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BUDGET 2009

Personal tax

Lecture P531 (13.24 Minutes)

Income Tax Changes for 2010/11 Onwards

For 2010/11 onwards the basic personal allowance will be reduced for those with adjusted net incomes over £100,000, and an additional higher rate of income tax of 50% will apply to taxable income above £150,000. The personal allowance will be reduced by £1 for every £2 by which adjusted net income exceeds £100,000. This measure replaces the changes announced in the November 2008 Pre-Budget Report.

Dividends that would otherwise be taxable at the new 50% rate will be taxable at a new dividend additional rate of 42.5%. The trust rate will be increased from 40% to 50% and the dividend trust rate will be increased from 32.5% to 42.5%.

This measure includes powers to vary the income tax rates applying to registered pension schemes to take account of the new additional higher rate.

Tax Relief for Pension Contributions

It has been announced that, for 2011/12 onwards, for individuals with taxable income of £150,000 or more, tax relief on pension contributions will be restricted to the basic rate of tax only.

There will be legislation to deter individuals from forestalling this change by increasing their pension savings in excess of their normal regular pattern prior to that restriction taking effect. Anyone with taxable income of less than £150,000 for 2011/12, and for each of the preceding two tax years, will not be affected by any of these changes.

Non-residents and Personal Reliefs

For 2010/11 onwards, the entitlement to UK personal allowances and reliefs will be withdrawn for non-residents who would otherwise qualify for them solely by virtue of their being Commonwealth citizens. Many of those affected will still be able to obtain these allowances and reliefs by virtue of double tax treaties.

Employer-provided Living Accommodation

Employees who are provided with living accommodation by their employer on short-term leases where a lease premium is paid upfront with a low rent have avoided tax. From 22 April 2009 leases entered into or extended that are for a duration of 10 years or less will have the lease premium spread over the duration of the lease and taxed along with the rent paid less any amount made good by the employee. These rules do not apply to leases relating to a property used mainly for business purposes and partly for the domestic use of the employee.

Changes to Company Car Tax from 2011/12

From 2011/12:

- the lower threshold emissions figure will be 125g/km;
- the £80,000 list price cap will be abolished;
- the appropriate percentage for electrically-propelled cars will be 9% (a simplification as this is effectively the current position, albeit achieved indirectly);
- the reductions for: electric/petrol hybrids; cars propelled by bi-fuels, road fuel gas or bioethanol; and Euro IV standard diesel cars registered before 1 January 2006 will all be abolished – thus changing the focus to concentrate solely on the emissions figure.

Financial Services Compensation Scheme (FSCS): Accrued Interest

New measures will ensure that amounts representing accrued interest, paid by the FSCS as part of compensation payments to customers of defaulting financial institutions, will be within the charge to income tax.

The legislation will ensure that customers are in the same position as if the accrued interest had been paid by the defaulting financial institution itself.

The measures will apply to payments made by the FSCS after 5 October 2008.

Remittance Basis

Finance Act 2008 made very significant changes from 6 April 2008 to the remittance basis of taxation which enables UK resident individuals who are either non-UK domiciled or not ordinarily resident in the UK to be taxed only on income and gains remitted to the UK. Some further (more minor) changes are to be made to the remittance basis regime. They can be briefly summarised as follows and, except where otherwise stated, apply with backdated effect from 6 April 2008.

- The obligation to file a UK tax return will be removed from certain employees with overseas employment income of less than £10,000 and overseas bank interest of less than £100 all of which is subject to foreign tax.
- The range of exempt property (i.e. property that can be remitted without a tax charge) is extended to include property purchased out of overseas employment income and chargeable gains.
- No claim is required to use the remittance basis if the individual's unremitted foreign income and gains amount to less than £2,000 in the tax year. The rules will be amended to make it clear that such an individual will be treated as having used the remittance basis unless he notifies HMRC that he wishes to be taxed other than on the remittance basis. Also, the situations where an individual need not claim will be extended to cover cases where he has total UK income or gains of no more than £100 which have been taxed in the UK and makes no remittances to the UK in that tax year.
- Certain transitional rules will be amended so that they operate as intended.
- From 22 April 2009, legislation will be introduced to clarify the interaction between the remittance basis regime and the tax rules which apply to settlements in which the settlor has an interest.
- Where an individual pays the £30,000 charge for using the remittance basis, this will count as tax paid for the purposes of Gift Aid relief.
- Certain additional anti-avoidance rules are to be introduced from 22 April 2009.

The Government will give statutory effect to Statement of Practice 1/09 in Finance Act 2010. (This Statement sets out how HMRC treat transfers made from an offshore account which contains only the income relating to a single employment contract, and how earnings should be apportioned between UK and non-UK employment where an employee is taxed on the remittance basis.)

Individual Savings Accounts (ISAs)

The ISA limit will be raised to £10,200, of which up to £5,100 can be saved in cash (the current limits are £7,200 and £3,600 respectively).

The new limits will apply:

- for people aged 50 and over, with effect from 6 October 2009; and
- for all investors, with effect from 6 April 2010.

The ISA Regulations will be amended by statutory instrument to reflect the changes.

Dividends from Foreign Companies

Where an individual receives a dividend from a non-UK resident company, he is currently entitled to a tax credit only if his shareholding in the company is less than 10% of its issued share capital. The tax credit operates in a similar manner to tax credits attached to dividends from UK companies; it can reduce a tax liability but it cannot be repaid. From 22 April 2009, individuals with shareholdings of

10% or more in receipt of dividends from non-UK resident companies will also be entitled to a tax credit, but only if the source country is a 'qualifying territory'. A territory is a 'qualifying territory' if it has a double taxation agreement with the UK with a non-discrimination article.

The legislation will include anti-avoidance measures to deter abuse. These will include a targeted anti-avoidance rule to deny a tax credit if the dividend is, in fact, from a non-qualifying territory but is re-routed via a qualifying territory.

Improvements to the Venture Capital Schemes

For employment of money invested, a more relaxed time limit of 2 years, or 2 years from the commencement of the qualifying activity, will be introduced. The new limit will apply, broadly, from 22 April 2009 and will affect the enterprise investment scheme (EIS), corporate venturing scheme, and the venture capital trust scheme.

Further measures affect only the EIS:

- the requirement to use money from the issue of shares of the same class issued on the same day as EIS shares within the same time limit will be removed with effect in relation to shares issued on or after 22 April 2009;
- restrictions on the carry-back of relief to the previous year will be removed (subject to the overall cap on subscriptions of £500,000) for 2009/10 and subsequent years;
- an anomaly preventing relief from CGT under the share-for-share exchange rules will be removed in relation to new holdings issued on or after 22 April 2009.

Save As You Earn (SAYE) Simplification

With effect from 29 April 2009 legislation will be introduced to transfer the process of specifying bonus rates and early leaver interest rates on SAYE savings and of authorising savings providers from HM Treasury to HMRC. HMRC will also be able to specify by notice of withdrawal or variation that prior bonus rates will be valid even where the new rates have come into effect and will modernise the advisory process with the banks and building societies.

Distributions from Offshore Funds

From 22 April 2009, individuals in receipt of dividends from corporate offshore funds will be entitled to a tax credit. This will not, however, be the case where the offshore fund holds more than 60% of its assets in interest-bearing (or economically similar) form. In such a case, a distribution will be treated in the hands of a UK individual investor as a payment of yearly interest. This means that no tax credit will be available and that the tax rates applying to the distribution will be those that apply to interest.

This change will not affect the taxation of UK investors in offshore funds that are transparent for the purposes of tax on income; in these cases the investor is taxed on his share of the underlying fund income and by reference to the type of income received by the fund.

Substantial Donors to Charity

The threshold by reference to which a donor to a charity is treated as a substantial donor is to be increased. Certain transactions between a charity and such a donor result in a tax charge on the charity. With effect on and after 23 April 2009, a donor who makes tax-relievable donations to a charity of £25,000 or more in a 12-month period or £150,000 or more in a period of 6 years will be treated as a substantial donor.

Inheritance tax

Extension of Agricultural Property and Woodlands Relief

Finance Bill 2009 will introduce legislation to extend inheritance tax (IHT) agricultural property relief and woodlands relief from 22 April 2009 onwards to property in the European Economic Area (EEA). Any IHT due or paid from 23 April 2003 will become eligible for relief by claim from 21 April 2010. Property qualifying for this extended IHT relief will also qualify for capital gains tax hold-over relief, as will disposals of such agricultural property in the past including property farmed by a person other than the owner. Claims for hold-over relief relating to 2003/04 can be made until 31 January 2010 and for the years 2004/05 and 2005/06 prior to 1 April 2010.

Administration

Review of HMRC Powers, Deterrents and Safeguards: Payments, Repayments and Debt

The following provisions will be introduced:

- instalment payment schemes will be available to individuals and companies who either wish to spread their tax payments over time or who have not been able to pay the tax they owe on time; and
- HMRC will have a third party information power to require businesses and companies to supply contact details for tax debtors with whom HMRC have lost contact.

The introduction of managed payment plans (MPPs) is intended to help taxpayers with their cash flow by allowing them to spread their income or corporation tax payments equally over a period straddling the normal due dates. The plans will be voluntary and late payments under the plan will not be liable to interest or penalties. The relevant legislation will have effect on and after the date of Royal Assent to the Finance Act, but in practice, MPPs will not be introduced before April 2011 to allow time for HMRC to make changes to their computer and accounting systems.

HMRC will be able to collect small tax debts through the PAYE system, thus allowing taxpayers to spread their debt repayments and reducing HMRC's collection costs. Existing safeguards which limit the amounts that can be collected in this way will be preserved. The new system is likely to begin from April 2012.

New Reporting Requirements for Tax Defaulters

From a date to be announced, HMRC will require those who have incurred a penalty for deliberate understatement in respect of tax of £5,000 or more to provide more information about their tax affairs for up to 5 years, to ensure they have proper systems in place to be able to make a correct tax return. They will be required to submit returns showing more detailed business accounts information, detailing the amount and nature of any balancing adjustments within the accounts.

New Offshore Disclosure Opportunity

The Chancellor has announced a new disclosure opportunity (NDO) for UK residents with unpaid tax connected to an offshore account. The NDO will run from autumn 2009 until March 2010 and taxpayers who take up this opportunity will be expected to pay the tax due, together with interest and a penalty. The level of penalty which will apply will be announced before the scheme starts, but is likely to be lower than that which applies under the normal rules.

HMRC are also seeking to issue notices to financial institutions requiring them to provide information about offshore account holders.

Reclaiming Income Tax, Capital Gains Tax and Corporation Tax Overpayments

The rules relating to error and mistake relief will be amended, with effect for claims made on or after 1 April 2010, as follows:

- the requirements that the overpayment must be the result of a mistake in a return and that it must be made under an assessment will be removed;
- the current restriction on the right of appeal will be removed – claimants will be able to appeal to the courts; and
- the grounds and time limits for a claim will be set out.

Currently HMRC must determine what amount, if any, is just and reasonable to repay and no repayment will be made where the return followed the general practice at the time it was made, or where the mistake was governed by another statutory claim. Under the new rules, HMRC will only be liable to repay an amount where it is provided for by legislation, and the claimant will be able to determine the amount to be repaid, subject to HMRC's right to enquire into the claim within the enquiry window.

Penalties for Late Filing of Returns and Late Payment of Tax

A new, aligned penalty regime will apply to the late filing of returns and late payment of tax for IT, CT, PAYE, NIC, the construction industry scheme (CIS), stamp duty land tax, stamp duty reserve tax, IHT, pension schemes and petroleum revenue tax. The rules provide for a proportionate response, ranging from removal of penalties where a time to pay arrangement has been agreed to significantly higher penalties for prolonged and repeated delay. Penalties will apply whether the obligation is annual or occasional. The regime will not apply to tax credits.

A large number of different penalty and surcharge regimes which currently apply and which are specific to individual taxes, will be repealed. Key elements are as follows.

Penalties for late filing:

- a fixed penalty due immediately after the filing date whether or not the tax has been paid;
- daily penalties of £10 per day, for a maximum of 90 days for returns that are more than 3 months late;
- penalty of 5% of the tax due for prolonged failures;
- higher penalties of 70% of the tax due where the failure continues after 12 months and information has deliberately been withheld.

