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Personal Tax

Reduction of the personal allowance from 2010/11 onwards

One of the stranger Pre-Budget Report announcements was the disclosure that, from 2010/11 onwards, the basic personal allowance will be subject to income limits in a manner not that dissimilar to the regime applying for the age allowance.

Where an individual's total income (as defined in S23 ITA 2007) less any trading losses for which he claims relief – HMRC refer to this as 'gross' income – is £100,000 or less, he will continue to be entitled to the full amount of the personal allowance. For the sake of completeness, it should be pointed out that this figure of £100,000 is *before* deduction of the personal allowance.

However, where that person's 'gross' income exceeds £100,000, his personal allowance will be withdrawn at the rate of £1 for every £2 of excess income up to a maximum of one half of the personal allowance.

Illustration 1

In 2010/11, David has a total income of £103,000. On the assumption that the personal allowance for that year is £6,605, David's taxable income is computed as follows:

	£	£
'Gross' income		103,000
Less: PA	6,605	
Less: Restriction (½ x 3,000)	1,500	
		5,105
		£97,895

Illustration 2

If David's total income for 2010/11 had instead been £115,000, his taxable income would be:

	£	£
'Gross' income		115,000
Less: PA	6,605	
Less: Restriction (½ x 6,605)	3,302	
		3,303
		£111,697

Note that, where a taxpayer's 'gross' income exceeds £100,000, the restriction is always rounded down, if relevant. Put another way, the remaining personal allowance is rounded up.

The effect of this restriction is to create a marginal income tax rate of 60% for the band of taxable income between £93,395 and £103,302!

There is a second withdrawal if an individual's 'gross' income exceeds £140,000. The balance of the personal allowance (£3,303 in Illustration 2) is clawed back on the same basis, but this time by reference to an income limit of £140,000.

Illustration 3

If David's total income for 2010/11 was £143,000, his taxable income would be:

	£	£
'Gross' income		143,000
Less: PA	3,303	
Less: Restriction (½ x 3,000)	1,500	
		1,803
		£141,197

With a residual personal allowance of £3,303, the relief runs out at £146,606. This final restriction creates another marginal rate band of 60%.

What an unnecessary complication of the income tax system! As one commentator has put it:

> 'It is hard to see where the logic is in this approach. The old canard that the personal allowance is worth more to higher rate taxpayers was trotted out yet again, but the Pre-Budget Notice itself gives the lie to this, saying correctly that "the basic personal allowance provides an amount of tax-free income". It should not, therefore, be seen as an allowance which comes off the top of your income saving you tax at your marginal rate, but rather as your lowest slice of income which is tax-free for everyone.'

As mentioned earlier, the restriction of the personal allowance mirrors the arrangements for withdrawing the age allowance. One of the difficulties with the age allowance rules is that they do not fit very comfortably within the PAYE system, requiring, as they do, estimates to be made of the taxpayer's income and hence of the personal allowance available. In the words of the commentator quoted above:

> 'Inevitably, these estimates turn out to be wrong, meaning that people will either overpay or underpay, creating work for both HMRC and the taxpayers and their advisers.'

There will be the same problems with the restriction of the personal allowance.

Article by Robert Jamieson

Lecture P511 (9.34 Minutes)

A new top rate of tax

An additional tier of higher rate tax set at 45% is to be introduced for taxable income above £150,000 from 2011/12 onwards. This will apply to all categories of income other than dividends. Dividend income above this threshold will be liable at 37.5% and so there will be three possible rates of tax for dividends:

(i) 10% for dividends falling within the basic rate band;

(ii) 32.5% for dividends falling within the higher rate band; and

(iii) 37.5% for all other dividends.

The effective rate of tax on dividends where taxable income exceeds £150,000 will therefore rise from 25% to 30.56%.

For example:

Dividends (x 100/90)	£1,000
	£
Tax @ 37.5%	375
Less: Tax credit	100
	£275

This produces 275/900 x 100 = 30.56%.

This change will reduce significantly the advantage of a dividend over a bonus in the case of an owner-managed company paying corporation tax at the small companies rate. For companies paying tax at the full rate of 28%, dividends will cease to be the preferred option in such circumstances.

There has been a considerable amount of discussion about the reason for the complicated formula for withdrawing the personal allowance discussed in paragraph 1 above. It has been calculated that, if the threshold at which the 45% rate started was around £85,000 (with the retention of a full personal allowance), this would raise roughly the same amount of tax as the £100,000 and £140,000 clawback rules. So why did the Chancellor not go for this simpler alternative?

The answer is twofold:

1. there are many more taxpayers with incomes of £85,000 than there are with incomes of £150,000 (and the headline threshold for the 45% rate is, of course, £150,000); and
2. although the Government made a pledge in 2005 not to increase the top rate of tax during the present Parliament, no such commitment was given to retain the value of personal allowances – there is no certainty that the next General Election will take place before 6 April 2010.

The proposed increase in the top rate of UK tax contrasts oddly with the global trend over the last decade and, if introduced, would mean that the UK's biggest earners will face a top rate significantly higher than the EU average. In a global economy with increased mobility for all sectors of the workforce, this has serious implications in terms of maintaining the UK as an attractive place in which to live and work. An individual earning, say, £300,000 faces the prospect of paying around 4% of his income (ie. nearly £12,000) in extra tax from 2011/12 onwards due to a combination of the 5% tax rate rise, the loss of his personal allowance and the 0.5% NIC increase. Entrepreneurs will also feel a growing tension between income generation and wealth creation, given a capital gains regime with a maximum rate of only 18%.

In addition, discretionary and accumulation trusts will not be immune from the tax rate rise. In 2011/12, the trust rate will go up to 45% and the dividend trust rate will become 37.5%.

Article by Robert Jamieson

Lecture P512 (17.20 Minutes)

Christmas benefits-in- kind

Christmas or annual party

There is a tax exemption under ITEPA 2003, s 264, which allows employers to have one or more annual events for employees and directors providing that the cost per head does not exceed £150.

When determining the cost of the event or events, you must include VAT and the cost of transport as well as overnight accommodation if these are also provided to enable the employees to attend.

The total cost of each function is divided by the total number of people who attend (including guests that are not employees) in order to arrive at the total cost per head.

Open to all employees

To take advantage of this tax exemption, the function must be open to all employees generally, including cleaners and security personnel should.

For companies that are spread across multiple sites this was always a problem, so different functions can now be held at different locations providing the party or function is available to employees generally at one location. The arrangement for separate functions at different locations can be extended to different sections or departments providing they are available generally to all staff at the site.

Exceeding the £150 limit

The £150 per head limit is not an allowance to be set against the cost if the cost of £150 is exceeded.

So for example, where an employee attends two functions during a tax year, one costing say £70 per head and the other £100 per head, the higher costing event is covered by the exemption, while the £70 is taxable.

Example

Let's suppose that the directors of a company hold a Christmas party for all their employees which costs £50 per head including VAT and then a second party which is not open to employees – only directors and their partners – and which costs £100 per head.

The directors' party is fully taxable because although the aggregate cost of the two events does not exceed the £150 limit, the second event is not available generally to all employees, only to the directors, so it does not qualify for the exemption.

Business contacts and partners

The £150 limit is not restricted to employees.

If the guests include customers, outside business contacts or employees' partners, providing the overall cost is no more than £150 per head then the tax exemption remains.

Trivial benefits at Christmas

It is traditional for some employers to provide their employees with a small gift of a Christmas turkey, a bottle of wine or box of chocolates.

P11D employees must have this gift declared on form P11D and they are taxed at the cost to their employer.

P9D employees are taxed on the second-hand value of the benefit.

Although tax and NICs are due on all benefits, tax is waived on benefits of a trivial nature such as turkeys, chocolates or one or two bottles of wine. No specific value has been placed on a trivial benefit so if in doubt a check should be made with the tax office. However, if the wine provided to an employee was an expensive bottle of vintage wine then the de minimis rule does not apply.

Vouchers

If the employer provides gifts such as gift vouchers or other items to employees then these are taxable and NICable.

The benefit is taxed by declaring the cost on the P11D, but Class 1 National Insurance is due through the payroll on the cost to the employer at the time that the voucher was provided.

If the voucher were exchangeable for cash, even though the cost to the employer may be less than the face value, the employee would be subject to tax and National Insurance on the face value.

Goods at a discount

Let's suppose that the employer is a manufacturer of goods and allows its employees to purchase goods at a discount of 40% off of the store price. To qualify for the discount the employee has to show a special card, which confirms that the individual is an employee of the company and entitled to the discount.

The cost of producing the goods costs the employer 50% of the store mark up price and because the employee is paying more than the cost price (60% of the mark up value) of the item there is no taxable benefit.

Because proof of the discount is the provision of a card, this falls outside of the definition of earnings and therefore there is no National Insurance liability.

Third party gifts

If an employee receives a gift from a third party who is not the employer or someone connected with the employer, providing the gift consists of goods or a voucher or token that is only capable of being used to obtain goods then this is not taxable.

The gift cannot be in recognition of the performance of particular services during the course of the employment or in anticipation of future services to be performed.

Furthermore, the employer or someone connected with the employer cannot have directly procured the gift. The limit on the cost of the gifts cannot exceed £250 and the total cost of all gifts by the same donor to the employee or members of their family or household cannot exceed £250 during the tax year.

If the gift is in recognition of the job that the employee performs, then the gift is taxable.

PAYE settlement agreement

And finally, remember where the employee is liable to the tax on any of the above benefits, the employer could enter into a PAYE settlement agreement (a PSA) with HMRC to meet the tax liability, which is due on the grossed up amount.

From an article by Linda Pullen

Lecture P513 (10.34Minutes)

NHS pension scheme changes

The schemes

New pension arrangements came into effect on 1 April 2008 from which date there will be two schemes:

1. The current modified scheme which will be called the *NHS Pension Scheme* and will apply to anyone who is an active member on or before 1 April 2008.
2. A new final salary scheme called the *New NHS Pension Scheme* which will be for anyone who joins on or after 1 April 2008.

Transition

Active members of the old scheme will be offered the choice, between 1 July 2009 and 30 June 2010, of moving to be part of the New NHS Pension Scheme.

Pension age

The schemes allow individuals to be members of the scheme up until the age of 75 with a maximum of 45 years of contributions.

<u>Contribution rates</u>

Where previously the contribution rate was 6% for doctors both schemes will move to a tiered system with contributions payable at 5% for earnings of around £19,000, up to 8.5% once earnings exceed £100,000.

Contributions are limited to 100% of pensionable pay for both schemes.

<u>Top up</u>

Previously members were able to buy added years or pay into a money purchase AVC.

Under the revised scheme, added years at 1 April 2008 will be honoured but from that date members will only be able to buy additional annual pension of up to £5,000pa or pay into an AVC money purchase scheme.

The same £5,000 limit or AVC contributions will apply to top up under the new NHS Pension Scheme.

<u>Accurals</u>

Under the old revised scheme the accrual rate for staff is 1/80th of final salary (1/60th for the new scheme).

Under the revised scheme, GPs are entitled to 1.4% of their pension pot for each year served (1.87% for the new scheme).

<u>Retirement lump sum</u>

GPs are entitled to 4.2% of the pension fund plus the ability to give up part of the pension for an increased tax free lump sum of up to 25% of pension value which is determined using a formula.

Under the new scheme members are entitled to receive up to 25% of pension value.

Lecture P514 (16.42 Minutes)
Lecture P515 (8.21Minutes)

Seafarers could enjoy 100% IT relief

Seafarers may be entitled to a 100% relief from income tax on their earnings under seafarer's earnings deduction if they work wholly or partly abroad on a ship, provided they are absent from the UK for an eligible period. See ITEPA 2003, ss 378 to 385.

In a recent Special Commissioners' decision (*Torr and others* SpC 679), concerning five individuals who had been employed on the Pride South America, the Commissioner decided that the vessel was not a ship for the purposes of the deduction, and the appellants were therefore not entitled to relief.

HMRC are aware of the uncertainty that this decision has caused. However, given the technical nature of the ruling, the department wants to work with representatives' bodies, including Nautilus and the National Union of Rail Maritime and Transport Workers, before issuing revised guidance (due for publication in February 2009).

