment extends beyond 12 months after the date of ceasing to be treated as a relevant associate, the Commissioners would nevertheless grant permission since the taxpayer has recovered only a fair and reasonable amount of input tax. Had the taxpayer deducted all the input tax on the cleaning services, unless there

was some way to re-visit the original input tax deduction within the confines of the law, permission would likely be refused.

Section 2 – Exclusions from the effect of an option to tax.

2.1 There are a number of exclusions from the effects of an option to tax. These are:

a) dwellings designed or adapted and intended for use, as dwellings;

b) buildings converted for use as dwellings etc;

c) buildings to be used for a relevant charitable purpose;

d) pitches for residential caravans;

e) moorings for residential houseboats;

f) land sold to a relevant housing association;

g) land sold to a DIY house builder.

a) Dwellings designed or adapted and intended for use, as dwellings

2.2 Your option to tax will not apply if you supply a building or part of a building, and the purchaser or tenant intends to use it as either:

- a dwelling, or a number of dwellings, or
- solely for a relevant residential purpose (providing the purchaser or tenant has informed you of their intention)..

b) Buildings converted for use as dwellings etc

2.3.1 . Your option to tax will not apply if you supply a building or part of a building which is not designed, adapted or used as a dwelling (or number of dwellings) or solely for a relevant residential purpose, if the recipient of your supply certifies that it is intended to be converted for use as a dwelling (or number of dwellings) or for a relevant residential purpose.

2.3.2 Buildings can be converted into a dwelling (or number of dwellings) or solely for a relevant residential purpose in one of two circumstances:

i) Sale or lease of the building direct from the seller to the person who will carry out the conversion; or

ii) Sale or lease of the building through one or more intermediaries to the person who will carry out the conversion.

(b)(i) Sale of the building direct from the seller to the person who will carry out the conversion

2.4 If the person carrying out the conversion meets the certificate conditions (in paragraphs 2.6.1 – 2.6.7 below), he can give a certificate to the seller, who subsequently exempts from VAT the supply or supplies of the building or part of a building to which the certificate relates.

(b)(ii) Sale of the building through one or more intermediaries to the person who will carry out the conversion

2.5.1 If you acquire a building with the sole intention of supplying it on to either someone who will convert it into a dwelling (or number of dwellings) or solely for a relevant residential purpose, or to another intermediary with the same intention, then you may be a “relevant intermediary” and be able to issue a certificate, subject to meeting the certificate conditions in (in paragraphs 2.6.1 – 2.6.7 below), to disapply your seller’s option to tax.

2.5.2 A building or part of a building is not regarded as intended for use as a dwelling (or number of dwellings) if it is intended it will not be used as such for any period of time (except for incidental or minor purposes).

2.5.3 As a recipient of a supply, you fall within the legal definition of a “relevant intermediary” if:

- you intend to dispose of the whole of the interest in the building or part of a building that is to be supplied to you by the seller and to whom you have given a certificate; and

- you have already received, from the person to whom you intend to supply the whole of the interest you have received from the seller, a certificate stating which of the following the recipient of your supply intends to do:

  i) convert the building for use as a dwelling (or number of dwellings) or solely

  ii) for a relevant residential purpose;

  iii) dispose of the interest to a person, a recipient, who intends to convert the

  iv) building for such use (see Figure 1); or

  v) dispose of the interest to a person who, in turn, intends to dispose of it to a

  vi) recipient for such use.

Figure 1 The seller (S) is seeking to sell a building that they have opted to tax. Their customer (P) has already found a buyer R (the recipient) for the property who intends to convert the building into a dwelling (or number of dwellings) or for a relevant residential purpose. R provides a certificate to P certifying they have an intention to convert the building. Once P has that certificate, it can then certify to S that it intends to dispose of the building to a person (R) who will convert it into a dwelling (or number of dwellings) or for a relevant residential purpose. Once S has the certificate, it can exempt its supply of the building to P and P can exempt its supply of the building to R.

2.5.4 If the supply chain has more than one relevant intermediary in it, each relevant intermediary can only give a certificate to the person supplying them the building (which will be either the seller or another relevant intermediary) once they have a certificate confirming that their customer is either going to convert the building into a dwelling (or number of dwellings) or for a relevant residential purpose, or is another relevant intermediary.

2.5.5 In arrangements involving relevant intermediaries, valid certificates will have a dual purpose of:

- disapplying a supplier's option to tax; and
- if the supplier is not the seller, treating the supplier as a relevant intermediary.

(b)(i) & (ii) Certificate Conditions

2.6.1 If you are a seller or relevant intermediary and have received a valid certificate from your customer who is either a relevant intermediary or the person who intends to convert all or part of the building into a dwelling (or number of dwellings) or solely for a relevant residential purpose, you must exclude your supplies of the building (or part of the building) to which the certificate relates from the effect of your option to tax (subject to meeting the timing conditions in paragraphs 2.6.4 & 2.6.5 below). The option, however, continues to have effect in relation to:

- parts of the building which will not be converted or adapted for use as a dwelling or solely for a relevant residential purpose; and
- other supplies of the building, unaffected by the certificate.

2.6.2 Where only part of a building is to be converted or adapted for use as a dwelling (or number of dwellings) or solely for a relevant residential purpose, the certificate must describe the parts of the building to which it applies and the percentage, on the basis of floor space, they represent of the whole building. In such cases, as seller you must apportion your supply between the part of the building to which the option continues to apply and the part in respect of which it is disapplied, and account for VAT accordingly.

2.6.3 If, as seller, you make more than one supply of a relevant interest in a property to the person who has given you the certificate, your option will be disapplied in relation to all subsequent supplies that arise from the same grant in the building or parts of the building covered by the certificate. Any other supply of the building you make will remain taxable.

2.6.4 A certificate notifying that a building or part of a building is intended to be converted for use as a dwelling (or number of dwellings) or solely for a relevant residential purpose must be given by the recipient of a supply to the person making the supply. The certificate will only cause a supply to become exempt if it is given to the seller who made the option by the time set out in Box B below. Where relevant intermediaries are in the supply chain, they act as both recipients when they acquire

the building from the seller and as a seller themselves when they supply the building on to either another relevant intermediary or to someone who will convert it into a dwelling (or number of dwellings) or solely for a relevant residential purpose.

Box B

Time by which a certificate of intended use as a dwelling (or dwellings) or solely for a relevant residential purpose must be given to the seller making the supply (for the purpose of paragraph 6(2) of Schedule 10 to the Value Added Tax Act 1994)
The certificate must be given before the price for the grant to the recipient by the seller is legally fixed, e.g. by exchange of contracts, letters or missives, or the signing of heads of agreement.