Penalties for late payment:

- 5% of the amount of tax unpaid 1 month after the due date;
- further penalties of 5% of any amounts still unpaid at 6 and 12 months;
- late payment penalties may be suspended where the taxpayer agrees a time to pay arrangement with HMRC.

There are similar penalties for late filing of CIS returns and for late payment of taxes and deductions collected through the PAYE system.

Taxpayers will have the right of appeal against all penalties and there is explicit provision for an appeal on the grounds of reasonable excuse. A penalty does not have to be paid before an appeal can be made.

Implementation of the new regime will be staged over a number of years, starting with penalties for payment of in-year PAYE from April 2010. Treasury orders will specify the date from which the provisions have effect.

Interest Harmonisation

The current range of different interest regimes for overpaid and late paid tax will be replaced by a single harmonised regime for all the taxes and duties administered by HMRC. For those taxes where HMRC currently charge and pay interest, rates will be aligned by Treasury order which will have effect shortly after Royal Assent. Interest on late payments of in-year PAYE is expected to be introduced, using a risk-based approach, from April 2010. Implementation of harmonisation requires changes to HMRC's computer systems and will be staged over a number of years.

Interest on late paid tax will be charged from the date that tax was due to be paid until the actual date of payment and HMRC will pay interest on tax overpaid from the date it was due to be paid (or actual date of payment if later) until the date of repayment.

The rate of interest on late paid tax will differ from that on overpaid tax, but for each there will be a single rate of simple interest, and regulations will establish the basis for calculating and applying the rates.

Rates will be implemented automatically based on the Bank of England base rate, and changes to rates will be made within 13 working days after any change in the bank rate.

Quarterly instalments payments (QIPs) for companies will be outside this scheme and different rates will continue to apply (although alignment will apply).

HMRC Charter

HMRC will be required by legislation to prepare and maintain a charter which will set out the standards of behaviour and values to which HMRC will aspire in dealing with taxpayers. They will also be required to report, on an annual basis, on how well they are meeting those standards. The charter must be in place by 31 December 2009 and HMRC propose to launch it by the autumn.

The existence of a charter has been the subject of consultation over some months and it was confirmed in November 2008 that this would be given legislative backing.

Business tax

Lecture B531 (22.16 Minutes)

Carry-back of Business Losses

The period to which businesses can carry back their trading losses is to be extended temporarily. The extended carry-back will apply to losses sustained by unincorporated businesses in 2008/09 and 2009/10 and by companies in accounting periods ending between 24 November 2008 and 23 November 2010. For unincorporated businesses, it applies equally to losses sustained in a profession or vocation.

The new proposals will enable losses to be carried back 3 years instead of 1. However, the amount that can be carried back more than 1 year is limited in total to £50,000, and it can only be set against taxable profits from the same trade. A separate £50,000 cap applies to each year's loss. The set-off must be made against later years' profits in priority to earlier years' profits.

Changes to Furnished Holiday Lets

On the pretext that they may not comply with EU law, because they apply only to UK holiday property, the Government has decided to repeal the rules relating to furnished holiday lettings with effect from April 2010.

From 2010-11, income from furnished holiday letting will be treated as any other let property.

Under the current furnished holiday letting rules, owners of UK holiday properties are treated as though their qualifying FHL business is a trade for the following purposes:

- loss relief;
- capital allowances;
- landlords energy saving allowance;
- certain capital gains reliefs; and
- relevant earnings when calculating the maximum relief due for an individual's pension contributions.

Until now these rules have only applied to furnished holiday accommodation situated in the UK, not in the European Economic Area.

Previously furnished holiday lettings in the EEA were treated as income from an ordinary overseas property business.

However, to ensure equal treatment for the period until the law is changed, if an EEA property satisfies all the other qualifying conditions, it will be a qualifying furnished holiday letting property for tax purposes.

The change does not affect those who let furnished holiday property situated outside the EEA.

Plant and Machinery: Temporary First-Year Allowance

A new, temporary 40% first-year allowance (FYA) will apply to expenditure on plant and machinery that would otherwise be allocated to the main pool because it is expenditure in excess of the £50,000

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cap for the annual investment allowance. Expenditure on certain assets, including long-life assets, integral features, cars and assets for leasing will be excluded.

The 40% FYA will be available, for expenditure incurred in the period of 12 months from 1 April 2009 for corporation tax and 6 April 2009 for income tax, to any company, partnership or individual carrying on a 'qualifying activity'.

Tax Relief for Business Expenditure on Cars

A car costing over £12,000 has until now been required to be placed in a single asset pool for capital allowances purposes. Writing-down allowances (WDAs) are available at 20% but cannot exceed £3,000 per annum for each such car. These were known as the 'expensive car' rules. The expensive car rules are abolished for expenditure incurred on or after 1 April 2009 for companies and 6 April 2009 for non-corporate businesses. Instead, all new qualifying expenditure on cars used exclusively for the business will go either into the main 20% pool or into the special rate 10% pool. This will be determined by the level of the car's carbon dioxide emissions. Cars with emissions over 160g/km will go into the special rate pool. Cars with an element of non-business use will continue not to be pooled but will attract only the 10% special rate of WDAs if their emissions exceed 160g/km. These rules will not apply to motor cycles, which will instead become eligible for the annual investment allowance, first-year allowances and short-life asset treatment. Expenditure incurred before 1 April/6 April 2009 on cars costing over £12,000 will continue to be subject to the previous rules for a transitional period of about 5 years. At the end of the transitional period, any remaining written-down value will be transferred to the main pool.

Where a car worth more than £12,000 is leased rather than purchased, there were rules restricting the amount of lease rentals deductible in computing business profits. These are also abolished, in this case where the lease period begins on or after 1 April/6 April 2009. Instead, only 85% of the expenditure on leasing a car with carbon dioxide emissions above 160g/km will be deductible. Where there is a chain of leases, this restriction will apply only to lease rental payments made by one lessee in the chain. There will be no restriction where the car is made available to the business for a period of no more than 45 consecutive days or if the business sub-hires the car to a customer for a period of more than 45 consecutive days (except where the business makes cars available to its employees or to the employees of a connected person). Lease periods or sub-hire periods may be aggregated in determining whether the period exceeds 45 days. There will be no restriction on the deduction of expenditure on the leasing of a car with lower emissions or of a motor cycle.

Corporation tax

Corporation Tax Main Rates

There is to be no change in the main rates of corporation tax. The main rate of 28% for financial year 2009, commencing on 1 April 2009, was fixed in FA 2008. The Finance Bill will set the main rate for financial year 2010 at 28%. The main rate for ring fence oil industry profits was fixed at 30% for financial year 2009 and will remain at 30% for financial year 2010.

Corporation Tax Small Companies' Rate

There is no change in the small companies' rate of corporation tax. The Finance Bill will set the rate for financial year 2009 at 21% and the fraction used in calculating marginal relief will be unchanged at 7/400. The November 2008 Pre-Budget Report announced that an increase in the small companies' rate to 22%, originally planned to take effect from 1 April 2009, would be deferred until 1 April 2010.

The small companies' rate for ring fence oil industry profits will be unchanged at 19% for financial year 2009, and the marginal relief fraction for such profits will remain at 11/400.

Taxation of Foreign Profits

The treatment of foreign profits will be amended so that:

- distributions from foreign companies received on or after 1 July 2009 will largely be exempt from CT;
- finance expense payable by UK companies in accounting periods beginning on or after 1 January 2010 will be subject to a cap equal to the group consolidated gross finance expense;

- with effect broadly for accounting periods starting on or after 1 July 2009 the CFC (superior and non-local) holding company exemptions and acceptable distribution policy exemption will be removed; and
- with effect for transactions undertaken on or after 1 July 2009 the Treasury consents rules are replaced by a post-transaction reporting requirement in relation, broadly, to transactions in excess of £100 million.

Draft anti-avoidance legislation in relation to loan relationships and derivative contracts, published on 9 December 2008, will not now be included in Finance Bill 2009.

Loan Relationships: Connected Companies

Two changes are to be made to the loan relationships rules in relation to connected companies:

- where a trade debt is released, the debtor company will no longer be chargeable on the resultant 'profit' (this will apply to releases on or after 22 April 2009);
- there will be a relaxation of the 'late interest rule' so that, broadly, it will only apply where the creditor is resident in a 'non-qualifying territory' (with the proviso that any abuse will result in anti-avoidance provisions).

This applies for accounting periods beginning on or after 1 April 2009, subject to transitional rules.

Groups: Reallocation of Chargeable Gains

From the date that Finance Act 2009 receives Royal Assent, companies will be able to elect to transfer a capital gain or a loss to another group company irrespective of whether the gain or loss is realised on a disposal to a third party.

This is a simplification of the current provisions contained in TCGA 1992, s 171A which previously only applied if there was a disposal to a third party and operated by deeming an asset to have been transferred intra-group prior to a disposal to a third party. This meant that the election could not be made for certain types of gains and losses (e.g. those arising on a negligible value claim).

These provisions will make it easier for groups to match gains and losses on the disposal of chargeable assets without the need to transfer ownership within the group.

Group Relief: Preference Shares

Where groups of companies issue particular types of preference share capital to external investors, provisions will be introduced in FA 2009 to ensure that such companies can still claim and surrender group relief within their group. These rules will, broadly, apply for accounting periods that commenced on or after 1 January 2008.

Tax Elected Funds

A new regime for UK authorised investment funds and their investors, to be introduced by secondary legislation with effect from 1 September 2009, will treat the investor as having invested directly in the underlying assets where the fund meets certain conditions and makes an election.

A tax elected fund will be required to make distributions of dividends and interest out of its income. UK dividend income will remain non-taxable in the fund and a deduction will be available to the fund for other income that is distributed as interest.

Authorised Investment Funds and Investors in Equivalent Offshore Funds

Secondary legislation is to be introduced in order to give authorised investment funds (AIFs), and UK investors in equivalent offshore funds meeting certain conditions, certainty that transactions appearing on a 'white list' will not be treated as trading transactions for tax purposes. There will be measures to ensure that financial traders cannot shelter profits by routing them through an AIF or an equivalent offshore fund. The new rules will apply for AIFs from 1 September 2009 and for equivalent offshore funds from 1 December 2009.

Investment Trust Companies

A new regime is to be introduced for investment trust companies (ITCs) investing in interest-bearing assets and their shareholders. In broad terms the shareholder's tax position will be the same as it would have been had he or she invested directly in the assets.

The ITC will remain liable to corporation tax on interest income, but will be able to opt to receive a deduction for any interest distributed. The new regime will be introduced by regulations and will apply for interest distributions on or after 1 September 2009.

Real Estate Investment Trusts: Amendments

The Finance Bill will include changes intended to clarify the legislation relating to real estate investment trusts (REITs). The existing legislation relating to the 'balance of business asset' test, whereby a REIT has to have 75% of its assets involved in the property rental business, will be amended to provide an accounting-based definition for all REITs. The legislation will also be amended to clarify the provisions relating to the apportionment of funds where an asset has been partly used for a property rental business and partly for non-rental purposes. There will also be changes governing the requirements which have to be met before a company can become a REIT. The changes will apply from 22 April 2009.

Corporation Tax: Agreements to Forgo Tax Reliefs

Legislation will be introduced to ensure that companies entering into arrangements to forgo tax losses or other reliefs (for instance, under the asset protection scheme) do not benefit from the automatic operation of those reliefs under the Corporation Tax Acts. This will apply to qualifying arrangements entered into on or after 22 April 2009.

Anti avoidance

Personal Tax Accountability of Senior Accounting Officers of Large Companies

New obligations on the senior accounting officers of large companies (i.e. companies other than those defined as small or medium-sized in the Companies Act 2006) will be introduced with effect for accounting reference periods beginning on or after the date of Royal Assent to Finance Act 2009.

Senior accounting officers must:

- take reasonable steps to establish and monitor accounting systems that are adequate for the purposes of tax reporting; and
- certify annually that the accounting systems in place are so adequate, or if not to specify the nature of any inadequacies and confirm that they have been notified to the company auditors.

Large companies will have to notify HMRC of the identity of the senior accounting officer.