This may affect taxpayers who need to file 2007-08 tax returns. HMRC confirm that all 2007-08 returns must be filed on time, regardless of whether this is before the relevant guidance is published.

Taxpayers who would rather see the Revenue's revised guidance before deciding that they are entitled to claim the deduction or not, can submit their return without a relevant claim.

They can amend the return in the usual way to include a claim to SED

Company cars – advisory fuel rates from 1 January 2009

HMRC have published figures which apply to all journeys on or after 1 January 2009 until further notice.

HMRC is content for the new rates to be implemented immediately.

Engine size	Petrol	Diesel	LPG
1400cc or less	10p	11p	7p
1401cc to 2000cc	12p	11p	9p
Over 2000cc	17p	14p	12p

Petrol hybrid cars are treated as petrol cars for this purpose.

These rates are calculated from the fuel prices in the tables below:

Petrol

Engine size (cc)	Mean MPG	Applied MPG	Fuel price (per litre)	Fuel price (per gallon)	Pence per mile	AFR
up to 1400	48·8	43·9	93·1	423·3	9·6	10
1400 – 2000	40·0	36·0	93·1	423·3	11·8	12
over 2000	28·1	25·3	93·1	423·3	16·7	17

Diesel

Engine size (cc)	Mean MPG	Applied MPG	Fuel price (per litre)	Fuel price (per gallon)	Pence per mile	AFR
up to 2000	50·9	45·8	107·8	490·0	10·7	11
Over 2000	38·7	34·8	107·8	490·0	14·1	14

LPG

Engine size (cc)	Mean MPG	Applied MPG	Fuel price (per litre)	Fuel price (per gallon)	Pence per mile	AFR
up to 1400	39·0	35·1	55·0	249·8	7·1	7
1400 – 2000	32·0	28·8	55·0	249·8	8·7	9
over 2000	22·5	20·3	55·0	249·8	12·3	12

Notes:

– Mean mpg – miles per gallon – from manufacturers information, weighted by annual sales to businesses (Fleet Audits, 2007).

– Applied mpg – adjusted downwards by 10 % to take account of real driving conditions and lower fuel economy for older cars.

– For LPG, mpg is assumed to be 20 % lower than for petrol due to lower volumetric energy density.

– Department for Business, Enterprise & Regulatory Reform's latest petrol and diesel prices (25 November 2008), LPG from AA website (November 2008). Prices have been adjusted for the impending changes to fuel duty and VAT.

Will the rate per mile figures change if fuel prices go up or down?

With effect from the January 2008 change, the rates will be reviewed twice a year. Any changes will take effect on 1 January and 1 July but will be published on the HMRC website about one month in advance.

HMRC will also consider changing the rates if fuel prices fluctuate by 5 % from the published rates when each review is made and we consider the price change will be sustained.

Employers should make themselves aware of any changes by referring to this page in June and December each year. It is the primary source of information.

VAT

Customs will also accept the figures in the table for VAT purposes though employers will need to retain receipts in line with current legislation.

HMRC Notice 4 December 2008

Residence and Domicile

HMRC have recently published a Q & A document on the new residence and domicile rules. Here are some of the more relevant items…

Alienation

How is income gifted by father to an adult son before 6 April 2008 taxed in the UK?

The child may remit the gift to the UK after 5 April 2008 without triggering a charge to tax on the father provided that the father does not benefit from the remittance, or anything derived from it.

Non resident companies

Are gains on non UK assets of a non–resident company within Section 13 TCGA 1992 taxed on an arising basis or on a remittance basis?

The gains are charged on the arising basis, unless the participator uses the remittance basis in which case gains on non UK assets are taxed on the remittance basis.

Does the UK resident participator obtain credit for relevant foreign taxes paid by the non UK resident company on the same gain in its jurisdiction of residence?

A chargeable gain that is apportioned between the participators of a non UK resident company under section 13 is computed as though it were chargeable to tax upon the company; credit is given for foreign taxes paid by the company in computing that gain. So the gain is already reduced before it is apportioned between the participators in the company.

Arising basis 1

Under what circumstances would a tax payer have to account for tax on un–remitted income or gains in the previous year (ie 2007–08 income and gains)?

If an individual paid tax on the remittance basis in 2007–08 or earlier years and has un–remitted income or gains from that year or earlier years remaining offshore, they will have to account for tax on that income or gains if they remit the income or gains to the UK. What is important is the basis on which they were chargeable to tax in the year in which the income or gains arose.

Arising basis 2

An individual is UK resident but non UK domiciled and not claiming the remittance basis.

Interest from an offshore account has been transferred since the start of my non–domiciled status to another mixed account offshore. Can capital only accounts still be transferred to the UK without incurring tax liability?

If the "capital account" consists of pure capital, then the monies can be remitted to the UK without a tax charge. But if the monies in the "capital account" were derived from untaxed income or gains then remittances will be taxable in the UK.

Given that tax will be due on any non–UK income, can this tax be paid from an offshore income account without incurring further tax on the remittance?

No

Day counting

How is residence determined in 2008–2009?

For 2007–08 and before, the old day counting practice (excluding days of arrival and departure) will continue to apply. For 2008–09, the new practice (counting days where the individual is present at the end of the day) will be applied. So when calculating periods of residence that straddle both sets of practice, individuals will have to take into account both of the day counting practices. You should therefore exclude days of arrival and departure for 2005–06, 2006–07 and 2007–08.

US LLC

Can you confirm that a UK resident and ordinarily resident taxpayer but who is not domiciled in the UK and has an interest in an LLC will not be regarded as a participator for the purposes of proposed Section 14A TCGA 1992?

1. New section 14A TCGA depends on section 13 and both of them refer to chargeable gains which accrue to a company. So for the gains of a particular body to be attributed to anyone with an interest in it, the body must first of all be a non–UK resident company. In the case of an LLC this will depend on the characteristics of the body. Whether it issues "share capital" to its investors/members is one factor in deciding this, but not the only one. Also, the (non UK resident) company would have to be a close company if it were resident in the UK . whether an LLC is considered to be a company for UK tax purposes generally will depend on all the facts and in particular on the terms of the law of the US state in question.

2. A further condition for sections 13 and 14A to apply is that a person must be a "participator" in the company. The term is defined at section 417(1) ICTA 1988 as "a person having a share or interest in the capital or income of the company". The word "share" is not used in the sense of issued share capital (ie a bundle of rights in a company), but in its non–technical sense of entitlement to part of, or a stake in, the company (as evidenced by the alternative term "interest in"), so someone can be a participator other than by owning share capital issued by a company. On the face of it someone with "an interest in" an LLC is capable of being a participator on this basis.

The answer to both questions will depend on the facts of the particular case.

S 624 ITTOIA and S 629 ITTOIA

How do s624 ITTOIA and s629 ITTOIA interact where you have a non domiciled UK resident parent not electing to use the remittance basis and a non domiciled child electing to use the remittance basis for 2008–2009?

Assuming that the parent is the settlor and settlor/spouse/civil partner can benefit from the trust then the income of the trustees is taxed on the settlor on an arising basis. If the settlor/spouse/civil partner are excluded from benefiting then the trust is taxed in the normal way but payments made to a minor child of the settlor are treated as the income of the settlor and not the income of the child (see section 629(1) so the child's election is simply irrelevant

Does it apply where the relevant capital and accumulated untaxed income arose from an outright gift by the parent under a bare trust?

Yes, income arising under a bare trust for a minor is treated as the income of the parent whether or not payment is made–section 629(1)(b)

Can the trustees of the bare trust remit the accumulated income and capital to the UK in 2007–2008 where the source ceasing rules have been used in prior years without a S660A or B tax charge on the settlor or a tax charge on the child?

The normal rules apply for the particular source or charging provision, but will be subject to the remittance basis rules now contained in Schedule 7, FA 2008. Where legislation deems income to be chargeable on an individual then the question of whether the remittance basis applies depends on whether or not the chargeable person has made a claim (where applicable) for it to apply. The question of whether there has been a remittance will depend on the actual facts.

Gifts outside the UK

If a gift is made outside the UK by a non UK R /non UK DOM individual to a UK R, non UK DOM connected person is there a tax charge if the funds are brought back to the UK by the donee?

If a genuinely NR person makes a genuine gift to a UK R individual there is no tax charge on the donee. A tax charge could arise where the donor and donee had entered into an arrangement where the effect was that the gift derived from the income or gains of the donee.

A non–UK Dom has been UK R for more than 7 years, and is the beneficiary of a non–UK trust with income/gains accruing. If he decides to not pay the £30,000, are the gains taxable on him?

If a non–domiciled beneficiary uses the remittance basis the gains will be chargeable to tax only where they are remitted to the UK. Any income received by the beneficiary will be taxable on the beneficiary as before, depending on whether the beneficiary opts to use the remittance basis. Whether or not a beneficiary uses the remittance basis has no effect upon how the trust gains or income are computed.

Rebasing

Could you please indicate for me how a non–resident trustee makes the election to rebase trust assets to market value as at 6 April 2008 so that trust gains accruing, but not realised, prior to 6 April 2008 will not be chargeable if matched to capital payments made on or after 6 April 2008 to non–UK domiciled beneficiaries?

HMRC is introducing a form for trustees of a non–UK resident trust to make a "rebasing" election. The earliest deadline for trustees to make an election for rebasing will be 31 January 2010 where a trigger such as a capital payment is made to a UK resident beneficiary in 2008–09 or the trustees transfer property in another settlement. See paragraph 126(2) of Sch. 7 of FA 2008.

Remittances

Can a UK resident non domiciled not electing to use the remittance basis in 2008–2009 continue to use his offshore current account for UK expenditure if he funds it totally from UK source taxed income eg a UK salary?

As long as the offshore current account contains only UK source, UK taxed income, payments from this account will not be taxed as a remittance. If interest on this income is paid into the account this will be foreign income. If the individual has chosen to use the arising basis for the year in which the interest has arisen they will have to pay UK tax on this income. However, if there is any untaxed interest in the account which arose in a year in which the individual was chargeable to tax on the remittance basis then the mixed fund rules will apply to remittances.

Asset bought overseas and later remitted

If an asset were purchased overseas in tax year 2008, using overseas income, for a value then equal to £200,000 but the asset is not brought to the UK until two tax years later, by which time it has depreciated to a market value of £100,000, would the remittance be charged at the lower amount, here market value?

If property is acquired off shore for a value of £200,000 but the value has dropped by the time it is remitted, the amount chargeable is the amount paid for the acquisition of the asset, namely £200,000.

Remitting capital and /or income?

At 6 April 2008 a non–domiciled has an offshore bank account which contains £100,000 capital and £50,000 interest accumulated over many years (mixed account). The interest credited in 2008–09 is £10,000 and the arising basis applies for 2008–09 onwards. He remits £5,000 to the UK in 2008–09 from the mixed account. Will this be deemed to come from the 2008–09 interest taxed on the arising basis or the untaxed interest not remitted from earlier years?

The mixed fund rules operate by matching remittances to the UK from a mixed fund in a year with the income, gains and capital credited to the account for that year. Only if the remittances are greater than the combined amounts credited in the year is it necessary to look at income, gains and capital credited in preceding years (on a year by year basis, starting with the latest year). Here a remittance of £5000 is made from an account to which £10,000 interest was credited in the same year, where the £10,000 is taxed under the arising basis. It follows that the £5000 is not taxable as a remittance because it has already been charged to tax.

UK salary paid overseas

A non UK domiciled resident in the UK for the past 7 years, receives salaries from a UK employer under his UK employment contract. These salaries are taxed in the UK and part of the salary is either paid directly to a bank account in Jersey or Guernsey by the employer or transferred by the employee to a Jersey/Guernsey banking account from the UK banking account where he receives his salary.

From tax year 2008–2009 onwards, they choose to be taxed on the "remittance basis" paying the £30,000 pa charge.

They invest the moneys (say £100,000) transferred to the Jersey account so that any interest earned on that money is paid to another account held by the individual with the same bank.

If the interest paid on the second account is not remitted, will the individual will be able to subsequently bring back the £100,000 to the UK with no tax consequences (on the basis that the £100,000 was moneys which have already been taxed in the UK)?

Account A appears to contain only taxed UK employment income; in general terms remittances to the UK that are clearly made from this account will be remittances of already taxed income and should not be subject to further taxation in the UK.