2.6.5 Should a certificate be issued after the time the price for the grant has been legally fixed, the seller may at his discretion, accept the certificate and disapply his option but only in respect of supplies that arise after the certificate has been given. In the case of a freehold sale, the certificate must be given before the supply (typically completion) to disapply the option to tax (subject to the vendor's agreement). In the case of a lease, if a certificate is accepted by a landlord, the option is disapplied only in respect of supplies (typically rental payments) that arise after the certificate is given. The certificate cannot have retrospective effect.

2.6.6 The certificate (to be made available from 1 June 2008 and currently outlined at Annex 2 given by those who intend to convert the building or part of it into a dwelling (or number of dwellings) or solely for a relevant residential purpose, or by a relevant intermediary must be made in the form specified and contain the information required.

c) Buildings to be used for a relevant charitable purpose

2.7.1 Your option to tax will not apply if you supply a building, or part of a building, and the purchaser or tenant informs you that they will be using it solely for a relevant charitable purpose. This means a building that is used by a charity for its non-business activities (except as an office), or as a village hall, or similarly to provide social or recreational facilities for the local community. See Notice 708 – Buildings and Construction, paragraph 14.7, for a definition of "relevant charitable purpose".

2.7.2 The Commissioners do not specify the form of a certificate. See paragraph 16 of Notice 708 for the necessary certification requirements.

2.7.3 A certificate cannot have retrospective effect, so it can only apply to supplies that arise after it has been given. Therefore to disapply the option to tax in the case of a freehold sale, the certificate must be given before the supply (typically completion). In the case of a lease, a certificate disapplies the option only in respect of supplies (typically rental payments) that arise after the certificate is given.

d) Pitches for residential caravans

2.8 Your option to tax will not apply if you supply a pitch for a permanent residential caravan. A residential caravan is one where residence is permitted throughout the year and is not restricted by planning consent, covenant or similar provision.

e) Moorings for residential houseboats

2.9 Your option to tax will not apply if you supply facilities for the mooring or berthing of a residential houseboat. A houseboat is a floating, decked structure that is designed or adapted for use solely as a place of permanent habitation. A houseboat does not have the means of self- propulsion, nor is capable of being readily adapted for such use. A residential houseboat is one where residence is permitted throughout the year, and is not restricted by planning consent, covenant or similar provision.

f) Land sold to a relevant housing association

2.10.1 Your option to tax will not apply if you supply land and the recipient of your supply is a housing association which certifies that it is intended for use (after any necessary demolition of existing buildings) for constructing buildings intended for use as a dwelling, a number of dwellings, or for a relevant residential purpose. Such a certificate will cause the supply by the vendor to be exempt from VAT.

2.10.2 If, as seller, you make more than one supply of a relevant interest in the land to the housing association which has given you the certificate, your option will be disapplied in relation to all subsequent supplies that arise from the same grant in the land covered by the certificate. Any other supply of the land you make will remain taxable.

2.10.3 A certificate notifying that land is intended for use (after any necessary demolition of existing buildings) for constructing buildings intended for use as a dwelling (or number of dwellings) or solely for a relevant residential purpose must be given by the housing association to you. The certificate will only cause a supply to become exempt if it is given to the seller who made the option by the time set out in Box C below.

Box C

Time by which a certificate of intended use of the land for constructing a dwelling, a number of dwellings, or solely for a relevant residential purpose must be given to the person making the supply (for the purpose of paragraph 10(2) of Schedule 10 to the Value Added Tax Act 1994)
The certificate must be given before the price for the grant to the recipient by the seller is legally fixed, e.g. exchange of contracts, by missives or letters, or the signing of heads of agreement.

2.10.4 If a certificate is given after the time the price for the grant has been legally fixed, the seller does not have to accept the certificate, but may do so at his discretion and disapply his option, but only in respect of supplies that arise after the certificate is given. In the case of a freehold sale, the certificate cannot be given after the supply has taken place (typically completion). In the case of a lease, if a certificate is accepted by a landlord, the option disapplies on supplies (typically rental payments) that arise after the certificate is given.

2.10.5 The certificate (to be made available from 1 June 2008 and currently outlined at Annex 2 must be made in the form specified and contain the information required.

g) Land sold to a DIY house builder

2.11 Your option to tax will not apply if you supply land to someone who will build a dwelling on it for their own use, and not in the course or furtherance of any business carried on by them.

Section 3 Definition of "occupation" of land for eligible purposes

3.1 There is an anti-avoidance provision which disapplies the option to tax in relation to a supply if the supply was made under a grant made by the developer of the land and the exempt land test is met (see paragraph 13.2 of Notice 742A, Opting to tax land and buildings). One of the conditions for this test to be met is that is that the land is not occupied by the grantor, a development financier or persons connected with either, "wholly" or "substantially wholly" for eligible purposes (see paragraphs 3.2.1 and 3.2.2 below). The terms "wholly" or "substantially wholly" are defined in Box D below.

Box D

Meaning of "wholly" and "substantially wholly" for eligible purposes (for the purpose of paragraph 15(5) of Schedule 10 to the Value Added Tax Act 1994)	
Expression	Meaning
Occupation "wholly" for eligible purposes	Land occupied 100% for eligible purposes
Occupation "substantially wholly" for eligible purposes,	Land occupied at least 80% for eligible purposes

What are eligible purposes?

3.2.1 You occupy land for an "eligible purpose" if you are a taxable person making supplies in the course or furtherance of business and on which any input tax wholly attributable to those supplies would be fully recoverable.

3.2.2 Occupation of land for "eligible purposes" also includes:

any land where occupation arises only because of an automatic teller machine fixed to the land;

land occupied by a Government department (within the meaning of section 41 of the VAT Act 1994), and

land occupied by a body within the scope of Section 33 of the VAT Act 1994 (e.g. local authorities) where that land is used for a non-business activity by that body.

Section 4 – Real estate elections ("REE")

a) Overview

4.1.1 If you have made a real estate election ("REE"), you will be treated (with certain exceptions) as having opted to tax every property in which you acquire a 'relevant interest' after making the REE. You do not therefore notify individual options in relation to properties you acquire after making a REE. Where the person making a REE is in a VAT group, special rules apply to relevant associates (see section 4(h) below)

4.1.2 Under a REE, each property is treated as individually opted, with all the normal rules for an individual option applying. This means that you can individually revoke the option on each property if the applicable conditions are met. For example, if you have made a REE but you do not wish a property in which you acquire a relevant interest to be opted, you may revoke the option under the "cooling-off" provisions (see Section 5 below) and the option is treated as though it was never made.

b) Opting to tax an individual property after making a REE.