The new obligations will be supported by penalties for careless or deliberate failures or inaccuracies: such penalties will be applicable to the senior accounting officer personally and to the company.

Publishing the Names of Deliberate Tax Defaulters

HMRC will be able to publish the names and details of all those who are penalised for serious defaults leading to a loss of tax of more than £25,000.

The measure will apply to individuals, businesses and companies who are penalised for deliberate or deliberate and concealed defaults, but will not affect those who make an unprompted disclosure, or full prompted disclosure.

In addition to the normal right of appeal against all aspects of a penalty, taxpayers will be informed prior to publication and will be able to make representations to HMRC. Details will be published quarterly within 1 year of the penalty becoming final and will be removed from publication 1 year later.

The measure will be brought into effect from a date to be announced by Treasury Order.

Foreign Exchange Losses: Targeted Anti-avoidance Rule

In relation to companies that hold investments in 'foreign operations' – subsidiaries or other business enterprises that operate in a different currency to the company – a number of tax avoidance schemes have been disclosed to HMRC that abuse the provisions for 'foreign exchange (forex) matching'. Finance Bill 2009 will aim to stop such schemes by providing that exchange gains or losses on borrowings or currency derivatives can only be 'matched' if they do not arise from tax avoidance arrangements. The measures will apply to company accounting periods beginning on or after 22

April 2009. Where an accounting period straddles 22 April 2009, it will apply only to exchange gains or losses arising between 22 April 2009 and the end of the period.

Transfers of Income Streams

The Finance Bill will include legislation intended to ensure that receipts which are derived from a right to receive income, and which are an economic substitute for income, will be taxed as income for the purposes of corporation tax and income tax. The legislation will apply to transfers of income taking place on or after 22 April 2009. It will not apply in relation to sales of income that arise from loan relationships or derivative contracts, where that income would have been subject to any exclusions under those rules. There will be provisions to exclude amounts which are already taxed as income, or where the transfer of the income is by way of security. Where the transferee is a company, it will be taxable only on its accounting profit from acquiring the income stream.

Disguised Interest

The Finance Bill will include legislation to provide that returns from arrangements which produce amounts which are economically equivalent to interest will be treated in the same way as interest for the purposes of corporation tax. The legislation will generally apply to arrangements to which a company becomes party on or after 22 April 2009, but will also apply to certain arrangements in place before that date that are within the scope of existing 'disguised interest' legislation which is to be repealed. There will be exclusions from the legislation where the return arises to a company purely from an increase in the value of shares that it holds in a connected company, and it is reasonable to assume that it is not a 'main purpose' of the arrangements to secure that the return is not charged to tax as income.

Financial Arrangements

Two schemes that have been notified to HMRC under the avoidance disclosure rules will be tackled by legislation introduced by Finance Bill 2009. In the first, intra-group finance is arranged under the terms of a bond that is highly likely to convert into shares of the issuing company. The debtor company accrues a deduction for a finance cost that is greater than the finance return that the creditor company brings into account. In the second, a company 'derecognises' in its accounts a derivative contract that is carried at fair value with the result that profits arising to the company on the contract fall out of account for tax purposes. The legislation has effect for debits and credits arising on or after 22 April 2009.

Interest Relief

The Finance Bill will include legislation intended to block schemes whereby the provisions which allow individuals to claim relief for interest payments on loans used to invest in partnerships or close companies are used in avoidance arrangements which purport to guarantee that the borrower will be able to make a profit as a result of the availability of the relief. The legislation will deny relief for interest which is paid as part of an arrangement that seems almost certain to allow the investor to exit the arrangement with more money than was originally invested, where the investor's main purpose in being party to the arrangements is to secure that result. The legislation will apply to interest payments made on or after 19 March 2009.

Employment Income Legislation

Employees and former employees are entitled to tax deductions for:

- premiums for insurance indemnifying them against employment-related liabilities such as damages relating to their employment or legal costs incurred in defending against such damages; and
- payments for such liabilities where they are uninsured.

In response to a known avoidance scheme, legislation is to be introduced that will deny such a deduction where the liability in respect of which the deduction would otherwise be due has been paid in connection with arrangements a main purpose of which is the avoidance of tax. The legislation will apply to payments made on or after 12 January 2009, regardless of when the arrangements that resulted in the payments were entered into.

An individual sustaining a loss in an employment or office (an 'employment loss') may make a claim for it to be set against general income. In response to known avoidance schemes the legislation is to be amended to deny relief for a loss if, and to the extent that, it is sustained as a result of anything done in pursuance of arrangements a main purpose of which is the avoidance of tax. This will have effect in relation to losses incurred in 2009/10 and subsequent tax years, and also in relation to a loss incurred in 2008/09 if, or to the extent that, it is occasioned by an act or omission occurring on or after 12 January 2009. Where the taxpayer has paid less tax on 31 January 2009 than he should have done, due to an employment loss that now falls to be disallowed, the due date for surcharge purposes is deferred until 1 April 2009, so that no surcharge will be due if the extra tax is paid before 29 April 2009. The legislation will also include protection from penalties where a person has made an employment loss relief claim at any time between 12 January 2009 and 1 April 2009 inclusive and the claim is affected by the new anti-avoidance rule.

Life Insurance Policies

In order to counter schemes that exploit the income tax loss relief rules by using offshore life insurance policies, legislation will be introduced to ensure that income tax losses arising on a chargeable event in connection with such policies do not attract loss relief from 6 April 2009. ITA 2007 will be amended accordingly.

ITA 2007 will also be amended so that transitional provisions will apply to 2008/09 to restrict such claims where on or after 1 April 2009:

- the policy or contract is made;
- terms of an existing policy are amended or a right under it is exercised;
- rights in the policy are assigned to a person claiming a deduction; or
- all or part of the rights become held as security for a debt.

Manufactured Interest

The Finance Bill will include legislation intended to prevent a High Court decision from affecting the tax treatment of payments of manufactured interest. The legislation is intended to ensure that the tax treatment of such payments will follow the treatment of the payments in company accounts prepared in accordance with generally accepted accounting practice. It will apply to deemed payments of manufactured interest made on or after 27 January 2009, but will apply to actual payments of manufactured interest made before as well as on or after that date, in order to ensure that existing practice is followed.

Plant and Machinery Leasing

Legislation, which was announced and published in draft on 13 November 2008, will be introduced in Finance Bill 2009 to counter avoidance involving the leasing of plant or machinery. It will ensure that:

- a business entering into a sale and leaseback or lease and leaseback does not gain more relief than it would have done had it obtained loan finance;
- tax is not avoided when a lessor grants a long funding lease; and
- when a long funding lease ends the lessee has obtained an appropriate amount of relief.

In addition:

- the definitions of sale and leaseback arrangements in existing anti-avoidance legislation will be amended for consistency and to achieve their objective; and
- amendments will be made to ensure initial payments under a lease do not escape taxation and to ensure consistency with the taxation of chargeable gains.

The measure will generally have effect for transactions entered into on or after 13 November 2008; but some aspects of the measure will have effect on or after 22 April 2009.

Real Estate Investment Trusts

The Finance Bill will introduce a power to make regulations that will prevent restructuring within groups of companies from enabling companies to meet the real estate investment trust (REIT)

conditions and tests when they would not have done so without that restructuring. The measure will also exclude owner-occupied properties from the regime, and will enable potential REITs with tied premises to enter the regime. The changes will take effect from 22 April 2009.

Double Tax Relief Avoidance

Anti-avoidance provisions will be introduced in relation to:

- banks and manufactured overseas dividends;
- banks and double tax relief credit rules; and
- repayment of foreign tax.

The provisions will take effect on 22 April 2009.

Value Added Tax

Registration and Deregistration

With effect from 1 May 2009, the VAT registration threshold will be increased from £67,000 to £68,000. The deregistration threshold will be increased from £65,000 to £66,000. The registration and deregistration thresholds for acquisitions from other EU member states will also be increased from £67,000 to £68,000.

Change of Standard Rate

The standard rate of VAT will return to 17.5% from 1 January 2010. The 2008 Pre-Budget Report announced a temporary reduction in the standard rate of VAT to 15% for a 13-month period from 1 December 2008 to 31 December 2009. The reduction was implemented by secondary legislation effective for 12 months. Legislation will be introduced in Finance Bill 2009 for the 15% rate to apply during December 2009 and for the rate to revert to 17.5% on 1 January 2010.

Change of VAT Rate: Anti-Forestalling Legislation

The Finance Bill will include provisions to counter schemes that purport to apply the 15% rate of VAT to goods or services to be supplied on or after the date that the VAT rate returns to 17.5%. The legislation will provide that, in certain circumstances, a supplementary VAT charge of 2.5% will be due on supplies of goods or services on which VAT has been declared at 15%. This will apply where the customer cannot recover all the VAT on the supply and one of the following conditions is met:

- the supplier and customer are connected parties; or
- the supplier funds the purchase of the goods or services (or the grant of the right to receive them); or
- a VAT invoice is issued by the supplier where payment is not due for at least 6 months.

The above provisions have effect on and after 25 November 2008.

A supplementary charge will also apply where a pre-payment of more than £100,000 is made before the rate rise in respect of goods or services (or the grant of a right to receive goods or services) to be provided on or after the date of the rate rise, unless the pre-payment is made in accordance with normal commercial practice in relation to such supplies when no VAT rate increase is expected. This provision will take effect from 31 March 2009, and the supplementary charge will have to be accounted for on the date that the VAT rate reverts to 17.5%.

Opting to Tax Land and Buildings

The procedure for opting to tax supplies of land and buildings, in respect of which taxpayers have made previous exempt supplies, will be simplified with effect from 1 May 2009 with the introduction of a new ‘automatic permission condition’. This is intended to allow more taxpayers to opt to tax without seeking prior permission from HMRC. HMRC will also withdraw a related informal extra-statutory concession with effect from 1 May 2010, and will partly regularise another such concession from the same date.

Changes to the Place of Supply Rules in Relation to Cross-Border Services

With effect from various dates commencing with 1 January 2010, a package of measures is being introduced on an EU-wide basis to counter fraud, and to simplify and modernise the VAT system in relation to cross-border supplies of services.

The main changes include:

- the default place of supply in relation to business to business services will be where the customer is established, subject to certain exceptions;
- changes to the time of supply rules in relation to cross-border services;
- UK businesses will be required to submit EC sales lists in respect of services supplied to businesses in other member states, where the customer is required to account for VAT under the reverse charge procedure;
- changes to the procedure by which a business established in one member state may seek a refund of VAT incurred in another.

Car Fuel Scale Charges

The scale used to charge VAT on fuel used for private motoring in business cars will be amended from the start of the first VAT period beginning on or after 1 May 2009.

Emission figures which are not multiples of 5 are rounded down. In the case of bi-fuel cars which have two emission figures, the lower emission figure should be used. For cars with no emission figures, HMRC have prescribed a level of emissions by reference to the engine capacity.

Stamp taxes

Shared Ownership

Relief from SDLT is available for certain land transactions where the purchaser is a ‘registered social landlord’ (RSL). RSLs are to be replaced, in England, by ‘registered providers of social housing’ (RPSHs), a new regime that will be open to profit-making companies.

The relief from SDLT will be extended to include profit-making RPSHs where the purchase is funded with the assistance of public subsidy.

Relief will also be available for purchasers under shared-ownership schemes operated by profit-making RPSHs, where the scheme is assisted by public subsidy. These measures will have effect for land transactions where the effective date is on or after Royal Assent to the Finance Act.

Measures will also be introduced to simplify the SDLT rules relating to the ‘Rent to HomeBuy’ shared ownership scheme, with effect where the effective date of the grant of the shared ownership lease under the scheme is on or after 22 April 2009.

Temporary Increase in Thresholds

The SDLT ‘holiday’, announced in September 2008, exempted from SDLT acquisitions of residential property where the chargeable consideration was not more than £175,000. The exemption applied to land transactions where the effective date was between 3 September 2008 and 2 September 2009.

The Finance Bill will raise the starting threshold for SDLT on residential property from £125,000 to £175,000 for land transactions where the effective date is between 22 April 2009 and 31 December 2009. From 1 January 2010 the threshold will revert to £125,000.