Any remittances from Account B would appear to be liable to taxation on remittance to the UK. However, on a cautionary note, if the income in Account A falls to be regarded as a "mixed fund", that is, it contains more than one type of income/capital or contains income/capital from more than one year (see Section 809Q (4) of the new legislation proposals) any remittances from this account may become subject to UK tax if these fall to be regarded as remittances of foreign income or gains.

£30,000 charge and payments on account

Mr Jones, a remittance basis user, has a tax liability for 2007–08 of £100,000 and would normally make payments on account of his 2008–09 liability of £50,000 on 31 January 2009 and £50,000 on 31 July 2009.

He anticipates that his liability for 2008–09 will be £110,000 being £80,000 on his UK income which will be lower than in 2007–08 and the £30,000 remittance basis charge. He wishes to pay the remittance basis charge from his offshore income.

Section 809V provides that money brought into the UK by way of direct payment to HMRC to meet the £30,000 Remittance Basis charge to be treated as not remitted to the UK.

The section provides for one or more payments to be made in relation to a tax year to which S809H applies, as long as they do not exceed £30,000 in total.

HMRC will apply this treatment to amounts received in relation to such a tax year (ie in relation to a tax year when the RBC is due), if paid directly from non–UK accounts, up to £30,000.

It will make no difference whether the £30,000 amount is paid in one lump sum or in several stages, and whether paid on the 31 January or 31 July as long as it is in relation to such a tax year.

Capital Gains Tax

Chappell v Revenue and Customs Commissioners SpC 717

The appellant and D agreed to form a consortium for property ventures in which they would each have a 50% interest. The consortium began negotiations to purchase the two leasehold interests in a substantial London property with the intention of reselling them at a profit. Under an agreement ("the agreement"), dated 1 May 2002, the appellant sold 10% of his 50% share in the consortium to S for £500,000. The agreement recited that the appellant, on behalf of the consortium, had been engaged in research in the London property project for two years and had received an offer from C for £175m for the two leasehold interests, which the appellant had accepted (subject to contract). The agreement also provided that the appellant "covenants with [S] to use his best endeavours to seek acceptances of the offers made for the respective leasehold interests". However the consortium failed to persuade the leaseholders to sell and the property was eventually sold to another purchaser. In his self-assessment return for the year 2002–03 the appellant described the £500,000 sum as a sale of his interest in the goodwill of the consortium and a capital asset that qualified for business taper relief of 75% under TCGA 1992 Sch 1A, para 5. HMRC opened an enquiry and on 21 June 2007 issued a closure notice, amending the assessment charging income tax under Case I of Sch D. The appellant appealed. At the hearing HMRC submitted that the sale was taxable under Case I, or Case VI or as a capital gain without its qualifying for any taper relief on the basis that—(i) if the purchase and sale of the leasehold interests had taken place, there would have been a trade, or at least an adventure in the nature of trade. That infected the sale pursuant to the agreement which was also a trading transaction; (ii) the payment under the agreement was made by an enforceable agreement for the provision of the appellant's services, resulting in a Case VI liability; and (iii) if the agreement created a capital gain, no business taper relief would be available as no trade had then begun. A preliminary issue arose as to whether, following *Tower MCashback LLP1 v Revenue and Customs Comrs* [2008] EWHC 2387 (Ch), [2008] STC 3366, HMRC were now entitled, having made the amendment and closure on the basis of income tax under Case I, to contend for other tax treatment.

On the preliminary issue, the Special Commissioner considered that HMRC were entitled to contend for other tax treatment for the £500,000 from that made on the amendment and closure notice on the basis that the factual background was the payment of £500,000 pursuant to the agreement.

The Special Commissioner found on the facts that the consortium was a partnership and the sale pursuant to the agreement was of a partnership share or interest, ie a share in the underlying assets, and as such was a capital asset liable to capital gains tax but, as the partnership had never started to trade, no taper relief was available under TCGA 1992 Sch 1A, para 5. In carrying out the two years' research including making offers to purchase, the parties had done enough to have commenced the joint enterprise. However it was impossible to commence a trade without acquiring trading assets. Although the consortium had accepted the offer from C to sell to it, that was subject to contract, and therefore there was insufficient business for a partnership to have started. The partnership interest which the appellant sold was a capital asset liable to capital gains tax, but the assets representing the partnership interest were not being used for the purposes of a trade carried at the time of the disposal of the partnership of which the appellant was a member, so no taper relief was available. Neither Case I, nor Case VI was applicable. There was no suggestion that the appellant entered into the consortium intending to sell an interest so it was difficult to see how he could be taxable on the sale under Case I. Although the appellant did agree to perform services, the payment was really for 10% of his 50% partnership share and not realistically for services which it was in his interests to carry out anyway because they benefitted his remaining 40% partnership interest, so no liability under Case VI arose. It followed that the appeal would be dismissed and amendment to the self-assessment would be upheld but as a capital gain without any taper relief.

Appeal dismissed.

Inheritance Tax and Trusts

Interaction of chargeable lifetime gifts and PETS

Gift of business assets (Holdover)(s165 TCGA 1992)

Up until 13 March 1989 there was a general relief for gifts of any asset. This was replaced by a requirement that the asset concerned was a "business asset". The relief applies where the transferor (individual or trustee) makes a disposal other than at arms length to a transferee, and the two parties make a joint claim for the gain to be held over. Where the transferee are the trustees of a settlement only the settlor is required to sign the claim.

An asset is eligible for hold over relief if either

- it is, or is an interest in, an asset used for the purposes of a trade, profession or vocation carried on by the transferor, his 'personal company' or a member of a **'trading group'** of which the 'holding company' is his personal company), or
- it consists of shares or securities of a **'trading company'**, or of the holding company of a **trading group**, where either the shares etc. are not listed on a recognised stock exchange or the trading company or holding company is the transferor's personal company.

For these purposes, an individual's '*personal company*' is a company the voting rights in which are 'exercisable', as to not less than 5%, by that individual.

For 2003/04 onwards, ***'trading group'***, ***'holding company'*** and ***'trading company'*** have the same meanings for these purposes as they do for the purposes of taper relief and entrepreneurs' relief (S 165A TCGA). For 2002/03 and earlier years, they had the same meanings as for the purposes of retirement relief.

Hold over relief is no longer available where the disposal is a transfer of shares or securities after 8 November 1999, and the transferee is a company. (For disposals between 6 April 2003 and 20 October 2003 this anti-avoidance measure was inadvertently repealed but reinstated by Finance Act 2004)

Where the disposal is at an undervalue and some consideration is received by the transferor, the amount of consideration received that exceeds the original cost of the asset cannot be held over but is chargeable (less entrepreneurs' relief) on the transferor.

To the extent that the gain is held over and not chargeable on the transferor entrepreneurs' relief is lost and the " clock" is restarted with reference to the period of ownership of the transferee. Thus it would take at least a year to get back to full relief.

Gifts on which there is an immediate IHT charge (s260 TCGA)

This provision provides for the resulting gain on the transfer of **any asset** to be held over in circumstances where there is an immediate charge to inheritance tax. The most common example is where the transfer is to or out of a discretionary trust although Finance Act 2006 has extended this to most lifetime transfers of assets to trust, including A&M settlements and interest in possession trusts, previously treated as PETs. (The only exception now would be transfers to a trust for a disabled person).

Note that the relief is still available where no inheritance liability results, for example where the value transferred falls within the nil rate band as IHT is still technically chargeable but at 0%.

Self settlement anti-avoidance

As a result of changes in Finance Act 2004, announced in the 2003 pre-Budget Report and taking effect from 10 December 2003, no hold over is available where the settlor has an interest in a trust to which an asset is transferred so a gain would crystallise upon the transfer to the trust. This has effectively blocked the use of a self-settlement to eliminate "tainted taper" where for example a shareholding did not qualify for business asset taper during the period 6 April 1998 to 5 April 2000.

A further measure bites where the settlor, or spouse, acquires an interest in the trust at any time in the six years following the year in which the asset was settled. Where the original hold over was on or after 10 December 2003 there will now be a clawback of any hold over relief claimed in the year in which the settlor acquires the interest.

Note that Finance Act 2006 extended the definition of settlor interested trusts to include trusts for the benefit of minor (U18) unmarried children.

Principal Private Residence Exemption

The principal private residence exemption can apply to a gain accruing to a trustee on the disposal of a residence, which is settled property, where during the period of ownership of the trustee the dwelling house or part of the dwelling house has been used as the only or main residence of a person entitled to occupy it under the terms of the settlement.

By extra statutory concession (number D5) relief is also given where the residence is occupied by permission of the trustees and the individual concerned is entitled to the whole of the income from the residence or from the proceeds of its sale.

Finally, where there is a choice of houses that should be treated as exempt, the usual election has to be made jointly by the trustees and the person entitled to occupy the house.

This relief has been severely restricted from 10 December 2003 by legislation that will be included within the Finance Act 2004 (as outlined above).

Some Basics of Inheritance Tax

a) Gifts made between individuals during their lifetime may be considered to be exempt from IHT as they are potentially exempt transfers (PETs).

b) Gifts made within seven years of death will be included within an individual's estate on death and may well be charged at 40% (see rates below) although after surviving three years there is a taper relief available (see below).

c) The use of trusts allows the beneficial ownership to be separated from the legal ownership allowing tax efficient gifts to be made to people such as children.

d) Gifts into many commonly used family trusts were also PETS until March 2006,namely:

   i) Accumulation and Maintenance Trusts
   ii) Life tenant Trusts (interest in possession Trusts) and certain transfers out of these Trusts.

e) Now all lifetime gifts into trust, with few exceptions, are treated like Discretionary Trusts (relevant property (see part B below) are not subject to the PET regime and therefore lead to immediate Inheritance Tax charges in some circumstances.

f) Where a donor reserves a benefit in any assets gifted, they are still treated as having a beneficial interest in the asset on death.

g) IHT is always charged on the diminution of value principle.

Rates etc

Since April 2008, IHT has been chargeable as follows:

Chargeable Transfers Gross	Rates on Gross
0 - £312,000	Nil
Excess	40%

Generally the above rates apply on the death of an individual. Where a lifetime gift is chargeable generally this will be at half the rates outlined above (i.e. 20%). This first band is generally called the “nil rate band” up to £312,000.

The 2007 Act provides certainty of the available inheritance tax nil rate band for more than one year ahead. Section 4 increases the nil rate band to £350,000 in 2010/11 and confirms that the rate of IHT will remain at 40%.

The FA 2006 set the bands for 2008/09 and 2009/10 at £312,000 and £325,000 respectively.

Where an individual dies then the above rates apply to any gifts made within seven years (although of course they may fall within the nil rate band, or straddle it). The tax calculated will then be subject to taper relief as follows:

Years Before Death	% of Tax Charged
0 – 3	100
3 – 4	80
4 – 5	60
5 – 6	40
6 – 7	20

The interaction between these concepts is complex and is best illustrated by an example.

Mr A is a relatively wealthy individual. He is a widower. His wife died more than 2 years ago utilising her nil band (as was usual then). He has made or makes the following gifts etc:

i) in 1995, he gives £75,000 to his son (but in a discretionary trust
ii) in 1999, he makes another gift of £325,000 to his daughter
iii) in 2004, he dies leaving an estate of £450,000

No IHT or CTT is due during his lifetime on the above gifts (annual exemptions have been utilised on the first day of each year by the appropriate small gifts).

On death, tax will be due on both the failed PET (payable by his daughter) and the estate held at death as follows:

a) Failed PET:

Gift	325,000
Gifts in previous 7 years	75,000
	400,000
Nil bank	255,000
Chargeable on Death	145,000

Tax @ 40%	58,000
Less taper relief @ 40%	23,200
Payable	£34,800

b) On his estate:

Estate at Death		450,000
Gifts in last 7 years		325,000
		775,000
Less nil band		255,000
		520,000
Tax @ 40%		208,000
Less tax on PET (as recalculated)		
Gift	325,000	
Nil Band	255,000	
@ 40%	70,000	28,000
Tax due on Estate (subject to planning)		£180,000

This example illustrates the 14 year window for Capital Tax planning.