4.2 An option to tax only has effect under a REE in relation to land in which you subsequently acquire a relevant interest. The option in respect of such a property has effect from the start of the day on which you acquire it. If you wish to make an option to tax on land in respect of which you do not hold a relevant interest, or if you wish an option to have effect earlier than the day on which you acquire a relevant interest, you may do so by making a separately notified option to tax. Such an option will take the form of a single option relating to the land specified. If such a single option covers several properties, it may only be revoked during the cooling-off period or after 20 years have elapsed, if all the properties it covers meet the appropriate conditions.

c) Properties excluded from the effects of a REE

4.3 A REE will have no effect in relation to property in which you acquire a relevant interest after making it, in the following situations:

if you have already opted to tax a property (after making the REE) with effect from a time before you acquired a relevant interest in it.

If you had already opted to tax a property before making the REE and continue to hold that interest.

If you held a relevant interest in a property at the time you made a REE and still hold that interest when you later acquire a further (different) interest in the property.

If you already hold a relevant interest in a property which is not otherwise subject to an option to tax and have made exempt supplies within the last 10 years.

d) Revocation of existing options to tax on property in which the taxpayer has no

relevant interest at the time of making a REE

4.4.1 When you make a REE, any existing option to tax you have made in relation to property in which you do not hold a relevant interest is revoked. If an existing option covers more than one property, it only continues to have effect in relation to any properties in which you hold a relevant interest at the time of making the REE and the remainder of that original option is revoked.

4.4.2 A situation might arise where you have acquired, or are in the process of acquiring, some or all of the land within a given area – for example, with a view to re-development. Before making a REE, you could well have had an option to tax covering the whole area. If you make a REE, your option is revoked on any property within that area in which you do not hold a relevant interest at that time.

4.4.3 Although you cannot retain an option on property in which you have no relevant interest at the time you make the REE, you may make a new option in respect of that property and notify it so that it has effect immediately after the REE has been made.

e) Ability to treat a single existing option to tax that affects several parcels of land (inc any buildings) as if it were separate options to tax.

4.5.1 Where, before you make a REE, you have an option to tax in relation to land or buildings which comprise separate parcels of land (or which could be divided into separate parcels), you may treat that option as if it were separate options to tax each of those parcels. This choice is only available in relation to land or buildings in which you have a relevant interest at the time you make the REE. Each parcel of land that is to be treated as being separately opted must meet the conditions set out in box E below.

Box E

<table>
<tr><td colspan="2">Conversion of an option to tax land exercised before a real estate election into separate options to tax land in which a relevant interest is held at the time when the real estate election is made (for the purpose of paragraph 22(6) of Schedule 10 to the Value Added Tax Act 1994.</td></tr>
<tr><td colspan="2">A person making a real estate election may treat an option to tax made before the real estate election is made as though there were separate options to tax of individual parcels of that land. Each parcel of land that is to be treated as being separately opted must:</td></tr>
<tr><td>1</td><td>be identified by at least one of the following – its postal address, land registry title number, map or plan or other description sufficient to identify it; and</td></tr>
<tr><td>2</td><td>its scope meets the conditions relating to the scope of an option contained in paragraph 18 of Schedule 10 to the VAT Act 1994.</td></tr>
</table>

4.5.2 The following treatment will apply to the new and existing options: -

a) Any option to tax taken out on an individual property where a relevant interest in that property is held at the time of making the REE will be unaffected by the making of the REE.

b) Any option to tax taken out on an individual property where a relevant interest in that property is not held at the time of making the REE is immediately revoked.

c) Any property on which there is no option to tax and exempt supplies have previously been made will be unaffected by the making of a REE.

d) Any option to tax made on a larger parcel of land (incl. buildings) will be revoked to the extent that a relevant interest is not held (if the relevant interest is held in all of the land covered by the option, clearly there will be no revocation). The person making the REE now has two choices following any revocation:

i. ,to continue with the remainder of the existing option as in a) above; or,

ii. to take the remainder of the land to which the option still applies and convert that into smaller parcels of land, each subject to it own option to tax. The original option now ceases to exist as it has been converted to new options and/or revoked (see conditions in Box F above).

4.5.3 If a person making a REE decides to adopt paragraph 4.5.3 d)(ii) above then the following conditions apply to the newly created options:

a) For the purposes of the 20 year revocation rule, these new options are treated as having effect from the time at which the original option had effect.

b) The six month revocation "cooling-off period" in section 5 below does not apply to the new options.

f) Notifying a real estate election

4.6.1 If you make a REE, you must notify it to HMRC within 30 days of having made it, or such longer period as they may allow.

4.6.2 Notification must be made in the form specified and contain the information required. The form to do this will be available by 1 June 2008 and the information required is currently outlined at Annex 3.

4.6.3 If you hold relevant interests in any property other than in dwellings or buildings designed or adapted for use as a dwelling, in addition to notifying the REE, you must also provide a list of all properties in which you hold a relevant interest at the time you notify the REE. You must send this list to HMRC within the time specified for notifying the REE; otherwise the REE will not be effective. This list must contain the information specified in Box F below.

Box F

<table>
<tr><td colspan="2">Information to be provided with a notification of a real estate election by a person holding one or more relevant interests in land or buildings (for the purpose of paragraph 21(7) of Schedule 10 to the Value Added Tax Act 1994 ("the VAT Act 1994")).</td></tr>
<tr><td colspan="2">The notification of a real estate election must contain the required information in relation to any land or buildings (other than buildings designed or adapted for use as a dwelling or a number of dwellings) in which the person making a real estate election holds a relevant interest at the time of notification.</td></tr>
<tr><td colspan="2">The required information must be provided by way of a list specifying the following in respect of each property (other than dwellings or buildings designed or adapted for use as a dwelling) in which the person holds a relevant interest:</td></tr>
<tr><td>1</td><td>a description of the land or buildings, identified by reference to postal address, land registry title number, map, plan or other description;</td></tr>
<tr><td>2</td><td>in the case of land or buildings in respect of which no option to tax made by the maker of a real estate election has effect, the date of acquisition of a relevant interest in that land or buildings;</td></tr>
<tr><td>3</td><td>in the case of land or buildings in respect of which an option to tax made by the maker of a real estate election has effect, the date when the relevant interest in the land or building was first acquired or, if later, the date when the option first had effect;</td></tr>
<tr><td>4</td><td>where an option has effect in relation to two or more separately listed parcels of land or buildings, they must be identified as being subject to the same option.</td></tr>
<tr><td colspan="2">Explanatory Note 1
"Relevant interest" .has the same meaning as in paragraph 21(12) of Schedule 10 to the VAT Act</td></tr>
</table>

1994.
Explanatory Note 2 If the person making a real estate election has more than one relevant interest in a parcel of land or a building that were acquired at different times, only the date of acquisition of the most recently acquired relevant interest is to be provided.
Explanatory Note 3 If the person making a real estate election is required to provide the date when an option first had effect in relation to a parcel of land or a buildings and that date is unknown, that person should record that fact and enter an approximate date, using that person's best judgement, and provide a written explanation of why that date is considered reasonable.