Leasehold Enfranchisement

Relief from SDLT, where the freehold of a block of flats is acquired by a ‘right to enfranchise’ company (RTE) on behalf of the leaseholders, has not been brought into force.

Reference to an RTE company will be removed to allow the relief to be claimed by any nominee or appointee who acquires the freehold of a block of flats on behalf of leaseholders under a statutory right of leasehold enfranchisement, thus enabling the relief to operate as originally envisaged.

The change will have effect for land transactions where the effective date is on or after 22 April 2009.

Personal Tax

Medical check-ups

On 10 December 2008, HMRC confirmed that legislation would be included in the next Finance Bill to exempt from tax and NICs the provision by employers of yearly health screening and medical check-ups without the proviso that such benefits have to be available generally to all employees.

This means that the tax and NIC treatment of health screening and medical check-ups will be broadly the same as it was before the present regulations were introduced on 14 August 2007 (SI 2007/2090). These regulations make the exemption conditional upon the benefit being available to *all* employees.

The new statutory exemption will have effect from 6 April 2009.

Article by Robert Jamieson

Lecture P532 (3.06 Minutes)

Pensions – trivial commutations

Hidden away in the detail of the recent Pre-Budget Report is a proposal which will adversely affect poorer pensioners.

Since 6 April 2006, people approaching retirement who have only accumulated a modest amount of private pension savings have been able to benefit from a provision which allows them to take out the whole of those savings as a lump sum. This is known as a 'trivial commutation'.

The trivial commutation rules are, however, restricted to those pensioners who have saved no more than 1% of the pension lifetime allowance. This allowance is currently £1,650,000 rising to £1,800,000 for 2010/11, which means that the trivial commutation limit is:

(i) £16,500 for 2008/09;

(ii) £17,500 for 2009/10; and

(ii) £18,000 for 2010/11.

John Andrews of the Low Incomes Tax Reform Group, which is an initiative of the CIOT set up to give a voice to those individuals who cannot afford to pay for tax advice, provides the following example:

> 'If you are a single woman aged 60 and your pension pot is £16,500 today, this might translate (after taking the 25% tax-free commutation) into an annuity of less than £9 a week with some inflation-proofing. For many people on low incomes, the trivial commutation is much more attractive.'

However, on 24 November 2008, the Chancellor announced that the lifetime allowance was to be capped at £1,800,000 for a further five years, ie. through until 2015/16. This of course limits trivial commutations to a maximum of £18,000 for the same five-year period, potentially handicapping some of the poorest pensioners who might otherwise have benefited from taking their pension monies all at once.

John Andrews continues:

> ‘Whilst it is difficult to predict what the economic climate will be like by 2011, it is well known that pensioners are currently facing huge financial difficulty. The unprecedented interest rate cuts of recent weeks and increasing longevity have caused annuity rates to fall. This is therefore not a good time to be announcing a provision which will naturally force more pensioners into a small annuity purchase when they retire.
>
> In light of the above, we urge the Government to reconsider this announcement to the extent that it affects those with the smallest pension pots. This could be achieved by uncoupling the trivial commutation amount from the lifetime allowance.’

Will the Chancellor listen to this sensible suggestion?

Article by Robert Jamieson

Lecture P533 (5.29 Minutes)

Revised arrangements for Short Term Business Visitors

With effect from 6 April 2009, Appendix 4 of HMRC's Employment Procedures manual follows the OECD “physical days of presence” method, which means that a part day spent working in the UK generally counts as a day of presence for the purposes of computing the 183 day period.

Under a longstanding arrangement set out in Appendix 4 of HMRC's Employment Procedures manual (EP), employers can agree with their HMRC Office to relax the strict PAYE requirements for employees on short term business visits to the UK.

In most circumstances, if an employee performs duties in the UK for whatever period, his/her employer must account for PAYE.

Where, however, an employee is

- resident in a country with which the UK has a Double Taxation Agreement under which the Dependent Personal Services/Income from Employment Article (Article 15 or the equivalent) is likely to be competent, and
- is coming to work in the UK for a UK company or the UK branch of an overseas company, and
- is expected to stay in the UK for 183 days or less in any twelve month period, then,

so long as the UK company or branch will not ultimately bear the cost of the employee's remuneration and certain other conditions are met, they can agree with HMRC that they need not operate PAYE in respect of those duties.

The arrangement described in EP Appendix 4 tells you what factors you must take into consideration when deciding whether or an employee has been in the UK for 183 days or less. Until now, when counting to 183 days for these purposes, a part day counted as a part day. So, someone spending three consecutive 8 hour days working in the UK was regarded as having spent one day in the UK for this purpose.

We have now, however, changed the wording of the arrangement so that, with effect from 6 April 2009, it follows the OECD “physical days of presence” method. Under this approach, a part day spent working in the UK generally counts as a day of presence for the purposes of computing the 183 day period. That means that, from 6 April 2009, the example above will result in the employee having spent 3 days in the UK for this purpose.

Full details of the revised Appendix 4 wording are available.

What should you do now?

From the date of this article, all new EP App4 applications and arrangements should use this revised wording.

From 6 April 2009, customers with existing agreements should use the "physical days of presence method" described in the new agreement for the purposes of computing the 183 day period.

HMRC Notice 9 April 2009

Capital Gains Tax

Current tax advantages of furnished holiday accommodation

With residential properties facing falling prices and a serious slowdown in sales, it is now a good time to look at the market for property letting and to reflect on the tax advantages of owning furnished holiday accommodation. Following sterling's decline against both the euro and the dollar and the collapse of a number of airlines, the UK-based tourist industry may currently be on the verge of a profitable upturn.

In the UK, the owner of a furnished holiday property business enjoys a number of tax benefits, including in particular:

- business property relief;
- entrepreneurs' relief;
- rollover relief; and
- the ability to offset business losses sideways against total income.

IHT and business property relief

It is important that clients who own holiday properties should try to ensure, as far as possible, that they qualify for this major IHT relief. Case law has suggested that, in order to be eligible for business property relief, it is necessary to be involved in the management of the properties (see, for example, *Furness v CIR (1999)*).

In practice, the relief is normally allowed where the following conditions are satisfied:

- the lettings are short-term (eg. weekly or fortnightly); and
- the owner, either himself or through an agent is substantially involved with the holiday-makers in terms of their activities on the premises, even if the period for which the property is let is only for part of the year.

HMRC Inheritance Tax now seem to accept that many more letting businesses will qualify for relief than they had previously envisaged (ie. they are not excluded by S105(3) IHTA 1984). The key criterion, they suggest, is where the owner is substantially involved with the holiday-makers in relation to their activities on and around the premises (see Para IHTM25278 of the Inheritance Tax Manual).

Risk areas which could jeopardise an IHT claim are:

- where little or no services are provided for the benefit of holiday-makers;
- where lettings are mainly to friends and relatives; and
- long-term lettings.

What qualifies as furnished holiday accommodation?

The property must meet various requirements in order to qualify as furnished holiday accommodation and so be eligible for the tax breaks mentioned above. Note that it does not have to be in a tourist area, although it must be situated in the UK and the pattern of lettings must satisfy three conditions:

- the property must be available for commercial letting to the public as holiday accommodation for at least 140 days in a 12-month period (usually, this coincides with the tax year);

- the property must actually be so let for at least 70 days in the 12-month period; and
- the property must not normally be let for a continuous period of more than 31 days to the same tenant during seven months out of the 12-month period (ie. the holiday season) – longer-term lettings are permitted in the remaining five months.

Other helpful factors which can be relevant are:

- the property is located in a tourist area;
- the property is marketed professionally;
- business rates are paid;
- the property is awarded a rating by the English Tourist Board (or equivalent);
- public liability insurance is paid on the property; and
- the business is operated on a commercial basis, with profits being made and tax paid accordingly.

Any tax planning confusion is largely caused by uncertainty about the extent of the landlord's involvement with his tenants. As stated earlier, it is helpful from a tax point of view if a number of services are provided for the holiday-makers, eg. meeting and greeting them, organising car hire, arranging for cleaning and laundry to be done, supplying basic foodstuffs for the fridge on their arrival and so on. There is nothing to stop the property owner subcontracting these services out to someone else. The important point is the extent of the involvement with the holiday-makers, even if this is handled by an agent. It is a good idea to ensure that there is a contemporaneous record of the services provided. Further examples are visits to the property with local maps and/or guides to historic attractions and organising maintenance of the property (including gardening, if relevant) before, during and after the period of the letting.

Application of entrepreneurs' relief

With effect from 6 April 2008, taxpayers are no longer entitled to business asset taper in connection with their business gains and the new flat rate of 18% applies to all gains. However, an entrepreneurs' relief claim, which produces an effective tax rate of 10% for the first £1,000,000 of lifetime gains on qualifying business disposals, is available in connection with the sale of furnished holiday accommodation (but not for other residential lettings or for let commercial property, including farm business tenancies).

If a landlord owns several holiday properties, care must be taken in the event of a disposal of one of them to ensure that the transaction does not fall foul of the so-called *McGregor v Adcock (1977)* trap.

As far as CGT is concerned, the furnished holiday accommodation provisions are found in S241 TCGA 1992. Interestingly, there does not appear to be any anti-avoidance legislation which prevents a landlord, who has been letting a residential property on, say, yearly tenancies, from changing to short-term tenancies for the final 12 months prior to the sale of the house or flat with a view to qualifying for entrepreneurs' relief. Nor is there anything in TCGA 1992 which requires a taxpayer, in the context of entrepreneurs' relief, to apportion his capital gain and exclude periods of non-furnished holiday letting activity.

Illustration

Chris owns 'Coastguard Cottage' which he has been letting for the last 10 years, the minimum tenancy being for 12 months. He thinks that he might sell the cottage in due course, but, in the current market, he is in no hurry to do so.

His tax adviser suggests that he should start letting to tenants on a short-term basis within the commercial letting of furnished holiday accommodation provisions and that he should delay any sale until he has established at least one year's activity in his new 'deemed' trade. The adviser explains that, as the anticipated gain on the property is under £1,000,000, the rate of tax to be applied to Chris' gain when he sells up should be reduced from 18% to 10%.

Rollover of capital gains

Furnished holiday accommodation qualifies as an asset into which capital gains can be rolled under S152 TCGA 1992. If it later turned out that a landlord's furnished holiday letting conditions became too difficult to satisfy so that the house was subsequently rented out on ordinary residential letting terms, any gain rolled over while the property *did* qualify would not be taxable until the house was sold.

Maximising income tax loss relief

Another advantage of furnished holiday lettings is the ability to claim loss relief against total income for the tax year of the loss and/or the previous year. This sideways loss relief makes interesting income tax planning in years of high earnings for the taxpayer and high property overhead or management expenses.

Some VAT considerations

Remember that the standard rate of VAT applies to rents for holiday lets as long as they are advertised as such (Group 1 Note 13 Sch 9 VATA 1994). However, if the property is offered at lower rates in the off-season, it can be treated as ordinary residential accommodation for VAT purposes provided that it is let for more than four weeks and the property is situated in a resort which is clearly seasonal.

Thus a VAT-registered sole trader owning a holiday property will have to charge output VAT on his VAT return, but will be able to claim input VAT relief on any repairs and related costs. If significant expenditure on a holiday property is planned, it will be important to ensure that the property falls within the scope of VAT for obvious tax planning reasons. Clearly, ownership of two or three holiday properties can easily cause the client's business turnover to rise above the VAT registration limit (currently £67,000).

Article by Robert Jamieson

Lecture B532 (20.12 Minutes)

STOP PRESS:

The chancellor is proposing to treat FHLs as any other property let with effect from 6 April 2010.

The new policy was instigated on the pretext that FHLs in the UK may not comply with EU law by being treated as trading income for their owners and operators - as they have been since 1983-84. Therefore the rules are to be extended to include furnished holiday lettings in the European economic area for 2006-07 to 2009-10 before the special treatment is abolished.

PKF tax partner Peter Harrup said that it was no surprise that the tax break has been removed given the country's current financial difficulties - but he criticised the move for denying owners of larger holiday letting concerns 'reliefs available to other businesses at a time when they are very much needed'.