The gift in 1986, some 8/9 years prior to the death clearly effects the total tax "take" at death. This indicates a general principle of staging Capital Tax planning in 8 yearly tranches.

Article by Bob Truncheon

SpC 720 Mr & Mrs Bird v Revenue and Customs

Mr P A Bird and Mrs F J Bird appealed against amendments to self-assessments. The principal issue in the appeals was whether dividend income received by their three minor daughters was income arising under a settlement within the meaning of the income tax "Taxation of Settlor" provisions in Part XV of Income and Corporation Taxes Act 1988 ("the Act").

Mr Bird and Mrs Bird also appealed against extended time limit assessments to income tax pursuant to section 36 TMA for the three years ended 5 April 1998; those three assessments, additionally, raise the second issue which is whether there has been a loss of tax attributable to negligent conduct on the parts of Mr and Mrs Bird.

The facts

Cargoitem Ltd was incorporated in September 1994 to trade as a wholesaler of specialist kitchen furniture. Its authorised share capital was £1,000 divided into 1,000 shares of £1 each. Two subscriber shares were issued. One such share was transferred to Mr Bird and the other to his wife, Mrs Bird.

Late in December 1994 Mr Bird's father died. He left his estate to such of the Birds' three daughters as should reach 18 in equal shares. The eldest daughter was 15 at the start of 1995; the other twin daughters were then 10. Mr Bird was the sole executor under his father's will.

Mr Bird transferred £7,000 from the estate to Cargoitem on 22 March 1995 as an unsecured loan with interest of 2% over Bank of England base rate. On 3 May 1995 a further payment of £54,364 was made to Cargoitem; this, says the Statement of Facts, was "characterised by the company as an unsecured loan from the minor beneficiaries to the company". The accounts indicate that that loan remained outstanding for at least two years.

On 4 April 1995 Cargoitem issued a further 98 ordinary shares at par. 19 of these were issued to each of Mr Bird and Mrs Bird and 20 were issued to each of the three daughters. There is no evidence as to whose money the daughters used to pay the subscription monies of £1 per share.

Cargoitem carried on its trade profitably and in each year to 2002, when it ceased business, dividends were paid to the shareholders including the three daughters.

The arguments on the main issue

HMRC argued that the dividends paid to the three daughters (until they each reached 18, which the eldest did on 13 July 1998) constituted income arising under a "settlement" within the meaning of that word in section 660G. In consequence the dividend income should be treated as that of Mr Bird and Mrs Bird equally by virtue of section 660B(1) of the Act. The steps taken to make each of the three daughters a 20% shareholder in Cargoitem amounted, say HMRC, to an "arrangement" within the statutory definition of "settlement".

Conclusions

Until the shares, giving 60% of the equity in Cargoitem to the three daughters, were issued on 4 April 1995, the company and all entitlement and expectation of profit belonged to Mr Bird and Mrs Bird.

The issues of shares to the daughters were not some form of consideration for the loans from Mr Bird's father's estate. The £7,000 paid from the estate to Cargoitem on 22 March 1995 was regarded as a loan at interest. There was no evidence of any connection between the £7,000 loan and the share issue.

The effect of the share issues of 4 April 1995 therefore was that each daughter's subscription of £20 gave her a 20% interest in Cargoitem at the expense of Mr Bird and Mrs Bird whose 50% equity holdings were consequently reduced to 20% equity holdings.

Arrangement?

Were the assessments within the scope of the taxation of settlor provisions?

The provisions (recently revisited by the House of Lords in *Jones v Garnett* [2007] 1 WLR 2030) deal, within certain defined limitations (one of which was present in the *Jones v Garnett* circumstances), with various kinds of arrangements under which a taxpayer seeks to save tax by diverting income to someone who pays tax at a lower rate, or not at all. Where the provisions apply, they treat the income arsing under the settlement as income of the "settlor" so that it is charged to tax as if it were his income and not the income of the person to whom it actually belongs.

The use of a corporate structure to provide an income stream to a minor child, thereby reducing higher rates of tax is a typical situation where the taxation of settlor legislation can and does apply. See *Copeman v Coleman* (1939) 22 TC 594 and *Butler v Wildin* (1988) 61 TC 666.

In the present case, Mr Bird and Mrs Bird arranged for their minor daughters to take the 60% share in Cargoitem thereby enabling the three children to share in the profits of the business that Mr and Mrs Bird had previously owned between them. In so doing Mr and Mrs Bird made an arrangement within the scope of the settlement provisions.

Element of bounty?

For an arrangement to constitute a settlement for purposes of the taxation of settlor provisions, there has to have been an element of "bounty". On the question of "bounty" the commissioner followed Lord Hoffman's approach in *Jones v Garnett*. In determining whether it amounts to an arrangement it is necessary to ask whether the appellant in question would have entered into it with someone with whom he was dealing at arms length?

Mr and Mrs Bird's argument was that the minor daughters' acquisitions of shares had been part of a purely commercial transaction, the shares being seen as some kind of *quid pro quo* for a loan which the children made to Cargoitem. In the commissioner's opinion, the minor daughters did not take part in any commercial transaction. While still executor of his father's will, Mr Bird arranged for monies owned prospectively by the three daughters (and contingent on reaching the age of 18) to be paid by way of a "loan" to Cargoitem. The risk involved in that transaction accrued to Mr Bird personally rather than to the children. Mr and Mrs Bird then arranged for the children to take a 60% share in Cargoitem to enable 60% of the profits to flow to the three daughters. That arrangement was at the expense of their existing equity interest in Cargoitem. This was not an arms length arrangement. There was, therefore, the necessary element of bounty to bring the arrangements within the scope of the expression "settlement".

Conclusion

It was concluded that the income arising to the three minor children (while each was a minor) was properly chargeable as the income of Mr and Mrs Bird under the taxation of settlor provisions.

Extended Time Limit ("ETL") Assessments

The assessments on Mr and Mrs Bird for 1995/96, 1996/97 and 1997/98 relate to income that arose outside the ordinary time limit. Section 36 of TMA enables HMRC to make ETL assessments where the taxpayer, known as "the person in default", has caused the loss of tax attributable to his fraudulent or negligent conduct or the fraudulent or negligent conduct of a person acting on his behalf.

Reasonable compliant taxpayer and Note 34

So what would the reasonable compliant taxpayer who had been a party to, and had the same degree of knowledge of, a transaction on lines similar to those summarised above, have entered in his return?

The only relevant box in the 1995 Tax Return was headed "Trusts and Estates". A note at the side of the subheading says, - "Income and Capital will be treated as yours if certain conditions apply; see Note 34". Note 34 of "11 P (1995)" reads, so far as is relevant:

> "A settlement includes not only a formal trust, but also an agreement, covenant, disposition, arrangement or transfer of assets. If you have directly or indirectly provided funds for a settlement, the income of that settlement will usually be treated as yours if … capital or income from the settlement benefits your own unmarried child or stepchild and the child is under 18".

The assumed reasonable compliant taxpayer should be expected to read the notes to the return. In the present case he or she should read Note 34.

How should the assumed reasonable compliant taxpayer have reacted to the words of "Note 34"?

Would the assumed reasonable compliant taxpayer in a similar position to that in which Mr and Mrs Bird found themselves have concluded that he had indirectly provided funds for the purpose of the arrangements that included the payment of the dividend?

No sum or sums of money were introduced into the arrangement by Mr and Mrs Bird. The thing that was provided to each daughter was the opportunity of participating in dividends and capital growth in Cargoitem.

The commissioner did not think that the reasonable compliant taxpayer would recognise it as a situation in which he had indirectly provided "funds" for the purposes of the arrangement.

He did not think there has been "negligent conduct" such that extended time limit assessments may be made on Mr and Mrs Bird

Lecture B511 (17.25 Minutes)

Administration

Online PAYE reminder for big firms

HMRC have issued a reminder to large employers about important PAYE changes coming into effect next year.

From 6 April 2009, firms with 50 or more employees must submit the following in-year PAYE information online:

- Form P45(1) - details of employee leaving
- Form P45(3) - new employee details
- Form P46 - employee without a form P45
- Similar information for people receiving a pension

To file online, employees must first register with the Revenue's online service: click on PAYE for Employers under the Do it Online menu.

Once registered, there are a number of methods by which to file:

- HMRC's free Online Returns and Forms software.
- Commercial payroll software.
- Electronic Data Interchange, a secure phone line suitable for large numbers of forms.
- A Revenue payroll agent or bureau can do it on an employer's behalf.

HMRC take position on late paper returns

HMRC have confirmed the position as far as they are concerned in respect of paper returns filed after 31 October 2008 due to technical problems.

The Working Together e-group pushed for clarification to ensure that there would not be any ambiguity at a later date which might have an impact on agents' professional indemnity cover and client fee protection insurance.

HMRC said: 'Where we accept that issues with the online filing system precluded online filing and that there is a reasonable excuse for late of filing a paper return, the paper return will be treated (under TMA 1970, s 118(2)) and recorded, as on time for any of the purposes of TMA 1970'.

This means that no penalty will be charged (or the penalty will be cancelled if already issued) and the enquiry window will not be extended.

Fast–track process for issuing Unique Taxpayer References (UTRs)

HMRC announces they are introducing a fast–track UTR process for those who were self–employed during 2007–08 but who have not yet registered with HMRC and received a UTR.

To help our customers to file their Self Assessment tax returns online this financial year, we have been working very closely with our agent colleagues in the Working Together Steering Group. As a result, we are introducing a fast–track UTR process for those who were self–employed during 2007–08 but who have not yet registered with HM Revenue & Customs (HMRC) and received a UTR.

The fast–track will be available from Monday 8 December 2008 to the end of January 2009 and can be only accessed using the Helpline for the Newly Self Employed Tel 0845 915 4515. The Helpline is open from 8.00 am to 8.00 pm, Monday to Friday and from 8.00 am to 4.00 pm, Saturday and Sunday.

If you use this service we'll aim to post your UTR to you within five working days.

Who should use the fast track?

This fast–track route should be used where a UTR is urgently required. In the main this will be where members of partnerships have not notified HMRC of their liability and the partnership needs to meet the filing deadline for the partnership return of 31 January 2009. Please do not use the fast track unless urgent since we don't want to slow down processing times.

Please note, the fast–track provides no guaranteed turnaround. Filing a return late because you do not have a UTR will not normally be accepted as a 'reasonable excuse'.

What can I do if I am self–employed and have not notified HMRC that I am liable to income tax and/or capital gains for 2007–08?

You should contact your local HMRC office and/or Helpline for the Newly Self Employed as soon as possible, to notify HMRC that you are liable to Income Tax and/or Capital Gains Tax. You will then be issued with a UTR and a notice to file will be sent to you. The return should be made to HMRC either on paper or electronically within three months of the notice being given.

Can I Avoid Paying A Penalty For Failing To Notify HMRC Before 6 October 2008?

To avoid a failure to notify penalty you should make a payment of all the tax due to HMRC before 31 January 2009. Please send a cheque to—

Accounts Office Shipley, HM Revenue & Customs, Bradford, BD98 1YY

The cheque should be accompanied by a note of your name and address. You should retain a copy of the cheque details (bank on which drawn, sort code, cheque number) and the date it was sent to HMRC and include these details with your tax return to make it easier to link the payment with the liability once the return has been filed.

Find out more about paying your Self Assessment.
(www.hmrc.gov.uk/payinghmrc/selfassessment.htm)

Where can I direct post–registration enquiries?

Customers should direct all post–registration enquiries about UTRs not to the helpline, but to the tax office that usually deals with your tax affairs or visit your nearest HMRC office where staff will help.

Notification of liability see *Simon's Taxes* **E1.202**

HMRC Guidance Note 11 December 2008

Business Tax

Changes to capital allowances on cars

Historically, the concept that underpinned the taxation of benefits in kind was that an individual should be taxed on a cash equivalent of the benefit that he received i.e. there should be some linkage between the benefit received and the amount on which the individual suffered tax.

The shift of the taxation of company cars to a CO2 emissions basis from 6th April 2002 essentially declared this approach to be obsolete: regardless of the extent to which a company car was an essential tool of the individual's employment, the amount on which an individual would be subjected to tax would be the same for a specific vehicle.