4.6.4 If you make a REE and do not have a record of the date when an option first had effect in relation to land or building, explanatory note 3 to Box G allows you to provide an approximate date, using your best judgment. You also have to provide an explanation of why you consider that date is reasonable. HMRC will normally accept lists with such dates without further enquiry, but reserve the right to review them either as part of their general assurance and tax maintenance work, or as a result of a specific event (e.g. notification of the revocation of an option to tax).

4.6.5 If you submit an incomplete list or one which contains incorrect information, you should submit a revised and current up-dated list to your Client Relationship Manager or, if you do not have one, to the Option to Tax Unit in Glasgow, as soon as you identify the error.

g) Information requirements after a real estate election has been made

4.7.1 If you have made a REE, HMRC may, at any time, require you to provide within 30 days (or such longer period as they may allow) a list of all properties and parcels of land you hold at that time, together with details of all acquisitions, disposals and conversions to dwellings made since you last provided a list. In such a case, you have to provide the information set out in Box G below.

Box G

<table>
<tr><td colspan="2">Information to be provided by the maker of a real estate election when required to do so by the Commissioners (under paragraph 2 1(8) of Schedule 10 to the Value Added Tax Act 1994 ("the VAT Act 1994")).</td></tr>
<tr><td colspan="2">When required to do so, the maker of a real estate election must provide to the Commissioners the following information in relation to any land or buildings (other than buildings designed or adapted for use as a dwelling) in which that person or a relevant group member:
- holds a relevant interest at the time of providing the required information; or
- has ceased to hold a relevant interest since making a real estate election or, if later, since the last occasion on which the maker of the real estate election provided such information to the Commissioners.

The information set out in Part A of this box is to be provided in respect of every such property; the information set out in Part B is to be provided in respect of every such property in which a relevant interest has been acquired or disposed of by the maker of the real estate election or a relevant group member since the date of the last such list, if any.</td></tr>
<tr><td colspan="2">Part A.

In respect of any land or building in which the maker of a real estate election or a relevant group member holds a relevant interest or has ceased to hold such an interest as described above, the following information must be provided by way of a list specifying:</td></tr>
<tr><td>1</td><td>the description of the land or buildings identified by reference to its postal address, land registry title number, map, plan or other description;</td></tr>
</table>

2	in the case of land or buildings in respect of which no option to tax made by the maker of a real estate election or relevant group member has effect, the date of acquisition of the relevant interest in the land or buildings;
3	in the case of land or buildings in respect of which an option to tax made by the maker of a real estate election or a relevant group member has effect, the date when the relevant interest in the land or building was acquired or, if later, the date when the option first had effect;
4	where an option has effect in relation to two or more separately listed parcels of land or buildings, they must be identified as being subject to the same option.

Part B.

The following information must be provided in respect of every property in which a relevant interest has been acquired or disposed of by the maker or the real estate election or a relevant group member since the date of the last such list, if any, by way of a list specifying:

1	As appropriate, the date of the maker of the real estate election or a relevant group member: • acquiring a relevant interest in land or buildings in which that person has no other relevant interest; • ceasing to hold a relevant interest in land or buildings without retaining another relevant interest in that property; • opting to tax land or buildings otherwise than by virtue of a real estate election; • converting a building or buildings into a dwelling or dwellings; • excluding a new building from the effect of an option; and • revoking an option to tax in relation to land or buildings; • identifying the land or building to which each occurrence relates.
2	The VAT-exclusive value of the supply of a relevant interest acquired or disposed of by the maker of a real estate election or relevant group member.
3	The VAT (if any) charged on the supply of a relevant interest by the maker of a real estate election or, where the supply occurred before its admission to the group, the relevant group member.

Explanatory Note 1

“Relevant interest” and “relevant group member” have the same meanings as they do in paragraph 21(12) of Schedule 10 to the VAT Act 1994.

Explanatory Note 2

Where the maker of a real estate election or relevant group member has more than one relevant interest in the same land or building that were acquired at different times, only the date of acquisition of the most recently acquired relevant interest is to be provided.

Explanatory Note 3

In the case of land or a building in which an interest has been held before the date of a real estate election, the date of the occurrence of the making of an option to tax by the person making a real estate election or a relevant group member is the date when that option first has effect.

Explanatory Note 4 The date of the occurrence of the revocation of an option is the date from which the revocation has effect.
Explanatory Note 5 The requirement to provide the information set out in Parts A and B above does not apply to the revocation of an option to tax by virtue of paragraph 23 ("the cooling off" period) or paragraph 24 (lapse of 6 years since having a relevant interest) of Schedule 10 to the VAT Act 1994.

h) Treatment of real estate elections in VAT groups

4.8.1 In a VAT group, any relevant interests held in property can be held by any group member and any option to tax can also be made by any group member (although the declaration of any tax liability will be made by the VAT group representative member). Any member of a VAT group can make a REE although we expect that normally this will be done by the VAT group representative member. When a REE is made, the member making the REE will need to consider all the property holdings and options to tax made by every member of the VAT Group.

4.8.2 At the time of making a REE, the following treatment will apply:

a) Any option to tax previously taken out on an individual property of any VAT group member where that property is still held will be unaffected by the making of the REE. The original opter remains the opter.

b) Any option to tax taken out on an individual property by any VAT group member where a relevant interest in that property is not held by any member of the VAT group (including the member making the REE) will immediately be revoked (but see para 4.8.3 below).

c) Any property of any VAT group member on which there is no option to tax and on which exempt supplies have previously been made, will be unaffected by the making of a REE.

d) Any option to tax made on a larger parcel of land (inc buildings) by a VAT group member will be revoked to the extent that a relevant interest is not held by any member of that VAT group (if the a relevant interest is held in all of the land covered by the option, clearly there will be no revocation). The original opter now has two choices following any revocation:

i) to continue with the remainder of the existing option as in a) above; or,

ii) to take the remainder of the land to which the option still applies and convert that into smaller parcels of land, each subject to it own option to tax. These new options become options of the member making the REE, irrespective of which VAT group member made the original option. That original option now ceases to exist as it has been converted to new options and/or revoked. The original opter (if not the member making REE) now becomes a relevant associate in respect of these new options.