Mr Harrup added: 'While it is only fair that UK owners letting property in Europe can now qualify for this tax treatment, it does not mean that it is sensible to withdraw tax breaks from all UK holiday lettings.'

Owners of FHLs in the UK and elsewhere in Europe who wish to benefit from the current rules on capital gains will have to sell their properties by 5 April next year.

'Thousands of people – from those owning one chalet to individuals running large holiday businesses – now face some tricky long term decisions at a time when they should be concentrating on preparing for the holiday season, and I fear that many owners will try to sell quickly,' said Mr Harrup.

'If this leads to a reduction in the number of tourists visiting UK holiday areas, it will hurt the wider UK tourist industry: one of the few sectors of the economy that had looked set to avoid the recession.

'The Government needs to rethink this policy quickly to avoid causing collateral damage to the UK tourist industry.'

Taxation website, 29 April 2009

CGT and foreign currency movements

Foreign assets

In relation to foreign assets, UK capital gains tax is calculated on the difference between the sterling values on acquisition and disposal. So while an asset may have actually fallen in value, there could still be a UK capital gain! See the example below, which looks at the purchase and subsequent sale of a US property by a UK resident, giving a loss in dollars but a gain in sterling.

Example

Purchase of a US property by a UK resident.

	$	£
Property cost (at $1.80)	400,000	222,222
Property sold (at $1.40)	350,000	250,000
Loss/gain	$50,000	£27,778
	loss	Gain

Now, you may say that's fair, because if the client converted sterling to buy the property and converts back on sale, he has made an actual gain. However, the gain will still arise if there has been no actual conversion back into sterling and he still leaves the proceeds in dollars. Indeed, in the example, the client might not be able to convert back to sterling if he still has a US$350,000 mortgage to repay!

The whole issue is exacerbated by two factors:

- the significant movement in sterling over the past year; and
- an increased number of non-UK domiciliaries who will fall to be taxable on the arising basis from 6 April 2008.

Those domiciled outside of the UK could be particularly affected as they, in particular, are likely to have foreign cash or assets. That leads directly on to the issues with currency and foreign bank accounts.

Foreign currency

Clients with bank accounts in foreign currency could also find that they have capital gains simply by using funds in that account.

By virtue of TCGA 1992, s 21(1)(b), currency is a chargeable asset for capital gains tax purposes. TCGA 1992, s 252 provides an exclusion for foreign currency in a bank account held for personal expenditure (including expenditure on the provision or maintenance of any residence outside of the

UK). So unless, foreign currency is held for personal expenditure outside of the UK, any disposal of that currency will give rise to a capital gain.

Returning to the basics of capital gains calculations, there needs to be a disposal of an asset previously acquired. It is therefore probably worthwhile considering when you might have acquired or disposed of foreign currency. The summary below provides some possible circumstances.

Acquisition of foreign currency	Disposal of foreign Currency
● Sale of an asset for foreign currency. ● Remuneration. ● Receipt of a gift. ● Inheritance.	● Acquisition of an asset (shares, property, etc). ● Acquisition of another currency. ● Gift. ● Payment of a fee.

So, some combinations of an acquisition and disposal giving rise to a potential chargeable gain could include the following situations.

1. Receipt of remuneration in US dollars (acquisition of US dollars) followed by an acquisition of a property in the US (disposal of US dollars).

2. Inheritance of a French property which is then sold (acquisition of euros). The disposal could be the purchase of another asset or currency or the conversion of the euros to sterling.

3. An offshore gift of US dollars by a father to his adult son (son's acquisition of US dollars) which is then converted to euros (disposal of US dollars and acquisition of euros) used to invest in a new business in Spain (disposal of euros).

On each acquisition and disposal date, the sterling value needs to be considered and the difference on disposal would create a capital gain or loss.

HMRC's *Capital Gains Manual* provides good commentary on currency gains at CG78300. Given that one of the only assets moving up in value is overseas currency, HMRC might be taking a closer look to find some capital gains to tax. Thinking about it makes you want to reach for the sangria now!

Gary Heynes and Sarah Turgoose of Baker Tilley writing in Taxation, 23 April 2009

Lecture P534 (8.41 Minutes)

Entrepreneurs relief and capital losses

Entrepreneurs' relief (ER) was slotted into our capital gains tax code just a year ago on 6 April 2008, but problems with its operation are already emerging. A particular area of confusion is the interaction of the relief and capital losses. In this article I outline the mechanisms that exist within the ER code for dealing with losses, and highlight the 'bear traps' that lie in wait for taxpayers who dare to use the relief. The legislative references are to TCGA 1992, unless otherwise stated.

Aggregation of losses and gains

Entrepreneurs' relief applies to the net profits from a qualifying business disposal. This means that where one or more qualifying business assets realise a loss on disposal and other assets from the

same qualifying business disposal realise a gain, the losses are first set against the gains before ER is applied to the net gain that is realised for the whole business.

This aggregation principle is set out in s 169N(1) and is explained in the HMRC *Capital Gains Manual* at paragraph CG64125. However, neither the legislation nor the HMRC guidance stipulate that aggregation must be restricted to losses and gains realised within a single tax year, it is just restricted to 'a qualifying business disposal'. This appears to mean the disposal of a single business. In the current difficult economic circumstances, the disposal of all the assets that comprised a single business can be spread over two or even three tax years as shown in example 1 below.

Example 1

Kevin owned a music business that consisted of a record label — Wonderful Plastic — and a retail shop that traded under the same name. Kevin sold the Wonderful Plastic record label, its associated music rights and stock in May 2008, but had difficulty in disposing of the leasehold of the shop, which he eventually sold for a loss in May 2009.

Under s 169N(1), Kevin is required to aggregate the relevant losses accruing on the disposal of relevant business assets comprised in the qualifying business disposal, with the relevant business gains comprised in the same qualifying business disposal. The lease is a relevant business asset as defined by s 169L as it was an asset used by the business and it was not an excluded asset because it was not held as an investment.

If we assume that the disposal of the lease is regarded as being comprised in the qualifying business disposal, the loss on the lease disposal should be aggregated with the earlier gain made on the rest of the business assets.

Kevin needs to report the net gain on his 2008-09 tax return, as follows:

2008-09	£
Record label sold May 2008	200,000
Less: Leasehold shop sold May 2009	20,000
Net gain	180,000
Less: Entrepreneurs' relief 4/9 x 180,000	80,000
Taxable gain:	100,000

This is a rare instance of a capital loss being carried back in time, although this rarity depends on all of the disposals being part of the same qualifying business disposal.

Qualifying business disposal

For individuals (not trustees), a qualifying business disposal is a material disposal of business assets (s 169I) or an associated disposal (s 169K). I will leave aside associated disposals and concentrate on the definition in s 169I(2) which allows a material disposal to be:

(a) the disposal of all or part of a business; or

(b) the disposal of assets that were used in the business at the time the business ceased, but which were disposed of up to three years after the business ceased.

The distinction of 'or' rather than 'and' in this definition has implications for whether aggregation under s 169N applies to the loss or not.

Should the loss be aggregated?

Relevant losses can only be aggregated with relevant gains where both arise from assets comprised in 'the qualifying business disposal' (so computed), (see s 169N(5)(b) and (6)(b)). However, it may

not be easy to draw a line around the transactions that are included in the qualifying business disposal and those which are not. This is because, in practice, the business assets may be disposed of piecemeal to a number of different buyers. There is nothing in the legislation that requires a qualifying business disposal to be contained within one sales contract.

As seen above, there is a distinction drawn by s 169I(2) between a material disposal that falls in subsection 2(a) and other disposals that fall in subsection 2(b). It appears that losses made in category (b) — after the cessation of the business — cannot be aggregated with gains made under (a) on disposal of the whole or part of business. This is a bear trap for entrepreneurs and their advisers.

In example 1, Kevin's Wonderful Plastic record business is likely to be treated as ceasing when the ownership of the record label and stock passes out of his hands, even though the business may continue to trade in some form under the new ownership. The disposal of the lease then becomes a post-cessation disposal under s 169I2(b), rather than a disposal under s 169I(2)(a). This means that the loss on the disposal of the lease cannot be carried back to be set against the gains arising on the disposal of the rest of the business assets, but can only be carried forward to be used against future gains as it falls in a later tax year.

It is crucial to fix the date on which the business is treated as ceasing. This date is usually a question of fact, according to HMRC in their *Capital Gains Manual* at CG64105. However, HMRC admit that there will be less clear-cut situations where the trade runs down gradually. A decision to dispose of the business does not amount to permanent discontinuance of the business if trading activity continues after that decision (see *J & R O'Kane & Co v CIR* [1922] 12 TC 303).

Timing issues

When making disposals that potential qualify for ER, timing is everything.

Say, in example 1, Kevin shut his record shop, and disposed of the lease, but carried on the Wonderful Plastic record label business, while selling the records through other outlets. HMRC may view the disposal of the shop lease as unconnected with the disposal of the whole or part of the business. Any gain made on the disposal of the lease is then excluded from an ER claim because it is not the disposal of the whole or part of the business. Any loss on the lease disposal is not aggregated with the other business gains. This problem can be neutralised if the rest of the business assets are disposed of shortly afterwards, and an argument can be made to link the lease disposal with the disposal of the rest of the business.

Where, as in example 1, the disposal of the lease occurs after the principal business assets, the lease disposal may well be treated as a post-cessation disposal. The gain on a post-cessation disposal will be eligible for ER if the asset was in use in the business at the date of cessation, and the owner carried on the business for at least one year before it ceased. Any loss realised on a post-cessation disposal, however, will not be aggregated with the gains on the other business assets.

Note that the three-year post-cessation period is defined by s 169I(4)(b), so any disposals outside of this period will not qualify for ER even if the asset can be clearly linked to the disposal of the main business. HMRC have no discretion to extend the three-year period, so it is vital to pin-down the business cessation date.

Example 2

Stephen gave 25% of the shares in his personal trading company to his daughter in June 2008 making a gain based on the transfer deemed to be at market value, of £270,000. The disposal for entrepreneurs' relief can be a gift.

Stephen also made a loss of £100,000 in October 2008 on the disposal of quoted shares.

His capital gains calculation for 2008-09 is as follows:

2008-09	£
Gain on gift	270,000
Less: Entrepreneurs' relief claimed:	
4/9 x £270,000	120,000
Taxable gain:	150,000
Less: Loss on quoted shares	100,000
Taxable gain before annual exemption	50,000

Where aggregation of the gains and losses is desired, the disposal of the various business assets needs to be carefully timed. Assets that are likely to realise losses should be disposed of before the principal business undertaking ceases and certainly before other disposals that are likely to realise gains. In this way the loss will either be aggregated with the main gains on the sale of the business, or be available as a non-ER loss to set off against the net gain after deduction of ER, (see below).

If the aggregation of gains and losses from the disposal of all the business assets is likely to result in a net loss, no ER is due as there is no gain to reduce. In this situation it may be advisable to delay some of the loss-making disposals into a later tax year. This will allow a net gain to be covered by the taxpayer's annual exemption, and the loss to be carried forward to use against future gains.

Interaction with other losses

Capital losses brought forward, or which arise in the same tax year from assets unconnected with the business disposal, are set-off against the net gain on the disposal of the business after entrepreneurs' relief has been applied as shown by example 2.

If, in example 2, Stephen could claim business asset holdover relief on the gift of the shares to his daughter under s 165, in place of the ER, the hold-over relief claim would defer the whole of the gain, leaving the loss arising on the sale of quoted shares unrelieved in 2008-09 and wasting the annual exemption.

The interaction of the various capital gains tax roll-over and deferral reliefs with ER is a can of worms which I do not propose to open in this article. The timing of asset disposals to achieve the best loss set-off is enough to boggle the mind for now.

Rebecca Cave writing in Taxation, 16 April 2009

Is it goodwill?

An interesting question was posted in Taxation a few weeks back.

A sole trader may incorporate his business. Does the value of current contracts represent goodwill that could be sold to the company?

I act for a sole trader who supplies labour in engineering contracting.

The business is profitable and anticipated profits in the current year are £180,000. The client has determined to incorporate the business. There are no chargeable assets beyond potential goodwill.

My client assures me that his trading name has no goodwill attached. It is a competitive business; he has contacts and tenders for the work and engages the labour.