Company cars were probably objectively unattractive in tax terms as at 5th April 2002. However, the impact of the CO2 basis of benefit taxation should have had the effect of putting the provision of a company car beyond the pale.

Example

This is best shown by example (using slightly out of date rates):

An individual is provided with a BMW 525i SE. Current list price is £30,300. Let us assume £32,000 after extras.

The CO2 emissions for the car are (a modest) 176g/km and therefore the benefit percentage is 22%.

The annual benefit in kind is £7,040. The tax cost of this to the individual is £2,816.

Let us assume the individual undertakes 8,000 business miles and 12,000 private miles per annum.

The estimated running cost of the vehicle (including depreciation) based upon AA rates is 37.7 pence per mile (excluding fuel). The company on this basis would incur a total annual cost of running the vehicle of £7,540. This would be augmented by Class 1A NIC of £901.

The cost of providing the car tax free to the employee can therefore be summarised as follows:-

Car running costs	7,540	
Class 1A NIC		901
Salary utilised in paying BiK		
£2,816 X 100/(100-41) x 1.128	5,383	
Pre tax profits dissipated		13,824

To contrast this first with funding the private funding of a car where there is an employee/employer relationship:

Annual running costs to be funded	7,540
Less:-	
Statutory mileage allowance	
8,000 miles @ £0.40	3,200
Net cost to be funded through earnings	4,340
Gross salary required	
£4,340 x 100/(100-41) x 1.128	8,297

Pre tax profits dissipated	
Statutory mileage allowance	3,200
Gross salary	8,297
	11,497

Consider also the changes proposed to the capital allowance regime available for such cars (10% WDA and no balancing adjustments). The contrast of the above with the costs of operating the same car through a partnership structure is stark: in pre-tax terms, a partnership would simply bear the expenditure of £7,540.

Upon the facts, the financial benefit that the individual actually receives is 60% of £7,540 (being the private mileage proportion of the total running costs). Using a partnership model, the individual essentially suffers tax on that benefit and that benefit only and therefore the total cost of providing the vehicle is £7,540 to the business. Capital Allowances would remain as now given the private use position.

Cars: more woes

The example above covers the position of the provision of a car, before consideration of fuel.

Where the terms under which a car is provided to an employee envisages the provision of fuel for any private mileage, the fuel charge accrues.

In recent years, the fuel charge has been calculated by reference to the figure of £14,400 charged at the relevant percentage based upon the car's CO_2 emissions. This has been increased from £16,900 from 6th April 2008.

Taking the example above, the benefit tax charge would be on £3,168 for 2007/08 and £3,718 for 2008/09.

Taking a fuel cost of £1.20 per litre of petrol, the benefit charge upon a conventional basis should purchase 580 gallons of petrol for 2007/08 and 681 gallons for 2008/09. The stated urban fuel consumption figures for this vehicle is 27.4mpg. Upon this basis, the fuel charge has paid for 15,892 private miles for the year to 5th April 2008 and 18,659 for the year to 5th April 2009.

Capital allowances on business cars – Consultation & PBR Announcements

Further details have been announced about the changes to the capital allowances rules for cars bought by companies and businesses. They take effect from 1 April 2009 for corporation tax and from 6 April 2009 for income tax.

The special rules that restrict allowances for cars costing more than £12,000 will be abolished. All expenditure on cars wholly for business use will be allocated to one of the two general plant and machinery pools:

- The general pool (20% allowance) for cars with CO_2 emissions of up to 160g/km.
- The special rate (10%) pool for cars with CO_2 emissions above 160g/km.

A proprietor's or partner's car with an element of non-business use will remain outside the pools.

These changes will dramatically reduce the timing of any tax relief as the example shows:-

Car – Cost £18,000, Sold £8,500 after 3 years (>160 gms per Km)

Current rules:

	WDAs	Cum. WDAs
Year 1	£3,000	£3,000
Year 2	£3,000	£6,000
Year 3	£2,400	£8,400
Year4 (sale)	(Bal.allow)£1,100	£9,500

New rules:

	WDAs	Cum. WDAs
Year 1	£1,800	£1,800
Year 2	£1,620	£3,420
Year 3	£606	£4,028
Year 4 (sale)	(No bal. allow)£547	£4,575

For leased cars with CO_2 emissions above 160g/km, there will be a flat rate disallowance of 15% of lease rental payments.

Disabled employees (blue badge holders) who drive automatic cars will be able to calculate the taxable benefit using the lower list price of the equivalent manual car. They can already base the benefit on the CO_2 emissions of an equivalent manual car. The change will also apply to the calculation of Class 1A NICs on the taxable benefit.

Company cars – Employee car ownership schemes

HMRC have published 'Report on the interaction between company cars, employee car ownership scheme cars and mileage payments'. It follows a period in which HMRC reviewed the taxation of Employee Car Ownership Schemes (ECOS) and its interaction with the benefit in kind rules and tax-free mileage allowance payments (AMAPs).

HMRC conclude in their report that from a cost-benefit analysis, there is not a sufficient justification at the moment for imposing a specific tax on ECOS or to amend the rules for AMAPs. However HMRC will monitor growth in this sector and how it impacts on the other aspects of the taxation of business cars.

Disabled drivers

Finance Bill 2009 will include legislation to extend the special treatment to allow disabled company car drivers driving an automatic car to use the list price of an equivalent manual car, if this is lower, to calculate the benefit in kind.

Article by Bob Trunchion

Lecture B512 (13.15 Minutes)

Developers and appropriations from trading stock

Developers will carry their stock of development properties in current assets. When they are sold the developer realizes a trading profit in the normal way.

Unfortunately the current market place does not offer an easy sell and developers have been considering alternatives to selling the property:

1. Taking the property out of the business themselves – possibly to let or even to occupy.
2. Letting the property out rather than selling the property. If the letting intention is long term then the developer must give consideration to moving the asset from current to fixed assets.

In either case this will be a deemed market value sale and direct tax will be due on the profit. The now codified principles of *Sharkey v Wernher* will generally apply.

Practical scenario

In July 2007 a question was raised in Taxation Readers Forum which is very apt in the current market.

Some years ago, my company purchased a property with a view to reselling it shortly thereafter. Unfortunately, a suitable purchaser could not be found and the property has instead been let out for a period of years. The previous accountant showed the property in the company accounts as trading stock.

It has now been suggested to me that this may not be correct and that the property should be shown in future accounts as a fixed asset. My concern is as to the possible tax or other implications arising from this.

Several readers made excellent comment:

Reply by BNB Tax Consultants:

"Developer's company acquired the property for resale and it was therefore correctly shown in the accounts as trading stock at that time. Whether that treatment continues to be correct depends very much on Developer's plans for the property and how long it has been owned. Although the property was acquired with a view to resale and has then been let out, it will still be treated as stock until such time as a firm decision is made to retain it for the long term.

If, with the passage of time, it has now been decided that the property will be retained indefinitely, Developer should consider whether the property should be transferred from trading stock to fixed assets to ensure that the company accounts represent a 'true and fair' view.

The tax effects which would follow such a reclassification are that there will be a deemed disposal for income tax purposes under TCGA 1992, s 161(2) and a taxable profit will arise on the difference between the value taken out of the trading account and original cost. That value will normally equate with the market value of the property at the time of the appropriation in line with *Sharkey v Wernher* (1955) 36 TC 275. The capital gains tax base cost of the property for purposes of a future disposal will also equate with the value at the time of appropriation. As the transfer to fixed assets is only a deemed disposal rather than an actual one, Developer will experience a cash flow problem since there will be no inflow of funds to meet the tax liability as would be anticipated from an actual disposal.

We are told that the property has been let out 'for a period of years', but we do not know how many. Developer should be aware that while his intention will be decisive in the short to medium term, HMRC have nevertheless been known to challenge the accounting treatment where property is shown in the trading account as stock over many years. Despite this, the courts appear to be reluctant to accept that property initially acquired as trading stock should be reclassified simply because it has been held for a number of years. Cases such as *Oliver (J & C) v Farnsworth* (1956) 37 TC 51 and *Speck v Morton* (1972) 48 TC 476 are worth looking at in this context.

If Developer does intend to sell the property in the future, it is suggested that a formal resolution or board minute records that intention, subject to market conditions and commercial considerations of course, to support the accounting treatment in the event of challenge."

Reply by Brinkley:
"The key to this situation is the intention of the company both at the acquisition of the property as well as the current date. The fundamental test for the treatment of a property transaction is the motive at its acquisition. If a property is acquired to generate income, the transaction is treated as a capital investment; if it is to generate a profit on sale, it is trading. It therefore appears that the property is correctly shown in trading stock rather than a fixed asset and its acquisition was for trading purposes.

An appropriation from trading stock need only occur if a positive decision is made to retain the property as an investment. In the absence of such a decision, the case of *Simmons v CIR* 53 TC 461 gives some protection against HMRC contending that an appropriation from stock has occurred where a property has simply been held for several years. A positive decision does not have to be written; it may be inferred from a course of action.

Should Developer decide that an appropriation is necessary, there may be unpleasant tax consequences. Corporation tax will be due on the profit calculated as if the property had been sold at its market value from stock and reacquired as a fixed asset at the same price under the deemed disposal provisions of TCGA 1992, s 161. This could give a major problem as the transfer will not generate any money to pay the tax.

Developer may also wish to consider the timing of any appropriation to take advantage of any group relief or losses available, as well as any cashflow benefits of deferring the transaction to a later year."

Conclusion

If the developer lets the property through the development business it could be argued that the property remains in stock providing the developers intention remains to sell the property. This would then avoid any direct tax issues when moving the property from stock to fixed assets.

If the developer takes the property out of the business this will be a market value sale and direct tax will be due on the profit. One would expect valuations to be low in the current market however. It should also be remembered that property is quite different to ordinary stock and consequently the sale should be subject to a formal transfer of ownership e.g. company to individual. The individual will also have to pay for the property to avoid any income tax issues on the acquisition. SDLT should be payable if the value of the property exceeds £175,000.

Lecture B513 (12.31 Minutes)

Corporation Tax

Debts and connected companies

Release of trade debts between connected companies

The next Finance Bill will include legislation to ensure that, where a trade debt between connected companies is formally released, the company which owes the money will not be taxed on the resulting credit.

At present, the creditor company is denied a tax deduction under the loan relationship rules for its 'loss', but the other company, although not taxed under the FA 1996 provisions, risks being caught by much older legislation.

This change, which will have effect for accounting periods beginning on or after 1 April 2009, should ensure equivalent treatment for both companies. Companies are connected for this purpose if one controls the other or both are under common control.

The relaxation will only apply to what HMRC call 'formal' releases (ie. where the release is written under deed). It will not protect the simple informal waiver of a trade debt, the release of which HMRC are likely to continue to regard as creating taxable income for the debtor company.

Late payment of interest on debts

The rules dealing with the late payment of interest on debts between connected companies (see (c) above for the definition of this term) are to be amended for accounting periods beginning on or after 1 April 2009. At present, the legislation denies a tax deduction where interest is:

1. paid late, ie. more than 12 months after the end of the accounting period in which it arose; and
2. paid in circumstances where receipt is not brought into account under the loan relationship rules.

In a typical case, this means that interest accrued in respect of, say, a loan owing to an overseas group member will not be eligible for tax relief until it is paid.

A consultation has taken place as a result of the ECJ having forced HMRC to accept that the existing regime for late paid interest could not be maintained under the EC 'freedom of establishment' rules.

No details have been provided of how Parliament proposes to amend FA 1996 and, in particular, how the revised provisions will be applied to close companies. Draft legislation is expected in the not-too-distant future.