4.8.3 If a member of a VAT group makes a REE and decides to adopt the option in paragraph 4.8.2 d)(ii) above, then the following conditions apply to the newly created options:

a) For the purposes of the 20 year revocation rule, these new options are treated as having effect from the time at which the original option had effect.

b) For the purposes of the rules governing relevant associates, these new options are treated as having effect from the time the REE is made

c) The six month revocation "cooling-off period" described in Section 5 below does not apply to the new options.

d) If a relevant associate subsequently leaves the VAT group with an interest in the property, the 6 year revocation rule in Section 6 below does not apply.

i) Revocation of a Real Estate Election

4.9.1 Once you have made a REE, it cannot be revoked but HMRC have the power to withdraw a REE if you repeatedly do not comply with its terms and conditions.

4.9.2 If the REE is withdrawn and subsequently, HMRC agree to a new application for a REE, paragraph 4.5.1 above will not apply to the new REE.

Section 5 – Revocation of an option to tax during the "cooling-off" period

5.1.1 In order for you to be able to revoke an option to tax during the "cooling-off" period, all the following conditions must always be met:

- no more than six months have passed since the day on which the option had effect;
- no use, including your own occupation, has been made of the land since the option had effect;
- no tax has become chargeable on a supply of the land as a result of the option;
- no transfer of a going concern has occurred; and
- you have notified the revocation to HMRC on the form set out in Annex 4 containing the required information.

5.1.2 In addition to these conditions, under paragraph 23(4) of Schedule 10 to the VAT Act 1994, HMRC specify an additional condition as set out in Box H below.

Box H

Additional conditions for revoking an option within 6 months of the option first having effect (under paragraph 23(4) of Schedule 10 to the Value Added Tax Act 1994 ("the VAT Act 1994")).
The revocation of an option to tax under paragraph 23 of Schedule 10 to the VAT Act 1994 is effective only if none of the input tax of the person who made the option (or a relevant associate of that person) is allowable for credit as being attributable to supplies that are excluded from Group 1 of Schedule 9 to the VAT Act 1994 by virtue of the option.
Explanatory Note For the purposes of the condition, input tax of the person who made the option shall not be regarded as allowable for credit if: (a) in the event of the option being revoked, that person would be liable to repay to the Commissioners an amount equal to that input tax by virtue of regulation 108 of the Value Added Tax Regulations 1995 ("the VAT Regulations 1995"); (b) that person is entitled to deduct it provisionally as attributable to taxable supplies by virtue of regulation 101 of the VAT Regulations 1995, or a method approved or directed by the Commissioners pursuant to regulation 102 of those regulations but it is not input tax on goods or services used or to be used by that person exclusively in making supplies that do not fall within Group 1 of Schedule 9 to the VAT Act 1994 by virtue of the option; or (c) it is input tax on a capital item, subject to adjustments in accordance with part 15 of the VAT Regulations 1995.

5.1.3 If all the conditions in paragraph 5.1.1 and Box I are met, you may revoke the option to tax, without prior permission from HMRC, but you must notify the revocation to them.

5.1.4 If one or more of the conditions for the revocation of an option to tax during the cooling-off period set out in paragraph 5.1 and Box I are not met then you may seek prior permission for revocation from HMRC, provided that you apply within 6 months of the date when the option first had effect. Permission must be sought in the form specified and contain the information required. The form to do this will be available by 1 June 2008 and the information required is currently outlined at Annex 4. In deciding whether or not to give permission, HMRC will give particular consideration to whether you or a third party have received a VAT benefit as a result of their action.

5.1.5 The revocation of an option to tax during its "cooling-off" period has effect from the day on which the option was exercised. However, the revocation of an option to tax may be disregarded where any conditions set by HMRC when granting permission to revoke are not met.

5.1.6 If you revoke an option to tax under the "cooling off" rules, you should adjust your input tax as set out below.

- if you are a fully taxable taxpayer, you are required to repay any such input tax under regulation 108 of the VAT Regulations 1995 (“clawback” provisions).
- if you are otherwise partly exempt you are required to repay any such input tax under regulation 107 of the VAT Regulations 1995 (the “annual adjustment”) if the input tax was deducted and the option to tax revoked in the same partial exemption longer period; otherwise, you should do this under regulation 108 of the VAT Regulations 1995 (“clawback” provisions).
- if you opt to tax a building after your occupation of it has ceased and have revoked that option (by meeting the conditions set out in paragraph 5.1 and Box I above or by obtaining prior permission of HMRC), you must make adjustments under the Capital Goods Scheme (Part XV of the VAT Regulations 1995).

5.1.7 The “cooling-off” period does not apply to new options to tax of a person making a REE that are created following the conversion of an existing option to tax into several separate options to tax at the time a REE is made.

Section 6 – Revoking an option where no interest has been held for more than 6 years

6.1.1 An option to tax exercised by any person in relation to a property where no interest has been held for over 6 years is treated as being automatically revoked from that time.

6.1.2 However the 6 year revocation does not apply where the opter has been a member of a VAT group during any time in the relevant 6 year period and any relevant associate of the opter (including those who were relevant associates prior to the start of the relevant 6 year period) has left the VAT group with a relevant interest in the property.

6.1.3 A “relevant 6 year period” means any period of 6 years commencing with when then opter or any relevant associate of the opter, ceases to have any relevant interest in the building.

Section 7 – Revocation of an option where more than 20 years have elapsed since it first had effect

a) Revocation of an option without HMRC’s prior permission

7.1.1 You may revoke an option to tax where more than 20 years have elapsed since it first had effect, provided the conditions specified below are met, or you obtain the prior permission of HMRC.

7.1.2 The conditions for the revocation of an option to tax without the prior permission of HMRC are set out in Box I below. In addition, in order for the revocation to be effective, you must notify it to HMRC, on the form to do this will be available by 1 June 2008 and the information required is currently outlined at Annex 5.

Box I

<table>
<tr><td colspan="2">Conditions for revoking an option to tax when more than 20 years have elapsed since a relevant interest was first held in an opted building or land and the option first had effect (for the purposes of paragraph 25(1)(a) of Schedule 10 to the Value Added Tax Act 1994 (“the VAT Act 1994“)).</td></tr>
<tr><td colspan="2">A taxpayer may revoke an option to tax made by the taxpayer if either condition 1 below OR all of conditions 2 to 5 are met.</td></tr>
<tr><td>1</td><td>The relevant interest condition

The taxpayer or a relevant group member has no relevant interest in the building or land at the time when the option is revoked.</td></tr>
<tr><td>2</td><td>The 20 year condition

The taxpayer held a relevant interest in the building or land at a time:
• when the option first had effect; and
• more than 20 years before the option is revoked.</td></tr>
</table>