No one would be prepared to pay any significant sum for the use of his trading name.

Why should they? If he were not tendering for the work, there are plenty of other contractors. He works from home, the work is all carried out on site and he moves his men around the country to different sites as necessary.

It seems to me that there is no goodwill of any type here, but my client raises an interesting point.

The current contracts might be expected to yield profits of, say, £300,000 over the next two or three years. With the consent of the customers, those contracts could be transferred to a buyer who would then receive the profits.

On the other hand, at a time when he held no contracts his business would have a value of nil. Is such a sum goodwill and potentially chargeable to capital gains tax?

Goodwill surely cannot have a substantial value one month, none the next and a substantial value again the following month?

17,388 – Fisher

Reply by New Road

The first question is whether there is any goodwill. Fisher appears to have answered in the negative. The second question appears to be how can goodwill seemingly disappear?

The answer to that is that Fisher has not valued goodwill. She or he has looked at the value of the existing contracts. This is an intangible asset, but those existing contracts are not the same as goodwill. Goodwill is a separate asset.

I can explain that point in several ways, but I will look at two only.

First, we can look at the definition of goodwill from the accountant's viewpoint. Financial Reporting Standard 10, 'Goodwill and Intangible Assets', defines purchased goodwill as the difference between the cost of a business entity and the aggregate fair values of its identifiable assets and liabilities at the date of acquisition.

The rights to income under the contracts would be one of the identifiable assets. Therefore, paying to obtain the rights to the contracts is not paying for goodwill.

Second, we could look at the tax definitions. Goodwill is a separate asset for the purposes of TCGA 1992. However, the term goodwill is not defined in the act. There is a discussion of goodwill in HMRC's *Capital Gains Manual*, starting at paragraph CG68000.

The manual quotes from a stamp duty case, *CIR v Muller & Co Margarine Limited* [1901] AC 217, where Lord MacNaghten said that goodwill 'is the benefit and advantage of the good name, reputation and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old-established business from a new business when it starts.'

If that definition may seem similar to the accounting definition, Fisher should bear in mind that paragraph CG68010 has the following comment:

> 'The decision of the Special Commissioners in *Balloon Promotions Ltd v Wilson* SpC 524 [2006] STC (SCD) 167, provides authority for the fact that for capital gains tax purposes goodwill should be construed in accordance with legal rather than accountancy principles'.

The legal principle will set the goodwill as separate from the rights to the contracts, and that is why a standard sale agreement will ascribe value to the rights of any contracts taken over and a separate value to the goodwill.

However, in both the accounting and the legal definitions, goodwill must be capable of having an existence with the business. It seems that any goodwill in the form of the reputation and connection with customers is linked to the sole trader.

It also seems that the ability to attract customers is the name, reputation and personality of the sole trader.

If the business is incorporated, Fisher would find little difficulty in persuading HMRC that the company is not allowed to claim a deduction for amortising goodwill and the director/shareholder does not have a loan account on which he is free to draw.

However, that is not the end of the matter. Fisher should consider what would be the case if someone were to come along to buy the business to add to their own. Would the sole trader try to obtain an additional value for 'the business'?

Also, what would be the case if the sole trader employed one, two or three members of staff obtaining the contacts, preparing tenders and engaging labour along with the sole trader?

The business would not be fundamentally different from how it is now, but there would be value in it apart from the personality of the sole trader.

I have seen HMRC try to argue against the existence of goodwill in more than one case following an incorporation, but that does not mean that they are right.

However, if Fisher is content to accept that there is no goodwill, that the company has no right to amortise the goodwill and the director does not have a tax free loan account on which to draw, there will be no need to value goodwill for the transfer to the limited company.

If HMRC do try to say that there is a capital gain arising on the transfer, Fisher should be ready to quote paragraph CG68010:

> 'Any goodwill attributable to the personal skills of the proprietor, for example the personal skills of a chef or a hairdresser, will not be transferred to the new proprietor.Advice should be obtained from the CG Technical Group if it is claimed that the goodwill attributable to the personal skills of the proprietor have been transferred with the business because his/her services have been retained for the foreseeable future by means of an employment contract.'

I am not sure that is right and I would attribute some value to the business, but if Fisher does not wish to pursue the point, I do not think that he or she should worry about the value that could be attributed to the contracts being treated as value attributed to goodwill.

Reply by Pegasus

The good news, as far as I am concerned, is that the business is not property-based (pubs, restaurants, etc, on which HMRC have recently issued guidance on their treatment of goodwill in such businesses), which makes this question relatively easy to deal with.

Goodwill, like any other asset – be it a share in a company or a commercial property – can rise and fall in value – Royal Bank of Scotland shareholders can attest to that. So in answer to Fisher's final question – yes, in theory, goodwill could have a substantial value one month, none the next and a substantial value again the following month. What is relevant for capital gains tax is the asset's value at the time of disposal and at no other time.

Of course, in the real world, such significant short-term fluctuations as Fisher suggests are unlikely.

He suggests that contracts may run for two or three years – if goodwill is based on the value of those contracts, and assuming that contracts are replaced on a rolling basis, the value of goodwill may fluctuate from time to time, but I would doubt to the extent indicated by Fisher.

The question of whether or not goodwill does exist in such a business can usually be fairly easily demonstrated on a sale – if the buyer is prepared to pay more than the net tangible assets are worth then there is, by definition, goodwill.

But here we are not dealing with a sale to a third party, where goodwill may easily be determined by reference to an excess of sale proceeds over asset values.

Although there will be an actual sale to the newly-formed company, the connected party rules require the sale to be treated as made at arm's length and so a market valuation, considering a hypothetical third party purchaser, will be required.

The test is whether or not that third party would be prepared to pay a premium in respect of the profits to be earned from the existing contracts.

It may well be that those clients would not be prepared to renew contracts if the current trader were no longer involved with the business, in which case it can probably be argued that goodwill has a fairly low, if not nil, value.

That, however, is a matter for debate based on the precise circumstances and is not one on which I would like to offer an opinion.

For argument's sake, though, what if it is established that Fisher's client's business does have significant goodwill? Goodwill in the hands of a sole trader is a chargeable asset for capital gains tax purposes. There are ways of deferring a capital gains tax charge – through incorporation relief under TCGA 1992, s 162 or holdover relief under TCGA 1992, s 165.

However, on the assumption that the trader has been trading for at least 12 months it may be better to realise a chargeable gain, taking advantage of the capital gains tax annual exemption and an effective tax rate of 10% through entrepreneur's relief, while at the same time generating a healthy credit balance on the director's loan account – from which funds can be drawn tax-free to pay the capital gains tax arising on the goodwill disposal.

And the company's position? Depending on when Fisher's client commenced in business (and depending on the method of incorporation), the company may be entitled to a tax deduction for either amortisation of cost of the goodwill or a flat-rate deduction of 4% per annum.

If trade commenced before April 2002, the goodwill will remain, in the company's hands, a chargeable asset for capital gains purposes.

Inheritance Tax and Trusts

McCall and another (PRs of McClean (deceased)) v R&C Commissioners

The deceased owned agricultural land, which comprised a number of fields in grass. The land was let under seasonal grazing arrangements, known as agistment arrangements. The deceased's son-in-law, M, looked after the fields. The work he did involved—(i) inspection of the perimeter fencing and walls, gates and water supply; (ii) removal of rubbish, unblocking of drains, emergency repairs to vandalised or damaged fencing and tending the drinking troughs; and (iii) informing the grazier of any problems he observed in their animals. In total, the work amounted to some 100 hours per year. The graziers themselves fertilised the land. Prior to the deceased's death, the land was zoned for developmental use, as a result of which its value as at the date of the deceased's death was far in excess of its purely agricultural value. In respect of the inheritance tax liability on the deceased's estate, a question arose as to whether the land attracted business property relief under s 104 of the Inheritance Tax Act 1984, and in particular whether the land amounted to "relevant business property" within the meaning of s 105(1)(a) of the 1984 Act. Under s 105(3), a business or interest in a business was not relevant business property if the business consisted wholly or mainly in, inter alia, making or holding investments. The Revenue decided that the land was not relevant business property. The deceased's personal representatives appealed. The special commissioner concluded that M's activities on the land coupled with the annual letting of the land to graziers was just enough to constitute a business, but went on to conclude that the business was one that consisted wholly or mainly of the holding of investments, and that therefore the estate was not entitled to business relief. The personal representatives appealed.

It was held—The term "business [of] holding investments" was not a term of art. The test to be applied was that of an intelligent businessman who would be concerned with the use to which the asset was being put and the way it was being turned to account. It was clear from authority that a landowner who derived income from land or a building would be treated as having a business of holding an investment notwithstanding that in order to obtain income he carried out incidental management and maintenance work, found tenants and granted leases. In the instant case, the special commissioner had been entitled to find that the activities of the deceased were in the nature of maintenance work necessary to enable the deceased to let the land for grazing. The work done was aimed at maximising the return from the grazing which represented income of the deceased by way of a return from the land. The absence of a full and exclusive right of occupation of the land for the graziers and the existence of a right by the owner to enter the land during the period of the agistment did not prevent the business from being regarded as an investment business. The use by the graziers was sufficiently exclusive for the land to be shown to be used as an investment—the agisting farmer had exclusive rights of grazing; he was entitled to exclude other graziers including the deceased; the deceased could not use the land for any purpose that interfered with the grazing and the letting. The deceased's business consisted of earning a return from grassland the real and effective value of which lay in its grazing potential. The special commissioner had been fully entitled to conclude that the business had been one of holding an investment. The personal representatives' appeal would, accordingly, be dismissed.

Weston (exor of Weston, decd) v IRC [2000] STC 1064 applied.

Court of Appeal, Northern Ireland, Girvan, Coghlin LJJ and Deeny J, 21 January, 25 February 2009

Administration

New HMRC powers and penalties regime

Her Majesty's Revenue and Customs (HMRC) is gradually overhauling all its powers in relation to compliance checking and inspection. The Finance Act 2007 included the first tranche of legislation and further details were contained in the Finance Act 2008.

Several new information and inspection powers come into effect on 1 April 2009.

All civil information powers will CEASE on that date.

Table summarising the new information powers

Power	Authorisation	Notice period	Appeal	Penalties
First party notice	HMRC officer, Authorised Officer or First Tier Tribunal	Reasonable time (usually ≥ 30 days)	Yes but not for statutory records	£300, and potentially £60 per day thereafter
Third party notice	First Tier Tribunal with the agreement of an Authorised Officer	Reasonable time (usually ≥ 30 days)	Yes but not for statutory records	£300, and potentially £60 per day thereafter
Third party, unnamed persons notice	First Tier Tribunal with the agreement of an Authorised Officer	Reasonable time (usually ≥ 30 days)	Yes but not for statutory records	£300, and potentially £60 per day thereafter
Right to inspect	HMRC Authorised Officer or First Tier Tribunal	With agreement of the person, 7 days notice or unannounced with authority of HMRC Authorised Officer	Yes but not for statutory records	£300, and potentially £60 per day thereafter** **no penalty unless visit is authorised by First Tier Tribunal

Information Notices

Any request for information or document must be reasonably required for the purpose of checking a person's 'tax position'.

'Tax Position' means a person's past, present and future liability to pay an of the following taxes:

- Income tax (including PAYE)
- CIS
- CGT
- CT
- VAT

- 'Relevant Foreign Tax' . This is any tax of an EU member state (outside the UK) that is covered by EU exchange of information Directives or other territory for which international enforcement arrangements have been made.

What is a document?

A document is anything in which information of any description is recorded. It extends to information contained on a computer.

Safeguards of the new powers

The powers are Human Rights Act (HRA) compliant. For any information or inspection to meet the protections under Article 8 of the HRA (right to respect for private and family life) any request must be lawful, reasonable and proportionate.

- the information or document must be in the power or possession of the person on whom the notice is served

- the person must be provided with a reason why HMRC want the information or document (usually at least 30 days, after receipt of the notice)

- the person must be given a reasonable opportunity to provide the information or document.