Article by Robert Jamieson

Lecture B514 (12.22 Minutes)

Test Claimants in FII Group Litigation v R&C Commissioners

The taxpayers were all companies which belonged to groups (the group) which had United Kingdom resident parents and foreign subsidiaries, both in the European Union and elsewhere (third countries). They comprised the publicly owned ultimate parent company of the group, the UK-resident intermediate parent companies through which non-resident subsidiaries were held, other UK-resident subsidiaries and other non-resident holding companies. In the period beginning in the financial years ending in 1973, the resident companies made payments of dividends to its public shareholders, and the non-resident subsidiaries made payments of dividends to the taxpayers. Between 1994 and 1999, the taxpayers made payments of foreign income dividends (FID) to their foreign subsidiaries. In the period commencing in the financial years ending in 1973, the taxpayers made payments of advanced corporation tax (ACT) to the Revenue. The taxpayers commenced proceedings against the Revenue, arguing that there were unjustified differences between the taxation treatment of UK companies with resident and non-resident subsidiaries respectively, which breached the provisions of art 43 (on freedom of establishment), and art 56 (on free movement of capital) of the EC Treaty and their predecessor articles. By a group litigation order, the Franked Investment Income (FII) Group Litigation (GLO) was established. At the trial of the test claims, the judge made a reference to the European Court of Justice (the ECJ). On 6 April 2006, the Advocate General delivered his opinion, and on 12 December 2006, the ECJ gave its ruling on the reference ([2006] All ER (D) 168 (Dec)). The taxpayers succeeded in many of their central complaints about the ACT regime. The Revenue was also successful on some important points, and a number of issues were left to be decided by the English court, one of which was whether the UK corporation tax regime for taxation of foreign dividends under Case V of Sch D (Case V) to the Income and Corporation Taxes Act 1988 (the 1988 Act), was compatible with Community law. The instant trial concerned the determination of the remaining issues, save for those relating to causation or quantification.

Issues arose, inter alia, as to—(i) whether the charge to tax under Case V was compatible with Community law; (ii) whether the ECJ ruling (see [118] of the judgment] in respect of ACT could be applied to the corporate tree points (see [118] of the judgment); (iii) how the incompatibility of the ACT provisions of UK domestic law should be remedied under English law, so as to give full effect to the directly effective rights of the taxpayers which had been infringed; (iv) whether it was open to the UK to confine the surrender of ACT to UK-resident members of the group, or whether some equivalent relief should have been granted to group companies resident in other member states in respect of their profits; (v) whether, on the assumption that art 56 EC had applied, and had been breached in relation to third country FID, the introduction of the FID regime was a new restriction such that the UK could no longer rely upon the standstill provision in art 57(1) EC; (vi) whether the principle that a member state was required to repay charges levied in breach of Community law (San Giorgio) had extended to all of the claims; (vii) whether the defence of change of position was available to the Revenue in respect of the claims in restitution, and, if so, by reference to what principles might it be relied upon by the Revenue; (viii) whether, in the context of their non-restitutionary claims for compensation under Community law, the claimants had satisfied the condition that there was a sufficiently serious breach on the part of the Revenue or the UK government; (ix) whether it was open to the Revenue to rely on FA 2004 s 320, and/or s 107 of the Finance Act 2007, as defences to mistake-based claims for restitution which pre-dated the commencement of the claim by more than six years; and (x) whether there could be recovery at common law, where the claim had fallen within the ambit of the statutory regime for repayment of tax paid by error or mistake in s 33 of the Taxes Management Act 1970 (the 1970 Act), or equivalent provisions in domestic UK tax legislation.

The court ruled—(1) In the instant case, the Case V claim would fail in its entirety. The UK system of taxation of dividends received from member states had at all material times infringed art 43 EC. The taxpayers which had subsidiaries in third countries had been entitled to rely on art 56 EC; however, that was subject to the provisions of art 57 EC. There had been no infringement of art 56 EC in relation to dividends received from third countries, because although art 56 was in principle engaged, it had at all material times been disapplied by art 57(1) EC (see [193] of the judgment).

(2) It could not safely be deduced or inferred from the court's limited reasoning what its answer would be to the corporate tree points. In those circumstances, a further reference to the ECJ on the corporate tree points would be necessary. That conclusion was tempered by the fact that the parties had been in agreement that those questions were important ones, and over £1b might turn on their resolution (see [138] of the judgment).

(3) The right way to bring foreign dividends into the ACT system was to confer a tax credit which would generate FII, at the same rate as that applicable to UK dividends, and not merely to allow a deduction from ACT for the foreign corporation tax which had been paid. Under the UK system, ACT was charged, and a tax credit was conferred, on the recipient of the distribution, at a fixed rate, regardless of the actual amount of corporation tax which was in fact paid on the distributed profits. That would be so even if, for example, because of the availability of various reliefs, no corporation tax was paid at all. What mattered was that the distributed profits were liable to corporation tax in the hands of the company making the distribution, not the amount of tax which had actually been paid (see [152] of the judgment).

(4) On the issue of ACT surrender, the ECJ had held that the ACT regime had infringed art 43 EC in that it had not permitted the surrender of surplus ACT to non-UK resident subsidiaries which were themselves liable to corporation tax in the UK because they had UK trading profits. However, the conclusion that a misunderstanding in that decision had occurred could not be escaped. It was for that reason alone that the ECJ had not considered the question of set-off of ACT against foreign profits. The issue of whether the inability to surrender surplus ACT for set-off, or equivalent relief, against the foreign profits of a foreign subsidiary had also infringed art 43 EC was an open one, which only the ECJ could resolve. There was enough doubt about the answer to justify, and indeed require, a further reference to the ECJ (see [163] and [197] of the judgment).

(5) The same corporate tree points had arisen in relation to FID as in relation to the ACT claims and accordingly, the same answers to the corporate tree questions in the context of the FID regime would be given to the corresponding questions in the context of the ACT regime. In relation to the issue of FID received from third countries, the FID regime had breached art 56 EC in relation to third country FID, and that breach had not been negated by art 57(1) EC. It followed that liability in respect of third country FID had in principle been established (see [179] and [191] of the judgment).

(6) The *San Giorgio* principle extended to all the claims for repayment of unlawfully levied tax by the companies which had actually paid the tax, and to associated interest and loss of use claims. It also extended to all claims for losses which were a direct or inevitable consequence of the unlawful levying of tax. The Community principles of equivalence and effectiveness required English law to provide two restitutionary remedies for *San Giorgio* claims, namely the cause of action for restitution of tax unlawfully demanded (*Woolwich)* and the cause of action for recovery of tax paid by mistake of law (*DMG*). The latter cause of action should be limited to claims for the repayment of tax paid by mistake and the reversal of any directly associated benefits retained by the Revenue as a result of the mistaken payment (see [441] and [442] of the judgment).

In the instant case, the only claims which had sounded in restitution as a matter of English law, and which were required, as a matter of Community law, in order to give domestic effect to the taxpayers' *San Giorgio* claims, were the claims for repayment of unlawfully levied ACT and Case V which had actually been paid to the Revenue, together with associated interest and loss of use claims (see [443] of the judgment).

Amministrazione delle Finanze dello Stato v SpA San Giorgio: 199/82 [1983] ECR 3595 considered; *Woolwich Equitable Building Society v IRC* [1992] 3 All ER 737 considered; *Deutsche Morgan Grenfell Group plc v IRC* [2006] All ER (D) 298 (Oct) considered; *Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v IRC* [2007] UKHL 34 considered.

(7) The defence of change of position should be available to the Revenue in respect of mistake-based restitutionary claims which had gone beyond the *San Giorgio* claims, although not in respect of *Woolwich* claims, and where the defence was likely to succeed on the facts. It would be inequitable to require repayment, bearing in mind that the taxpayers had a perfectly good separate *San Giorgio* claim for repayment of the unlawfully levied tax itself, free from any change of position defence (see [445] of the judgment).

Amministrazione delle Finanze dello Stato v SpA San Giorgio: 199/82 [1983] ECR 3595 considered; *Woolwich Equitable Building Society v IRC* [1992] 3 All ER 737 considered.

(8) In all the circumstances, the taxpayers had failed to establish any sufficiently serious breach on the part of the Revenue or the UK government, and their non-restitutionary claim for compensation would accordingly fail (see [446] of the judgment).

R v Secretary of State for Transport, ex p Factortame Ltd: C-48/93 [2000] 1 AC 524 considered.

(9) It was not open to the Revenue to rely on s 320 of the 2004 Act and s 107 of the 2007 Act as defences to the test claims, where such claims were properly classified in English law as claims in restitution based on a mistake of law, and where the claims were necessary in order to provide the taxpayers with an effective remedy under the San Giorgio principle. In breach of Community law, those two sections had purported to curtail the limitation period applicable to San Giorgio claims without providing any transitional arrangements (see [447] of the judgment).

(10) Although s 33 of the 1970 Act, and other equivalent provisions in domestic UK tax legislation, by implication had excluded any other domestic remedy in cases where the facts had fallen within the scope of the section, they had not excluded other domestic remedies in cases

where for any reason, the facts had fallen outside the scope of the section, and they were in any event overridden by the principle of effectiveness under Community law, where the taxpayer sought redress for a San Giorgio claim (see [449] of the judgment].

Service Companies – update on the nature of intermediaries

This HMRC guidance is being published in response to emerging developments in the Service Company sector and frequent questions posed to HMRC. It is intended to be read primarily by individuals providing their services through intermediary companies which they do not control and employment businesses, particularly those placing workers in the construction sector.

The following article [below], together with questions and answers [below], are being published in response to emerging developments in the Service Company sector and frequent questions posed to HM Revenue & Customs (HMRC). They are intended to be read primarily, but not exclusively, by

– individuals providing their services through intermediary companies which they do not control
– employment businesses, particularly those placing workers in the construction sector

The term 'Managed Service Company' (MSC) is defined in legislation having regard to certain criteria. In layman's terms, an MSC is one which is provided specifically to enable a worker to avoid tax and National Insurance contributions on employment income. Individuals who arrange for their income to be paid via a company with the intention specifically to avoid employed levels of tax and National Insurance contributions need to consider carefully whether the company through which they are paid may be an MSC.

These articles do not represent a change in policy from HMRC, rather they seek to clarify existing policy in light of recent developments. Particularly, there has been no change of policy in terms of individuals genuinely in business on their own account who provide their services though a company which they control.

How sure are you that your company is not a Managed Service Company (MSC)?

Since the introduction of the Managed Service Company legislation (Chapter 9, Part 2, Income Tax (Earnings and Pensions) Act 2003) with effect from April 2007, HM Revenue & Customs (HMRC) has seen a growth in intermediary companies which are marketed to individuals for the provision of their services to clients.

These companies are being marketed to a wide range of workers in various sectors and are based both in the UK and overseas.

The companies claim that they are not MSCs, usually by virtue of the fact that the provider of the intermediary is an officer or partner of the intermediary and that consequently as there is no separate MSC Provider, the MSC legislation does not apply.

HMRC's position

HMRC has now considered fully the arguments advanced by these intermediaries as to why they are not MSCs. Having taken counsel's advice, HMRC has come to a view on the nature of the intermediaries. HMRC's position is that being an officer/partner in a service company does not preclude that person from being an MSC Provider.

HMRC considers that companies and partnerships which otherwise fall within the Managed Service Company legislation (that is, fulfil the criteria of Chapter 9 ITEPA), but claim not to be MSCs because the provider is an officer/partner of the intermediary, are MSCs.

HMRC will now look for suitable cases to investigate and, where appropriate, challenge and litigate. HMRC is aware that some Service Providers claim to be in receipt of counsel's opinion that their particular intermediary does not fall within the Managed Service Company legislation. Such opinions do not alter HMRC's view regarding whether the Managed Service Company legislation applies.

Consequences for individuals, intermediary providers and third parties

Where HMRC challenges successfully a company as being within the Managed Service Company legislation and that company is unable to pay the resultant PAYE and National Insurance debt, HMRC will invoke the transfer of debt provisions.

Section 688A, Part 11 ITEPA provides for the transfer of debts of MSCs to a number of specified parties where the debts of the MSC are irrecoverable from the company. Providers of such companies, their associates and individuals providing their services through such companies will be those most at risk from the transfer of debt provisions.

It should be noted that simply because an intermediary is based outside the UK does not mean the Managed Service Company legislation does not apply. Those providing their services though companies based outside the UK should not assume that this fact alone exempts their company from the legislation and them from the consequences of non-compliance. If the provider and their associates are based outside of the UK tax jurisdiction, then the persons most at risk are individual workers based in the UK.

<u>Are you sure of the Construction Industry Scheme status of the construction intermediary you are paying?</u>

The growth in intermediary companies marketed to individuals for the provision of their services to clients is prevalent in the construction sector. These companies interpose themselves between the worker and payer (usually an Employment Business) so enabling the worker to claim to have 'self-employed' status.