3	The capital item condition Any land or building that is subject to the option at the time when it is revoked does not fall, in relation to the taxpayer, for input tax adjustment as a capital item under part 15 of the Value Added Tax Regulations 1995 (adjustments to the deduction of input tax on capital items).
4	The valuation condition The taxpayer has made no supply of a relevant interest in the building or land subject to the option in the 10 years immediately before revocation of the option that: • was for a consideration that was less than the open market value of that supply, or • arose from a relevant grant.
5	The pre-payment condition No part of a supply of goods or services made for consideration to the taxpayer before the option is revoked will be attributable to a supply or other use of the land or buildings by the taxpayer more than 12 months after the option is revoked.
Explanatory Note 1 "Taxpayer" means- (a) a person who exercised the option to tax or treated as making that option by virtue of a real estate election pursuant to paragraph 21 of Schedule 10 to the Act; and (b) in relation to an option to tax treated as exercised by virtue of a real estate election made pursuant to paragraph 21 of Schedule 10 to the VAT Act 1994 by a body corporate treated as a member of a group under sections 43A to 43D of the Act other than the person described in (a) above, the body corporate whose relevant interest gave rise to the option to tax. "Relevant interest in the building or land" means an interest in, right over or licence to occupy the building or land (or any part of it).	
Explanatory Note "a relevant group member" means a body corporate which is treated under Sections 43A to 43D as a member of the same group as that person at that time	
Explanatory Note 3 "Relevant grant" means a grant that the taxpayer intends or expects will give rise to a supply made after the option is revoked for a consideration significantly greater than any consideration for any supply arising from the grant before the revocation (except as a result of a rent review determined according to normal commercial practice).	
Explanatory Note 4 In relation to condition 2 above, it does not matter whether, at the time the option is revoked, the taxpayer continues to hold the relevant interest in the building or land that meets the condition.	

b) Prior permission to revoke an option where one or more of the automatic permission conditions to revoke are not met.

7.2.1 If you do not meet the conditions set out in Box I above, you may apply to HMRC for prior permission to revoke an option to tax. If condition 1 is not met, permission will not be given unless condition 2 is met. You must make an application for prior permission of HMRC for the revocation of an option to tax in the form shown in Annex 5. It must contain the required information.

7.2.2 HMRC will only give permission in relation to those of conditions 3 to 5 in Box I above that have not been met. You will need to certify those conditions that have been met. In deciding whether to give permission, HMRC will give particular consideration to whether or not you or a third party have received a VAT benefit as a result of you action.

7.2.3 For example, a case could arise where one year before revocation, you had pre-paid for the next three years' cleaning services and, because of your intention to revoke, you only deducted one third of the input tax charged. While you fail to meet condition 5 of the automatic permission conditions because the pre-payment related to services being received more than 12 months after the date of revocation, HMRC would nevertheless grant permission since you would have recovered a fair and reasonable amount of input tax. If you had deducted all the input tax on the cleaning services, unless there was some way to re-visit the original input tax deduction within the confines of the law, permission would likely be refused.

c) Incorrect certification given

7.3.1 If you certify that you have met one or more of the automatic permission conditions and it later transpires that any of those conditions were in fact not met, your revocation will be invalid and the property will remain subject to the option to tax. However, HMRC may nevertheless treat the option as though you had validly revoked it, especially if permission would have been granted had prior permission been sought on the condition at the time.

Section 8 – Changes to the option to tax

a) Changes to the option to tax from 1 June 2008

8.1.1 The new Schedule 10 to the VAT Act 1994 makes it clear that an option to tax land equally applies to a building upon it (either at the time of opting or constructed later) and vice versa. The previous Schedule 10 also clearly applied to supplies of land and buildings. However, HMRC had a policy of allowing businesses to opt to tax land and buildings separately. This policy is withdrawn with effect from 1 June 2008 and, from that date, it will no longer be possible to opt to tax a building separately from the land.

8.1.2 However, in order to provide business with similar flexibility to that available under HMRC's former policy, the new Schedule 10 permits a new building (and the land within its curtilage) to be permanently excluded from the effects of an option to tax at certain points in time (see Section 9 below for more details).

b) Treatment of existing options to tax.

8.2.1 Any option to tax that has already been made or notified will be taken as an option to tax the land and any buildings on it in accordance with the legislation (both former and new). However, as a transitional rule, provided that it is clear from your notification of the option to tax that the option was made on the building only, you may, if you wish, treat the option as revoked when the building is demolished at any time in the future. If you wish to take advantage of this transitional rule, you do not need to notify HMRC before revoking the option. However, you should retain your evidence in case it is requested in the future.

8.2.2 If you had opted to tax land only, that option was previously suspended when a building was constructed upon it. This suspension will no longer be available because of Section 9 below.

c) Coverage of an option to tax

8.3 A future option to tax does not need to cover just a single property. It can also cover an area of land (e.g. City of London) or wider geographical area (e.g. Wales). However, you should be aware that in order to revoke that option all the relevant interests in land held must all meet the conditions. You should also remember that the 6 month "cooling off" period only applies to the time the option is made and not when an individual property was acquired. A real estate election may provide an alternative solution.

Section 9 – Excluding the effects of an option on a new building.

9.1 When you construct a new building on opted land (and that new building is not within the curtilage of an existing building), you can exclude the new building (and land within its curtilage) from the effects of an option to tax. The time when construction of a new building begins is determined by box J below.

Box J

The time at which the construction of a new building is taken to begin for the purposes of excluding it from the effect of an option to tax (for the purposes of paragraph 27(7) of Schedule 10 to the VAT Act 1994).
Construction of a building begins when it progresses above the level of the building's foundations.

9.2 If you decide to exclude a new building from an option to tax, the effect of that exclusion is permanent (but you may make a fresh option to tax in the future). The exclusion must have effect from the earliest of the following times:

- when a grant of an interest in, or in any part of, the new building is first made;
- when the new building, or any part of it, is first occupied; or
- when the new building is completed.

You must notify the exclusion to HMRC before the date that it is to have effect on the form to be made available from 1 June 2008 (currently outlined at Annex 6).

Section 10 – Obtaining prior permission from HMRC before making an option to tax where exempt grants have already been made

a) Automatic permission

10.1 If an exempt supply of the land has been made in the period of 10 years before the intended first effective date of an option to tax, then written permission to opt to tax is required from HMRC. Alternatively, if one of the automatic permission conditions set out at paragraph 5.2 of Notice 742A (Opting to tax land and buildings) is met, and so certified, then permission is deemed to have been granted automatically to the taxpayer. A written notification of the option to tax still needs to be made to HMRC on the form to be made available from 1 June 2008 (currently outlined at Annex 7).

b) Prior permission

10.2.1 If an exempt supply of the land has been made in the previous 10 years and none of the conditions for automatic permission as set out in paragraph 5.2 of Notice 742A (Opting to tax land and buildings) are met, you must first seek written permission to opt to tax from HMRC. As part of your application, you must notify from which day you want your option to be effective from. This can be any date on or after the date you make your application. Before granting such permission, HMRC will consider the facts of each case and you will need to provide appropriate information. A form for this purpose will be made available from 1 June 2008 (currently outlined at Annex 7).