HMRC cannot seek a document

- that is more than six years old, unless it is approved by an Authorised Officer

- that relates to the conduct of an appeal

- that is a person's Person Records (as defined in s12, Police and Criminal Evidence Act 1984 (PACE)

- that is journalistic material

- that is subject to Legal Professional Privilege

- that is an Auditor's papers

- that are a Tax Adviser's papers that contain Relevant Communications (ie communications that give or obtain tax advice)

- in cases of third party notices they should not be unduly onerous.

There are grounds of appeal but not if the requests are to review Statutory Records or any notice has been authorised by the First Tier Tribunal.

Statutory records

Statutory records are records which a person is required to keep or preserve by the Taxes Acts or VAT legislation. Where the person is not carrying on a business and the records are not required to be kept and preserved by VAT legislation, the information or document does not become part of their statutory records until the chargeable period to which it relates has ended. This means that those records cannot be requested or inspected until AFTER the chargeable period has ended.

There are penalties for failure to comply with an information notice where there is no reasonable excuse. The penalty is £300, with the scope for daily penalties of £60 per day thereafter.

Power to inspect

All of the powers and safeguards referred to above also apply to the power to enter and inspection. There are powers to enter and inspect business premises and premises used in connection with the supply of goods.

HMRC has the powers to inspect
- the premises
- the business assets on those premises or goods

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- the business documents on those premises or relating to goods.

The power is to enter and inspect. It is not a power to force entry or undertake a search.

There are some specific safeguards:

- the inspection should be undertaken with the agreement of the person whose premises are being inspected
- the person should be given 7 days notice, unless it is approved by an Authorised Officer, and/or the First Tier Tribunal.

The person has the right to refuse entry, however, there are potential penalties if the person obstructs an inspection which has been authorised by the First Tier Tribunal. The penalties are £300, with the potential for £60 per day thereafter.

Power to copy, take extracts or remove documents

On both information notices and inspections, HMRC has the power to copy a document, take extracts, or remove it. Again, any action must be reasonable and proportionate. Also, if HMRC remove a document and they lose it, they will be required to pay compensation.

Link between Information and Inspection Powers under Schedule 36 FA 2008 and assessing time limits under Schedule 39 FA 2008

Any request for information or to inspect should take into account the new assessing time limits.

The table below summarises the new assessing time limits:

Tax	Mistake	Discovery	Failure to take reasonable care	Deliberate understatement or Failure to Notify
VAT	4 years		6 years	20 years
IT/CGT		4 years	6 years	20 years
CT		4 years	6 years	20 years
PAYE		4 years	6 years	20 years
NIC		4 years	6 years	20 years

In terms of direct taxes, the normal assessing time limits will change on 1 April 2010 from six years to four years. One can expect to see a flurry of protective direct tax assessments before 1 April 2010.

The current VAT time limit for assessments for errors in respect of any VAT period is the **later of**

- two years after the end of the VAT period; or
- one year after evidence of fact, sufficient in the opinion of HMRC, to justify the making of an assessment, comes to their knowledge

but in any case not more than three years after the end of the VAT period. From 1 April 2009, the three year limit will increase to four years.

As the assessing time limits are being brought in on two dates, 1 April 2009 for VAT and 1 April 2010 for direct taxes, it is proposed that there will be transitional rules for VAT in the period 1 April 2009 to 31 March 2010.

HMRC should not use the new powers to obtain information or a document which they had requested under the old powers prior to 1 April 2009.

New penalty regime, s27 FA2007 amended by s40 and s41 FA 2008

The new penalty regime relates to: income tax, capital gains tax (CGT), corporation tax, VAT, PAYE, National Insurance Contributions (NIC) and the Construction Industry Scheme (CIS). It came into force on 1 April 2008 for returns to be filed after 31 March 2009.

A penalty may arise if you 'give' a return (or a supporting document) to HMRC which contains an inaccuracy and the inaccuracy resulted from careless or deliberate behaviour.

A penalty may also occur where HMRC issues an assessment that understates a taxpayer's liability in respect of income tax, CGT, corporation tax or VAT and the taxpayer fails to take reasonable steps to notify HMRC within 30 days of the issue of the under-assessment.

Finance Act 2008 introduces an aligned penalty regime for failure to notify HMRC of a chargeability to tax. This will also apply to obligations arising on or after 1 April 2009.

What amount of penalty is payable?

The table below sets out the maximum and minimum penalties by reference to the relevant behaviour and whether there is a prompted or unprompted disclosure:

Unprompted Disclosure				
Type of inaccuracy	Mistake	Careless	Deliberate	Deliberate and concealed
Maximum	No penalty	30%	70%	100%
Minimum		0%	20%	30%
Prompted Disclosure				
Maximum	No penalty	30%	70%	100%
Minimum		15%	35%	50%

No penalty will be charged by HMRC where a person makes a mistake but take reasonable care.

Potential lost revenue

'Potential lost revenue' generally refers to the additional amount of tax or NIC payable as a result of the amendment, including where the inaccuracy is in respect of a loss which has been used to reduce the amount of tax due.

There are special rules where a loss has been wrongly recorded but has not been used to reduce a tax liability. In this case a nominal rate of tax is applied (10%).

There are also provisions to charge a penalty where the inaccuracy is in respect of tax that is being declared later than it should have been. A nominal rate of 5% per year of adjustment is applied.

Penalty reductions

Penalties may be reduced based on whether the disclosure is 'prompted' or 'unprompted', and based on the 'quality' of the disclosure.

The quality of the disclosure is determined by considering the following three factors:

- telling (potential reduction of 30%)

- helping (potential reduction of 40%)

- access (potential reduction of 30%)

The resulting reduction is applied to the difference between the maximum and minimum penalties.

Example

Fred is a sole trader who did not keep his records up to date and has not kept any details of the amount of his drawings or of payments made in cash. HMRC opened an enquiry before any disclosure was made. He cooperated fully once enquiry commenced.

The likely offence is that of lack of reasonable care and the disclosure is prompted. The maximum and minimum penalties are 30% and 15%.

Fred can reduce the maximum penalty by the difference between the maximum and minimum penalty of 30% - 15% ie 15%.

The extra 15% reduction can be achieved by gaining the maximum reduction for telling (30%), helping (40%) and access (30%). However, for the purposes of demonstrating this example, say in this case he only achieved 80%. The additional 15% is therefore limited to 80% of 15% ie 12%. The maximum penalty of 30% can therefore be reduced by 12% and so the penalty is 18%.

Suspended penalties

In cases of careless inaccuracy, HMRC may suspend all or part of the penalty for a period of time, not exceeding two years.

If, after the period of suspension, HMRC is satisfied that all the conditions have been complied with, then the suspended penalty is cancelled. Otherwise the penalty becomes payable.

Right of appeal

The person has the right to appeal to the new Tax Tribunal.

The person may appeal on the following points:

- The decision by HMRC that a penalty is payable
- The amount of the penalty
- The decision by HMRC not to suspend a penalty
- The decision by HMRC in setting the conditions of a suspension of a penalty.

Individual liable for a company's penalty

Where a penalty is payable by a company in respect of a **deliberate** offence and the inaccuracy is attributable to an officer of the company, all or part of the penalty can be attributed to the officer personally.

Article by Francesca Lagerberg

Lecture B535 (11.08 Minutes)

Reviews and Tribunals

On 1 April 2009 the General and Special Commissioners; VAT & Duties Tribunal and Section 704 Tribunal were replaced by a two-tier unified tribunal structure. These changes arise from Sir Andrew Leggatt's report "Tribunals for Users: One System, One Service" published in August 2001. The key recommendation was that there should be a single tribunals system independent of the departments sponsoring them to counter the feeling of users that "Every appeal is an away game."

The tribunals were to be grouped by subject matter with:

- a first-tier tribunal hearing appeals on questions of fact or law
- a second-tier hearing appeals from the first and more complex appeals in the first instance,

So within the Ministry of Justice we now have the Tribunals Service (created in April 2006) which is responsible for the First-tier Tax Chamber and the Finance and Tax Chamber in the Upper Tribunal. The Tribunals Service is currently responsible for three other chambers that have nothing to do with tax or finance.

We are not just talking about a new name for the General and Special Commissioners. The changes arising from the Leggatt proposals are significant and HMRC have taken the opportunity to align the appeals systems for both direct and indirect taxes.

It should also be recognised that HMRC's published Litigation and Settlement Strategy now puts far greater pressure on officers to take disputes towards a hearing rather than cut a deal. If you want to do the best for your client then you need to know your way around the system. As Flavius Renatus wrote 1600 years ago:

> "Let him who desires peace prepare for war."

A fundamental part of negotiations is addressing your BATNA or "best alternative to a negotiated agreement". Clearly in tax terms that is the tax tribunal.

Online guidance for customers and advisers can be found at:

http://www.hmrc.gov.uk/dealingwith/appeals.htm

http://www.hmrc.gov.uk/about/tribunals-reform.htm

Provides many useful links including:

- HMRC's "Appeals reviews and tribunals guidance" manual
- HMRC's Fact sheet
- Tribunals service

Internal reviews

This is the logical starting point for the new system effective from 1 April 2009. The idea of trying to settle disputes between the taxpayer and the tax authorities without recourse to a formal hearing is not new. Customs & Excise had a local reconsideration system. The Revenue had a more informal approach but inevitably a senior inspector would have a close look at the papers of any case where the advisor was unhappy or where it looked as if a contentious hearing was likely.

Leggatt strongly approved of internal reviews believing that an efficient system should reduce the number of indefensible decisions going to tribunal and assist in the case management when the review did not lead to agreement.

The basic rules are unchanged so for direct taxes:

- appeals may be made to HMRC within 30 days
- late appeals may be made
- tax may be postponed
- the appeal may be settled by agreement.

Factsheet HMRC1 states that:

> "When we make a decision you can appeal against, we will write and tell you. We will also explain how we arrived at the decision and tell you about your appeal rights. If you do not agree with the decision, write and tell us straight away, but in any event within 30 days of the decision. In direct tax this is known as an appeal to HMRC..
>
> ..If you have further information or you think we have missed something, please tell us.. We find that most disagreements are resolved by discussing them with us."

ARTG1030 states that where a customer disagrees with any HMRC decision appealable to the Tax tribunal they are entitled by law to an internal review.

In direct tax HMRC may offer a review or the taxpayer may ask for one. For indirect tax:

- HMRC must either offer a review at the time the decision is notified or
- the taxpayer may request a review if they were not the person to whom the decision was issued.

The processes for direct and indirect taxes are essentially the same. Looking in detail at direct taxes if the officer believes no more progress can be made an explanation of their current view and an offer to review should be made in writing.

The taxpayer then has 30 days to accept the review offer or notify the appeal to the tribunal. If they do neither then the appeal is treated as settled on the basis of HMRC's view.

If the review offer is accepted then the decision maker prepares a report and sends this and papers to a review team in the relevant area and a review officer is appointed.

The review is undertaken by an officer with relevant experience who is independent of the decision maker and their line management. The review should be proportionate and effective. ARTG4080 emphasises that the reviewer must consider whether HMRC would want to defend the decision at the tribunal.

> "..it is essential that HMRC only pursues sensible cases with good prospects of success."

The reviewer will write to the taxpayer explaining the process and asking for further information or arguments they want considered. The reviewer will not normally negotiate directly with the taxpayer and "discussing cases with caseworkers during the review should generally be avoided." If exceptionally a detailed discussion is needed with the officer than the same facility should be made available to the taxpayer.

The review conclusion should be sent to the taxpayer within 45 days of the date:

- of the acceptance of the review
- the date of the letter setting out HMRC's view where taxpayer asked for review (direct) or
- the date the review request received by HMRC (indirect)

HMRC may negotiate a longer time frame. If the taxpayer does not agree the extension then the reviewer will immediately uphold the decision and tell the taxpayer that they have 30 days to notify the appeal to the tribunal.

The reviewer may uphold, vary or cancel a decision. The conclusion letter will give the decision; explain the reasoning and what happens next. If the taxpayer disagrees with the decision they have 30 days to notify the tribunal of the appeal. If the taxpayer takes no action then the HMRC decision is final and appeals etc are treated as settled by agreement.

Criticisms

The main criticisms of the internal reviews focus on:

- HMRC's centralised approach to compliance
- the constraints of HMRC's Litigation and Settlement strategy
- the quality and impartiality of the reviewer

- the unreasonable raising of expectations and costs of taxpayers.