Such intermediary companies may be MSC since many claim not to be MSCs by virtue of there being no separate MSC Provider (see above). Irrespective of whether the intermediary is or is not a MSC, payers (including Employment Businesses and main contractors) need to understand that there are specific Construction Industry Scheme (CIS) issues which must be considered when paying an intermediary.

Such intermediaries invariably have gross payment status under CIS and those who pay such intermediaries are determining the intermediary's CIS status and paying them accordingly.

Depending on the contractual relationship between the parties and the true nature of the services provided by the intermediary, the intermediary may not be a contractor within the meaning of CIS legislation, rather they may simply be a nominee of the worker. Where the intermediary is a nominee, both the intermediary and the worker must have gross payment status in order for payments to be made gross.

Payers are reminded that where they are operating in the construction sector, including providing labour, and are therefore a contractor for the purposes of CIS, they must ensure that they correctly establish their contractual relationships with intermediaries and workers in order to decide whether they are paying a contractor or nominee. They must then ensure that payments are properly made in accordance with the legislative provisions of CIS , that is, that payments are only made gross where all relevant parties hold gross payment status.

<u>Will HMRC's views on which companies are MSCs increase the risk to employment businesses having debts transferred to them?</u>

HMRC will continue to apply its guidance and policy in terms of whether a debt would be transferred to an employment business/agency. That is, there would have to be evidence of active involvement by the Employment Business/Agency in the workers' provision of their services through a Managed Service Company (MSC) (see paragraph 4.2 of the MSC Guidance).

<u>Will the fact that many of the service providers are overseas increase the risk that HMRC will look to employment businesses, as the parties with greater assets, to transfer debts?</u>

No. Employment businesses should bear in mind that HMRC will only consider transferring debts to an employment business both if debts are irrecoverable from Service Provider or workers, and there is evidence that the employment business was actively involved in the provision of the workers' services through an MSC.

<u>Should employment businesses refuse to make payments to a workseeker's company if it is outside the UK?</u>

Whom an employment business chooses to pay or not to pay is ultimately for the employment business to decide based on commercial considerations and statutory obligations.

What if the service company provider or the workseeker provide written assurance that the workseeker's company is not an MSC?

Some Service Company Providers are providing service companies which HMRC consider to be MSCs but which the Service Providers claim are not. Simply obtaining an assurance from a Service Provider or workseeker would not guarantee that HMRC would not consider transferring an MSC's debts to a statutorily prescribed third party. However, whether HMRC would consider transferring an MSC's debts specifically to an employment business would be decided in accordance with our current guidance (see paragraph 4.2 of the MSC Guidance.)

Can employment businesses continue to pay umbrella companies without fear of debt transfer?

HMRC is aware of at least one company calling itself an 'Umbrella Company' where workers' income is not being treated as employment income. Employment businesses should therefore not simply rely on the term 'Umbrella Company' but should seek assurance that the company treats all of their workers' income as employment income.

How can a contactor or employment business decide whether an intermediary being paid is a nominee of the sub-contractor?

As payer you must make sufficient enquiries to satisfy yourself as to the true nature of the intermediary you are paying. Where payment is to a nominee, both nominee and worker must be registered with HMRC for gross payment status in order for you to make payments gross.

Managed service companies see *Simon's Taxes* **E4.901**

HMRC Notice 3 December 2008

ECL Solutions Ltd v Revenue and Customs Commissioners SpC 721

HMRC opened an enquiry into the appellant company's corporation tax returns for the years ending 31 October 1999 to 2002 under FA 1998 Sch 18, para 24. The company had made deductions in its trading accounts in respect of licence fees paid to G and HMRC formed the opinion that the payments were annual payments under TA 1988 s 349 on which income tax should have been deducted. HMRC subsequently issued assessments pursuant to TA 1998 Sch 16, para 4(2) (which was the provision covering assessments of tax due under s 349). They also issued determinations under reg 80 of the Income Tax (Pay As You Earn) Regulations 2003, SI 2003/2682 on the grounds that if they were not annual payments they were Sch E emoluments. The company appealed against the assessments and reg 80 determinations. In September 2008, while those appeals were still pending, the company applied for a closure notice under FA 1998, Sch 18, para 33. In arguing that they had reasonable grounds for not giving a closure notice HMRC submitted that (1) the enquiry depended on the outcome of the outstanding appeals, and that neither the assessments based on annual payments or the alternative reg 80 determinations concerned corporation tax; and (2) an enquiry under FA 1998 Sch 18, para 24 into a company tax return did not cover income tax on annual payments. The appellant argued that (2) it was entitled to a closure notice so as to know what the conclusions of HMRC were; and (2) the assessments under TA 1988 Sch 16, para 4(2) were corporation tax assessments and HMRC were now out of time to make an assessment to corporation tax by reason of FA 1998 Sch 16, para 46.

The Special Commissioner found that the corporation tax enquiry depended on the result of the appeals in respect of the annual payments and the reg 80 determinations, and that HMRC had reasonable grounds for not giving a closure notice whilst those appeals remained to be determined. On the facts the assessments in May 2005 were to income tax and not to corporation tax. They referred in terms to "Schedule 16 ICTA 1988 paragraph 4(2)" and although there was no express mention of income tax they applied the basic rate of income tax. The tax due on the reg 80 determinations were also to income tax and not corporation tax. It followed that the application for a closure notice would be dismissed.

Application dismissed.

Value Added Tax

Latest VAT issues on the Betting, Gaming and Lotteries exemption

The two *Rank Group plc* Tribunal cases on the exemptions for gambling have attracted considerable interest. Rank themselves were reclaiming £25m in net VAT (with interest on top), and the second case was said to be a test case with 1,100 more repayment claims standing behind it. The trader won, but it is not yet clear whether HMRC will try a new line of defence or will simply pay up. Other claimants may now come forward to add to the queue: they will have to pay attention to the three-year cap on repayment claims, because HMRC will argue that the facts of the *Rank* case relate to legislation which changed in December 2005.

Gaming machines

In general, gambling is exempt from VAT under Sch.9 Group 4 VATA 1994 (squeezed between "postal services" and "financial services"). However, there are exceptions, and supplies made by means of a "gaming machine" are supposed always to be taxable:

The current law defines a gaming machine as follows (s.23 VATA 1994):

(4) In this section "gaming machine" means a machine which is designed or adapted for use by individuals to gamble (whether or not it can also be used for other purposes).

(5) But—

(a) a machine is not a gaming machine to the extent that it is designed or adapted for use to bet on future real events,

(b) a machine is not a gaming machine to the extent that—

(i) it is designed or adapted for the playing of bingo, and

(ii) bingo duty is charged under section 17 of the Betting and Gaming Duties Act 1981 (c. 63) on the playing of that bingo, or would be charged but for paragraphs 1 to 5 of Schedule 3 to that Act, and

(c) a machine is not a gaming machine to the extent that—

(i) it is designed or adapted for the playing of a real game of chance, and

(ii) the playing of the game is dutiable gaming for the purposes of section 10 of the Finance Act 1997 (c 16), or would be dutiable gaming but for subsections (3) and (4) of that section.

(6) For the purposes of this section—

(a) a reference to gambling is a reference to—

(i) playing a game of chance for a prize, and

(ii) betting,

(b) a reference to a machine is a reference to any apparatus which uses or applies mechanical power, electrical power or both,

(c) a reference to a machine being designed or adapted for a purpose includes a reference to a machine to which anything has been done as a result of which it can reasonably be expected to be used for that purpose,

(d) a reference to a machine being adapted includes a reference to computer software being installed on it,

(e) "real" has the meaning given by section 353(1) of [the Gambling Act 2005,

(f) "game of chance" includes—

(i) a game that involves both an element of chance and an element of skill,

(ii) a game that involves an element of chance that can be eliminated by superlative skill, and

(iii) a game that is presented as involving an element of chance, but does not include a sport,

(g) "bingo" means any version of that game, irrespective of by what name it is described.

(h) "prize", in relation to a machine, does not include the opportunity to play the machine again,

(i) a person plays a game of chance if he participates in a game of chance—

(i) whether or not there are other participants in the game, and

(ii) whether or not a computer generates images or data taken to represent the actions of other participants in the game.

The previous definition, which applied up to 5 December 2005, was:

a machine in respect of which the following conditions are satisfied, namely—

(a) it is constructed or adapted for playing a game of chance by means of it; and

(b) a player pays to play the machine (except where he has the opportunity to play payment-free as a result of having previously played successfully), either by inserting a coin or token into the machine or in some other way; and

(c) the element of chance in the game is provided by means of the machine.

HMRC's understanding, early 2005

Machines governed by s.16 and s.21 of the Gaming Act 1968 could only be situated on premises licensed for gambling. HMRC accepted that they might not fall within the definition of a VATable gaming machine – the following is an extract from the Rank Tribunal decision which explains HMRC's own views of the distinction between an exempt machine and a taxable gaming machine in early 2005:

28. A guidance manual produced by Customs in January 2005 contained the following at 12.4.2 of Chapter 19 on Betting and Gaming:

"12.4.2 Fixed Odds Betting Terminals (FOBTs) and Section 16 and Section 21 Gaming Terminals

FOBTs look like traditional gaming machines and can be played for cash. They allow a variety of simulated games to be played on them including roulette, virtual horse and dog racing, golf, and number games. A central feature of their operation is that the terminal is connected to a remote server, which contains a random number generator (RNG). It is this RNG that creates the chance element of the games. The FOBT itself contains the visualisation software. They are located at bookmaker's premises.

Section 16 and Section 21 terminals are similar to bookmakers FOBTs. They offer games of chance, usually roulette-based games, and again are driven by a remotely sited, random number generator. They have a maximum stake of 50p, a maximum cash prize of £25 and can also offer non-cash prizes. In bingo clubs, the non-cash prizes are restricted to a maximum value of £500. These gaming terminals are being provided under the terms of The Lotteries and Amusements Act 1976 and the Gaming Act 1968. Under this social law, it is only premises that hold the appropriate permits that are allowed to provide these gaming facilities.

Because the element of chance is not provided by the terminals themselves, but by a RNG which is outside the machine, both bookmaker's FOBTs and Section 16 and Section 21 terminals cannot be treated as gaming machines. Consequently, if the terminals offer the facilities for the placing of bets or for playing any games of chance, they will be exempt from VAT under Schedule 9, Group 4, Item 1 of the VAT Act 1994."

The Linneweber decision

The start of the current dispute was the *Linneweber* decision in the ECJ in 2005, summarised in Tolley's Tax-Link as follows:

German law provided that turnover within the scope of the Betting and Lotteries Act, and the turnover of licensed public casinos, was exempt from VAT. However, the exemption under German law did not extend to income from gaming and entertainment machines not situated in licensed public casinos. The tax authority sought to impose VAT on a trader who had not accounted for VAT on such income. The German court referred the case to the CJEC for a ruling on the scope of Article 13B(f) of the Sixth Directive. The CJEC held that Article 13B(f) 'precludes national legislation which provides that the operation of all games of chance and gaming machines is exempt from VAT where it is carried out in licensed public casinos, while the operation of the same activity by traders other than those running casinos does not enjoy that exemption'. Furthermore, Article 13B(f) 'has direct effect in the sense that it can be relied on by an operator of games of chance or gaming machines before national courts to prevent the application of rules of national law which are inconsistent with that provision'. Finanzamt Gladbeck v Linneweber, CJEC Case C-453/02; [2008] STC 1069.

HMRC's reaction

Customs commented in late 2006 on the fact that they had received a large number of repayment claims based on the ECJ decision in *Linneweber* which suggested that the exemption for gaming machines might be more widely available on the basis of preserving fiscal neutrality where identical machines were making exempt supplies and competing with the machines in question.

Customs did not accept that the UK's rules breached the principle of fiscal neutrality. However, traders who believed that their situation is on all fours with *Linneweber* could submit claims. They would only be considered by Customs if they are supported by evidence that:

- the machines are identical or substantially the same as those that the business is comparing them with;
- these machines are treated differently for VAT purposes; and
- this has caused distortion of competition.

Claims received without this evidence would be rejected.