10.2.2 HMRC will not grant permission to opt to tax unless you have provided all the specified information, and any additional information requested. HMRC may refuse permission if they are not satisfied that granting permission would result in a fair and reasonable attribution of input tax. Once HMRC are satisfied, permission is granted and the option takes immediate effect from the date you notified with your application. There is no separate notification after permission is granted

10.2.3 The law does not provide for permission to opt to tax to be granted retrospectively. Any VAT that may have been charged in error is not output tax, and unless this is corrected, HMRC will collect it as a debt. Any input tax that has been claimed in error is exempt input tax and is not deductible.

c) What if an option to tax is exercised where prior permission was required?

10.3. If an option to tax has been notified but should have been subject to the prior permission of HMRC, then HMRC may allow the option to tax to be retained. In such a case, the option is treated as having been validly made and effective from the date it was originally notified.

Annex 1 – Form to be specified by the Commissioners pursuant to paragraph 4 of Schedule 10 to the VAT Act 1994 -

Notification by a body corporate ceasing to be a Relevant Associate including application for prior permission.

This form (to be designed by HMRC forms unit) will seek the following information:

- the name, address and (if appropriate) the VAT registration number of the relevant associate;
- the date when the body corporate ceases to be a relevant associate
- the address or precise location of the opted property and/or (if appropriate) the land registry number; and
- the date the interest in the opted property was acquired.

In addition, where the relevant associate meets the conditions for ceasing to be a relevant associate of the opter, it must certify that all the following conditions have been met:

Condition 1 – The grouping condition (yes/no)

Condition 2 – The 20 year condition (yes/no)

Condition 3 – The capital item condition (yes/no)

Condition 4 – The valuation condition (yes/no)

Condition 5 – The pre-payment condition (yes/no)

For those seeking prior permission who are unable to meet one or more of the conditions 3, 4 or 5 (permission will not be granted in any circumstance where conditions 1 and 2 are not met) must certify those conditions which are met and provide full details of why the other conditions have not been met, for the Commissioners to consider whether to grant permission.

In all cases, the name of signatory and date must be shown and the form signed (by a named authorised signatory e.g. sole proprietor, partner, company secretary, director, trustee or any other person for whom one of those above have provided written authority to provide this certificate on their behalf).

Annex 2 – Form to be specified by the Commissioners pursuant to paragraph 6 of Schedule 10 to the VAT Act 1994 –

Certificate excluding a building from the effect of an option to tax.

This certificate must be used to:

1) Exclude the effect of an option to tax in relation to a supply of a building to be converted into a dwelling (or number of dwellings) or for a relevant residential purpose and can be issued by the person carrying out the conversion or a relevant intermediaries; or

2) Exclude the effect of an option to tax in relation to a supply of land to a relevant housing association where the land is to be used for the construction of a building or buildings to be used as a dwelling (a number of dwellings) or solely for a relevant residential purpose

This certificate (to be designed by HMRC forms unit) must be received by the supplier before his supply is made and show the following information:

- name, address and VAT registration number (if appropriate) of purchaser;
- name, address and VAT registration number (if appropriate) of vendor;
- address of the opted building/land;
- if only part of a building is to be converted, a clear description of the parts to be converted;
- name, signature and date (must be signed by a named authorised signatory e.g. sole proprietor, partner, company secretary, director, trustee or any other person for whom one of those above have provided written authority to provide this certificate on their behalf)

The person giving the certificate needs to certify one of the following:

(1) I certify that the building, or part of the building, described above is intended for use as a dwelling (or number of dwellings) or solely for a relevant residential purpose within Note (4) to Group 5 of Schedule 8 to the Value Added Tax Act 1994, because I intend to use the building or part of the building for such a purpose,

(2) I certify that the building or part of the building described above is intended for use as a dwelling (or number of dwellings) or solely for a relevant residential purpose within Note (4) to Group 5 of Schedule 8 to the Value Added Tax Act 1994, because I intend to convert the building or part of the building with a view to its being used for such a purpose, .

(3) I certify that I am a relevant intermediary, within the meaning of paragraph 6(4) of Schedule 10 to the Value Added Tax Act and I intend to dispose of my entire interest in the building or part of the building which is to be granted to me by the seller to either another relevant intermediary or to someone who intends to convert the building into a dwelling (or a number of dwellings) or for a relevant residential use and I already hold a certificate from them to me confirming this

(4) I certify that the land described above (after any necessary demolition of existing buildings) is being supplied to a housing association and is intended to be used by them to construct a dwelling (or a number of dwellings) or solely for a relevant residential purpose within Note (4) to Group 5 of Schedule 8 to the Value Added Tax Act 1994

Annex 3 – Form to be specified by the Commissioners pursuant to paragraph 21 of Schedule 10 of the VAT Act 1994 –

Notification of a Real Estate Election

This notification (to be designed by HMRC forms unit) will seek the following information. It is likely that it will be combined with the VAT 1614 – Notification of an option to tax.

This notification must be given to the Commissioners within 30 days of the date of making a real estate election or such longer period as the Commissioners may allow. The following information will be required:

- name and address of taxpayer;
- VAT registration number
- effective date of the universal option
- is any relevant interest (see paragraph 4.3.1) held in property (yes/no) (if a relevant property interest is held, the appropriate list of property information as set out in Box F must accompany the notification)
- name, signature and date (must be signed by a named authorised signatory e.g. sole proprietor, partner, company secretary, director, trustee or any other person for whom one of those above have provided written authority to provide this certificate on their behalf)

Annex 4 – Form to be specified by the Commissioners pursuant to paragraph 23 of Schedule 10 of the VAT Act 1994 -

Revocation of an option to tax during the “cooling- off” period.

This notification must be made before the end of the 6 month cooling-off period. The conditions set out in paragraph 5.1 above and the additional condition set out in box H must be met. If all these the conditions are met then the option will be revoked with effect from the day on which it was made.

If one or more of the conditions in paragraph 5.1 or the additional condition set out in Box H above are not met, then prior permission may be sought from the Commissioners. The applicant will have to certify which of the conditions are met and then provide full details of which conditions have not been met for the Commissioners to consider whether to grant permission.

The following information will be required in all cases:

- name, address and VAT registration number (if appropriate) of the applicant;
- identification of the opted property (the property or area of land is to be identified by its address or precise location and/or (if appropriate) the land registry number);
- the date of acquisition of the interest in the opted property; and
- the date on which the option was made.
- name, signature and date (must be signed by a named authorised signatory e.g. sole proprietor, partner, company secretary, director, trustee or any other person for whom one of those above have provided written authority to provide this certificate on their behalf)

Annex 5 – Form to be specified by the Commissioners pursuant to paragraph 25 of Schedule 10 to the VAT Act 1994 -

Revocation of an option to tax after 20 years have passed since the option to tax had effect.