Business Brief 20/06

At the same time, there were changes to the general law on gambling in the Gambling Act 2005. This led to changes in the definitions in the VAT Act which applied from December. Some might say that the changes in the law suggested that the previous law was flawed, but HMRC would argue that the timing was a coincidence: the redefining of a taxable gaming machine was nothing to do with *Linneweber*, but rather was a consequence of other reforms being made at the same time.

In late 2006, Customs clarified their policy following these changes. Further statutory instruments were issued to tidy up anomalies in the law, in particular the fact that pinball machines had been brought within the scope of the exemption by importing the Gambling Act concept of gaming machines (applied to games of chance and not requiring the offer of a prize). These machines became taxable again on 1 November 2006, but traders who had been accounting for output tax on them from 6 December 2005 to 31 October 2006 were able to make a reclaim (subject to the usual rules on adjusting input tax as well).

Business Brief 16/06; SI 2006/2685, SI 2006/2686

Bingo

The leading case brought on the basis of the ECJ's decision in *Linneweber* has resulted in success in the Tribunal for the company. It supplied "mechanised cash bingo" (MCB), which HMRC ruled should be excluded from exemption; it also made supplies which were accepted as exempt supplies of gambling. The argument based on *Linneweber* was that a provision, such as VATA 1994 Sch.9 Group 4 Item 1 Note 4, which made a distinction between very similar and competing supplies, such that one was exempt and the other was not, could not be justified. In the circumstances, both supplies had to be treated as exempt.

The Tribunal decision goes into detail about the way in which MCB worked. The distinction drawn by the law depended on whether s.14 or s.21 of the Gaming Act 1968 applied. S.14 applied to games with larger stakes or prizes. The evidence showed that these games were practically indistinguishable to the player, and it therefore made no sense for one to be exempt and the other taxable.

The specific rules distinguishing s.14 and s.21 do appear to draw a surprising distinction:

- If a bingo game had a stake of 50p or less and the cash prize offered was £25 or less, then the game was played under s.21 (exempt as betting).
- If a non-cash prize was offered, the maximum stake for such a game was 50p and the value of the non-monetary prize no more than £500, then that type of bingo was also played under s.21 (exempt as betting).
- If a game had a stake greater than 50p or if the cash prize was more than £25, then the game was being played under s.14 (taxable, according to the notes to Sch.9 Group 4).

HMRC tried to argue that this did not involve distortion of competition because the trader was not competing with itself. It was simply a fact that some of the games were taxable and some were exempt, but that would be the same for all traders offering a similar mix of games.

The Tribunal agreed with the trader's counsel that this was not the correct interpretation of the principle. It would require the application of fiscal neutrality to be determined on a detailed case-by-case basis, which made no sense: if a trader only supplied s.21 games it would appear to be unfairly discriminated against in comparison to a trader who only supplied s.14 games, but this appellant – according to HMRC – was not unfairly treated because it supplied both at once.

The appeal was allowed in principle and the parties were sent away to discuss the amounts of VAT that would be repaid as a result.

VAT Tribunal (20,688): *The Rank Group plc*

Jackpot

The last update included the first Tribunal decision in the *Rank* case. The Tribunal held that cash bingo machines should have been treated as exempt because treating them as taxable created a fiscal distortion: effectively identical supplies were distinguished by the law.

Now the other, more significant part of the dispute has also been decided, and the taxpayer has won again. The decision states that Rank's claim was for nearly £26m net, and that some 1,100 appeals by other traders had been stood over awaiting the outcome of this case. The subject of this claim was gaming machines, and the essence of the argument was the same: very similar machines were accepted as being exempt by HMRC either as a matter of law or a matter of practice, and that could not be accepted. The taxable machines also had to be exempt.

The law up to December 2005 excluded from exemption supplies from a "gaming machine", which was defined as follows:

(3) 'Gaming machine" means a machine in respect of which the following conditions are satisfied, namely –

(a) it is constructed or adapted for playing a game of chance by means of it; and

(b) a player pays to play the machine … either by inserting a coin or token into the machine or in some other way; and

(c) the element of chance in the game is provided by means of the machine.

The element of chance in Rank's machines was provided by a Random Number Generator (RNG). At some point no later than 2003, new machines were being supplied to Rank which did not contain a RNG. Some had the RNG physically separated from the machine, for example contained within the plinth on which the machine stood or attached to the wall behind it; some were terminals connected to a single computer server which provided the RNG for a network of such terminals. Rank argued that these machines were not covered by the definition as a matter of law, and were treated as exempt as a matter of practice. By virtue of the ECJ's decision in *Linneweber* (Case C-450/02), Rank argued that its other gaming machines should also be treated as exempt because to draw a VAT distinction between effectively identical services offended against the fundamental principles of VAT.

HMRC argued that there was no fiscal distortion. On the matter of law, they contended that the location of the RNG was irrelevant: it was attached to the machine and was therefore part of its apparatus. On the question of practice, they argued that regarding such machines as exempt was a mistake by the authorities in their understanding of new products, and they had acted with due diligence in changing the law by December 2005 to make it clear that such new machines should be taxable. HMRC also argued that there was no fiscal distortion, because there was no evidence that VAT considerations affected the choice of machines operated by businesses such as Rank.

The Tribunal decision examines the nature of the machines in detail, and also considers other legislation relating to them such as the Gaming Act. A key point is that the Tribunal regards the expression “the machine” in the definition as requiring “one RNG per machine”. Where there is a network, that would require the whole network (with perhaps 10 terminals) to be treated as a single machine. HMRC suggested that it was, but Rank’s counsel pointed out that gaming legislation restricted the number of machines that could be sited on any premises. This interpretation would allow 10 times more terminals than everyone believed were permitted under those rules. Accordingly, the Tribunal held that such networks did not fall within the definition of gaming machines up to December 2005, and they were exempt as a matter of law. It was also clear from the evidence that HMRC had accepted this as a matter of practice until claims based on *Linneweber* had started arriving.

The Tribunal did not accept that machines which had a single RNG fell outside the definition just because the RNG was physically separated from them. However, by that point it no longer mattered: as the networks were exempt, and they competed with other machines that had been treated as taxable, the basis of Rank’s argument had been established.

The Tribunal went on to consider the question of fiscal distortion. It rejected HMRC’s argument that the trader’s reasons underlying the installation of the machines was relevant, or that the trader had to show that there was a significant change in behaviour resulting from the difference in treatment. The facts spoke for themselves: effectively identical machines were treated differently, and that was fiscal distortion.

The question of whether HMRC could mount a defence based on “due diligence” was deferred. The chairman outlined the basis of such a defence but suggested that it would require a reference to the ECJ. HMRC were invited to go away and think about whether they wished to present such an argument in more detail.

VAT Tribunal (20,777): *The Rank Group plc (no.2)*

Lecture B515 (19.10 Minutes)

Excess charges in non–local authority car parks

This Revenue & Customs Brief explains their revised policy on VAT on excess charges and other penalties levied in non–local authority car parks and what you should do if you have incorrectly accounted for VAT on such charges. Certain excess charges which have to date been regarded as further consideration for a taxable supply of parking are now regarded as outside the scope of VAT.

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Background

Business Brief 19/02 explained our policy on the VAT treatment of excess charges in off–street car parks following the tribunal case of *Bristol City Council* (LON/99/261) (“BCC”). The Tribunal had concluded that excess charges levied by the Council in its off–street car parks were outside the scope of VAT because they were levied pursuant to the RTA 1984 and were not part of the contract entered into between the driver and the council. We accepted that the decision would also apply to other local authorities operating off–street car parks under the same statutory framework.

However, where off–street car parks were not operated by local authorities, we considered that excess charges would normally be subject to VAT because they arose under the terms of the contract between the driver and car park operator. This followed the rationale adopted by the Tribunal in the case of *J G Leigh t/a Moor Lane Video* [LON/89/83X], which concerned additional charges for videos held by customers beyond the agreed period of hire.

Revised policy

We have recently reconsidered that policy in the light of new legal advice and have concluded that, in the case of BCC, the Tribunal's decision was founded as much upon the contractual relationship as the statutory regime. Therefore, we now accept that there is a difference between the situation where the contract under which parking is supplied allows for an extension of the original terms, for which additional consideration will be payable, and the situation where the driver is not permitted to extend the original terms and a penalty for breach of contract ensues if this in fact happens. Thus, where a car park operator makes an offer of parking under clear terms and conditions, setting punitive fines for their breach, the fines constitute penalties for breaching the contract, rather than additional consideration for using the facilities. Consequently, they are outside the scope of VAT. Since the same contractual relationships arise between drivers and local authority car park operators as arise between drivers and other car park operators, we have also concluded that the VAT treatment of excess charges will be the same for all car park operators.

Excess charges not subject to VAT

The penalty charges that will no longer be subject to VAT are those that are levied where a driver is in breach of the terms of the contract with the car park operator.

The commonest situations where a driver may be in breach of the contract are—

- no parking ticket on display
- underpayment
- overstaying purchased parking time
- returning within a specified time
- parking outside marked bays
- parking in bays set aside for disabled drivers or parents with children

Excess charges subject to VAT

Where the terms and conditions make it clear that the driver can continue to use the facilities after a set period upon payment of a further amount without being in breach of the contract–for example, no charge for an initial three hours parking but £70 if that period is exceeded–then the payment will be consideration for use of the facilities and subject to VAT.

Excess charges retained by contractors

Some parking site owners contract out the management and operation of their parking sites and allow the contractor to retain all or part of the penalties collected. Any such payments retained by the contractor will constitute further consideration for their services supplied to the parking site owner and are subject to VAT.

What next?

If you believe that you have accounted for VAT when you should not have done, you may make a claim for the overpaid tax in line with the provisions of Notice 700/45—How to correct errors on your VAT Return. Please note that such claims will be subject to “capping” and may also be subject to the unjust enrichment provisions.

HMRC Brief 57/2008 9 December 2008

VAT on leases and SDLT

HMRC has published clarification of how the changes in VAT announced at Pre Budget Report 2008 will affect calculation of the net present value of the rent payable under a lease where VAT is charged on the rent. The PBR08 changes mean that rents which include VAT in the NPV calculation will be viewed, for Stamp Duty Land Tax purposes, as rents which are variable or uncertain.

Changes to VAT announced in the Pre Budget Report 2008 affect the calculation of the net present value (NPV) where VAT is charged on the rent.

When calculating VAT, the tax point for rental payments is the date on which a VAT invoice is issued or a payment is received, whichever is the earlier. The rate that is in force at the tax point will be the rate that applies.

Effective date of lease on or after 1 December 2008

If the effective date of the grant of a lease is on or after 1 December 2008 you should estimate the NPV using the following VAT rates:

- 15 % to 31 December 2009
- 17·5 % from 1 January 2010

Effective date of lease on or after 1 January 2010

Where the effective date of the lease is on or after 1 January 2010 the VAT rate of 17·5 % will apply.

VAT changes result in a variable or uncertain rent

As a result of the VAT changes at Pre Budget Report 2008 rents which include VAT in the NPV calculation will be viewed, for Stamp Duty Land Tax (SDLT) purposes, as rents which are variable or uncertain.

When the amount of rent payable for the first five years of the term of the lease becomes certain the purchaser can review the NPV payable on the rent and submit a return to HM Revenue & Customs (HMRC). At that point if NPV calculation was based on the VAT rate of 17·5 % and resulted in an overpayment a claim for repayment can be made.

When the VAT rate returns to 17·5 % again on 1 January 2010 HMRC will treat this type of rent as certain. A new return is not required if the SDLT estimated in the earlier return was correct. FA 2003 Sch17A Para 8 (1)(b) deals with cases where rents cease to be uncertain

Repayments of overpayments

It is likely that claims for SDLT repayment will be small for example we estimate that on an annual rent of one million pounds the repayment would be less than £250. We do not intend to make any repayments before January 2010 except where the lease ends before 31 December 2009.

If the fifth year of the lease ends before 31 December 2009, any claim for repayment of overpaid tax should be made within thirty days of the date when the rents for the first five years of the term become certain. Interest will be paid on repayments on the usual basis.

Making a claim for repayment

To make a claim you should write to The Compliance Team, Birmingham Stamp Office (www.hmrc.gov.uk/so/mctu.htm). Letters should be headed 'VAT on leases- overpayment claim'.