This notification (to be designed by HMRC forms unit) will seek the following information:

- name, address and VAT registration number (if appropriate) of the taxpayer;
- address or precise location of the opted property (the property or area of land and/or (if appropriate) the land registry number);
- date of acquisition of interest in the opted property;
- date of revocation (this must not be a date before the date of the notification containing the required certificate);

I certify that on the date of revocation of the option that the following conditions contained in Box “I” are met in relation to the option-

Condition 1 – The relevant interest condition (yes/no). (If this condition is met the remaining conditions need not be certified).

Condition 2 – The 20 year condition (yes/no)

Condition 3 – The capital item condition (yes/no)

Condition 4 – The valuation condition (yes/no)

Condition 5 – The pre-payment condition (yes/no).

If condition 1 is not met, but condition 2 is met, the Commissioners may give prior permission to revoke an option after 20 years where one or more of conditions 3, 4 or 5 above have not been met. Full details of why the other conditions have not been met must be provided if the Commissioners are to consider whether to grant prior permission.

In all cases, the name of signatory and date must be shown and the form signed (by a named authorised signatory e.g. sole proprietor, partner, company secretary, director, trustee or any other person for whom one of those above have provided written authority to provide this certificate on their behalf).

Annex 6 – Form to be specified by the Commissioners pursuant to paragraph 27 of Schedule 10 of the VAT Act 1994 -

Exclusion from the effects of an option to tax – New Buildings

This form of notification (to be designed by HMRC forms unit) must be given to the Commissioners before the time from which the exclusion is to have effect. The following information will be required:

- name, address and VAT registration number of the taxpayer;
- identification of the opted property to be excluded from the effects of the option (the property or area of land is to be identified by its address or precise location and/or (if appropriate) the land registry number);
- the date from which the exclusion will have effect, being the earliest of the following:

  (a) the first grant of an interest in the new building;

  (b) when the new building is first used; or

  (c) when the construction of the new building is completed;

Name, signature and date (must be signed by a named authorised signatory e.g. sole proprietor, partner, company secretary, director, trustee or any other person for whom one of those above have provided written authority to provide this certificate on their behalf).

Annex 7 – Form to be specified by the Commissioners pursuant to paragraph 29 of Schedule 10 to the VAT Act 1994 -

Application for prior permission from the Commissioners to opt to tax.

Application for prior permission of the Commissioners to opt to tax a property, where any exempt supplies have been made during the period of 10 years ending with the intended date from which the option to tax will take effect.

The following information must to be provided if none of the conditions set out in paragraph 5.2 of Notice 742A – Opting to tax land and buildings are met:

(a) A description of your future plans for the land or building should we grant permission to opt to tax. Please include the expected value of taxable supplies in the next 10 years as well ensure your application includes the full address of the property including postcode or land registry title number. Please note that if you are opting to tax a discrete parcel of land to tax we will require a map outlining the area to be covered by the option.

(b) If you wish to recover pre-election input tax please provide a schedule of the preelection input tax you wish to reclaim. This schedule, together with copies of the original invoices, should show the name of the supplier, date of the invoice, invoice number, total cost, VAT amount and description of goods or services supplied.

(c) What is the value of the input tax you expect to incur in the future if we grant permission to opt to tax? Please give full details, for example of any Rents, Premiums, Surrenders , or, Refurbishments, etc.

(d) Prior to opting to tax, what is the total value of exempt supplies made in relation to the land/building in the last 10 years?

  (i) Is the land/building currently being used to make exempt supplies? If not, please advise when your last exempt supply was made.

  (ii) Have there been any grants made for a premium or pre-payment of rent? If yes please provide full details.

(e) Are any exempt supplies likely to be made after your option to tax is effective? If yes please give details, e.g. if the option to tax is to disapply for any reason (section 3 of notice 742A refers).

(f) whether you, or anyone who has helped to fund the land or building, (the financier), or anyone connected to you or the financier is occupying or intending to occupy any part of the land or building.

Disapplication scheme worked

A college wanted to renovate its library, while minimising the cost of irrecoverable VAT on the renovation works. It formed a wholly-owned subsidiary company, elected to waive exemption over the library building, and granted a lease to the subsidiary. It then claimed input tax on the costs of renovation, on the grounds that it was making a taxable supply of the library to the subsidiary. The subsidiary would be able to recover the VAT as it was making zero-rated supplies of books.

Customs objected, and the Tribunal agreed. According to the Tribunal, the college remained in occupation of the library throughout, and the disapplication rules in Sch.10 para.2(3AA) applied. Occupation was a question of fact, and the facts did not point to any separate occupation for a taxable purpose by the subsidiary.

The Court of Appeal overturned this decision. The appeal court judges decided that the arrangements were real and had to be given their legal consequences, even if they were entered into for no commercial purpose other than a VAT advantage; even though the library staff remained employees of the college throughout, they had been seconded to the subsidiary and were answerable only to the subsidiary during their period of secondment. It was therefore not possible to say that the college remained in occupation of the building. The court distinguished the case of *Brambletye School Trust* (VTD 17,688) on the basis that the school's own staff were in occupation and control of the sports hall in that situation.

The House of Lords has dismissed HMRC's appeal against this decision by a majority of 3-2. It was critical that HMRC deliberately did not attempt to rely on any overriding anti-avoidance principle such as "abuse of rights", but rather wanted to test whether the existing anti-avoidance rules worked: it is clear that they do not.

The case turned only on whether the college remained "in occupation of" the library after the lease was put in place. The Lords discussed the concept of "occupation" at length and the difference between "occupation" and "use". Lord Hoffmann held that Parliament must have intended that these words came with well-established meanings, because they are not defined in the law; according to law and practice, the mere right to use land was not the same as "occupation". In spite of the artificiality of the arrangements, it was the subsidiary that occupied the land. The services provided by the company were not merely passive.

The ECJ tests of "letting or leasing of land" were considered relevant – as in the *Sinclair Collis* decision, it was relevant to consider who had the right to exclude others and act as if the owner of the land. That was the subsidiary, not the college.

House of Lords: *Newnham College in the University of Cambridge v HMRC*

Produced by Mike Thexton

Lecture B500 (22.33 Minutes)

Stamp Duty & Stamp Duty Land Tax

Stamp duty land tax threshold

The Chancellor has announced that stamp duty land tax will not apply to land transactions consisting entirely of residential property where the chargeable consideration is not more than £175,000. The relief will apply to transactions with an effective date on or after 3 September 2008 and before 3 September 2009.

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