The general consensus amongst VAT practioners is that the reconsideration system was not a great success. The costs regime put pressure on making an appeal rather than negotiating with HMRC and it was the appeal which usually brought the VAT officer to the negotiating table. The tendency was for the reconsideration to be used where it was felt that the taxpayer's case was relatively weak, there being more chance of getting some result from the review than from the Tribunal.

If the reviews are found to be of good quality then there now seems little to lose in going down the review road. Even if the decision is upheld the time and costs of the review are likely to be of value in any tribunal hearing and you will be clear why HMRC thinks this is a case where they have "good prospects of success".

The new tax tribunals

HMRC are no longer responsible for notifying appeals to the tribunal. These are now made direct by the taxpayer to the Tribunals Service in Birmingham.

Leggatt envisaged efficiency improvements through:

- a single point of contact for users
- a better distribution of tribunal centres
- common standards, better training etc.

On receipt of the appeal the Tribunals Service will make an allocation direction to one of four tracks:

Default paper

These relate to straightforward direct tax penalties and surcharges involving "reasonable excuse" issues. HMRC must provide a statement of case within 42 days and the taxpayer has to respond within 30 days. The appeal will only be listed for hearing if either party requests or the tribunal directs.

Basic

These are listed for hearing without further documentation and the case is presented relatively informally. "Turn up and talk". Typical cases will involve:

- less straightforward penalties and surcharges etc
- late appeals
- applications for enquiry closures.

Standard

HMRC must provide a statement of case within 60 days and then lists of documents are requested and directions given. Most cases involving matters of substance will be on this track.

Complex

As Standard but in such cases (estimated at 5% of the total) the loser is at risk of bearing the other party's costs. The taxpayer may opt out of the costs regime within 28 days of categorisation. Typical cases will involve lengthy hearings with a mix of size, complexity and points of principle. These cases will be allocated to the Upper Tribunal but only if both parties agree.

The allocation may be changed by the Tribunal Service either on their initiative or on application.

The main driver behind these changes is to ensure the appeals process is independent of HMRC and enable more consistent and appropriate procedures to apply to each particular case. Leggatt referred to:

- cases taking too long with poor preparation
- the need from the time the decision is made for vigorous time constraints which are applied with sanctions.

Clearly HMRC see this whole new review and appeals process speeding up the settlement times of enquiries. At present the average time CT and IT full enquiries take to settle is 2 years and 18 months respectively.

Appeals will be allocated on a post-code basis to 130 First-tier Tribunal venues. There were 400 bodies of General Commissioners. The Upper Tribunal will conduct hearings in Edinburgh, Manchester and London.

The tribunal Judges will be lawyers or have gained experience in law. Members will include those with no legal background (including those with accountancy and tax qualifications or experience). General Commissioners and Clerks have not been automatically being transferred to the Tax Chamber and the clear majority of members will be qualified lawyers, accountants and tax advisors. The benefit to appellants of being adjudicated by their peers in an informal setting is likely to be diluted. Although most cases will be heard by a Judge and at least one Member the nature of the case will determine who hears it and straightforward cases may be heard by one member.

New procedural rules are set out in Statutory Instruments 2008 No.2685 (L.13) and (L.15) for the First-tier and Upper Tribunals respectively.

There is an appeal from the First-tier to the Upper Tribunal on a point of law but only with the permission of either tribunal. From the Upper Tribunal there is a further appeal to the Court of Appeal but again only with permission.

As for costs, in the First-tier can be recovered where:

- there has been unreasonable behaviour by any party
- the appeal is "complex" unless the appellant opts out within 28 days of notification of the notice of allocation.

This is a significant change in relation to Indirect tax appeals.

Costs in the Upper-tier can be recovered where:

- there is an appeal or transfer from the first tier
- the proceedings relate to a judicial review
- there has been unreasonable behaviour by any party
- there is a wasted costs order.

So plenty of changes to keep us on our toes. HMRC will have great expectations that the appeals process will prove much quicker and more cost effective. Advisors will have concerns that a more legalistic and formal system will be unhelpful particularly to taxpayers with shallow pockets. Time will tell but it is certain that the framework of the new system will be with us for decades.

Article by Chris Chadburn

Lecture P535 (12.35 Minutes)

Business Tax

Budget Resolutions on extension of trading loss carry back

Text of the Budget Resolutions currently before Parliament containing provisions for the measure announced in Budget Note BN13 to extend the trading loss carry back for income tax (Resolution 20) and corporation tax (Resolution 21).

20. Extension of loss carry back provisions (income tax)

That—

(1) A person who has made a loss in a trade in the tax year 2008-09 or 2009-10 may make a claim for relief under this Resolution if—

(a) relief is available to the person under section 64 of the Income Tax Act 2007 (trade loss relief against general income) in relation to an amount of the loss ("the section 64 amount"), and

(b) condition A or B is met.

(2) Condition A is that the person makes a claim under that section for relief in respect of the section 64 amount—

(a) where it is a loss made in the tax year 2008-09, for either or both of the tax years 2007-08 and 2008-09, or

(b) where it is a loss made in the tax year 2009-10, for either or both of the tax years 2008-09 and 2009-10.

(3) Condition B is that—

(a) where it is a loss made in the tax year 2008-09, for the tax years 2007-08 and 2008-09, or

(b) where it is a loss made in the tax year 2009-10, for the tax years 2008-09 and 2009-10,

the person's total income is nil or does not include any income from which a deduction could be made in pursuance of a claim under that section for relief in respect of the section 64 amount.

(4) The amount of the loss that may be relieved under this Resolution ("the deductible amount") is—

(a) in a case where condition A is met, so much of the section 64 amount as cannot be relieved pursuant to the claim under section 64 of the Income Tax Act 2007, and

(b) in a case where condition B is met, the whole of the section 64 amount,

(but see paragraph (12)).

(5) A claim for relief under this Resolution is for the deductible amount to be deducted (in accordance with paragraph (6) and with whichever is applicable of paragraphs (7), (8), (9) and (10))—

(a) where it is a loss made in the tax year 2008-09, in either or both of the following ways—

(i) in computing the person's total income for either or both of the tax years 2005-06 and 2006-07 in accordance with section 835 of the Income and Corporation Taxes Act 1988, and

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(ii) in calculating the person's net income for the tax year 2007-08 in accordance with Step 2 of the calculation in section 23 of the Income Tax Act 2007 (which applies as if this Resolution were a provision listed in section 24 of that Act), or

(b) where it is a loss made in the tax year 2009-10, in either or both of the following ways—

(i) in computing the person's total income for the tax year 2006-07 in accordance with section 835 of the Income and Corporation Taxes Act 1988, and

(ii) in calculating the person's net income for either or both of the the tax years 2007-08 and 2008-09 in accordance with Step 2 of the calculation in section 23 of the Income Tax Act 2007 (which applies as if this Resolution were a provision listed in section 24 of that Act).

(6) A deduction is to be made only from profits of the trade (and accordingly, in relation to the tax years 2007-08 and 2008-09, subsection (2) of section 25 of the Income Tax Act 2007 has effect as if this paragraph were included in subsection (3) of that section).

(7) This paragraph explains how the deductions are to be made in a case where the loss is made in the tax year 2008-09 and the person makes a claim under section 64 of the Income Tax Act 2007 for relief in respect of the section 64 amount for the tax year 2007-08.

Step 1
Deduct the deductible amount from the profits of the trade for the tax year 2006-07.
Step 2
Deduct from the profits of the trade for the tax year 2005-06 so much of the deductible amount as has not been deducted under Step 1.

(8) This paragraph explains how the deductions are to be made in any other case where the loss is made in the tax year 2008-09.

Step 1
Deduct the deductible amount from the profits of the trade for the tax year 2007-08.
Step 2
Deduct from the profits of the trade for the tax year 2006-07 so much of the deductible amount as has not been deducted under Step 1.
Step 3
Deduct from the profits of the trade for the tax year 2005-06 so much of the deductible amount as has not been deducted under Step 1 or 2.

(9) This paragraph explains how the deductions are to be made in a case where the loss is made in the tax year 2009-10 and the person makes a claim under section 64 of the Income Tax Act 2007 for relief in respect of the section 64 amount for the tax year 2008-09.

Step 1
Deduct the deductible amount from the profits of the trade for the tax year 2007-08.
Step 2
Deduct from the profits of the trade for the tax year 2006-07 so much of the deductible amount as has not been deducted under Step 1.

(10) This paragraph explains how the deductions are to be made in any other case where the loss is made in the tax year 2009-10.

Step 1
Deduct the deductible amount from the profits of the trade for the tax year 2008-09.
Step 2
Deduct from the profits of the trade for the tax year 2007-08 so much of the deductible amount as has not been deducted under Step 1.
Step 3
Deduct from the profits of the trade for the tax year 2006-07 so much of the deductible amount as has not been deducted under Step 1 or 2.

(11) The provision made by the preceding provisions means that the following sections of the Income Tax Act 2007 apply in relation to relief under this Resolution as in relation to relief under section 64 of that Act—

(a) section 66 to 70 (restrictions on relief under section 64),

(b) sections 74B to 74D (general restrictions on relief),

(c) sections 75 to 79 (restrictions on relief under section 64 and early trade losses relief in relation to capital allowances),

(d) section 80 (restrictions on those reliefs in relation to ring fence income), and

(e) section 81 (restrictions on those reliefs in relation to dealings in commodity futures).

(12) The total amount that may be deducted in accordance with paragraph (7), or in accordance with Steps 2 and 3 in paragraph (8), is limited to £50,000; and the total amount that may be deducted in accordance with paragraph (9), or in accordance with Steps 2 and 3 in paragraph (10), is also limited to £50,000.

(13) A claim for relief under this Resolution must be made—

(a) where the relief is in respect of a loss made in the tax year 2008-09, on or before the first anniversary of the normal self-assessment filing date for that tax year, and

(b) where the relief is in respect of a loss made in the tax year 2009-10, on or before the first anniversary of the normal self-assessment filing date for that tax year.

(14) This Resolution applies to professions and vocations as it applies to trades.

(15) This Resolution is subject to paragraph 2 of Schedule 1B to the Taxes Management Act 1970 (claims for loss relief involving 2 or more years).

(16) Sections 61 to 63 of the Income Tax Act 2007 (meaning of "making a loss in a tax year" etc and prohibition against double counting) have effect as if this Resolution were included in Chapter 2 of Part 4 of that Act.

(17) Subsections (1) to (3) of section 127 of that Act (UK furnished holiday lettings business treated as trade) have effect as if this Resolution were included in Part 4 of that Act.

(18) The reference in paragraph 3(1) of Schedule 2 to the Social Security Contributions and Benefits Act 1992 and Social Security Contributions and Benefits (Northern Ireland) Act 1992 (levy of Class 4 contributions with income tax) to section 64 of the Income Tax Act 2007 includes this Resolution.

And it is declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

21. Extension of loss carry back provisions (corporation tax)

That—

(1) Section 393A of the Income and Corporation Taxes Act 1988 (losses: set off against profits of same or earlier accounting period) has effect in relation to any loss to which this Resolution applies as if, in subsection (2) of that section, "3 years" were substituted for "twelve months" (but subject as follows).

(2) This Resolution applies to any loss incurred by a company in a trade in a relevant accounting period (but subject to paragraph (3)); and a relevant accounting period is one ending after 23 November 2008 and before 24 November 2010.

(3) The maximum amount of loss to which this Resolution applies in the case of any company is—

(a) £50,000 in relation to losses incurred in relevant accounting periods ending after 23 November 2008 and before 24 November 2009, and

(b) £50,000 in relation to losses incurred in relevant accounting periods ending after 23 November 2009 and before 24 November 2010;

and the overall limit or limits apply whether a loss is incurred by the company in only one relevant accounting period or losses are so incurred in more than one such period.

(4) Subject to that, if in the case of the company the length of a relevant accounting period is less than one year, the maximum amount of the loss incurred in that period that may be set off under section 393A of the Income and Corporation Taxes Act 1988 by virtue of this Resolution is the relevant proportion of £50,000.

(5) "The relevant proportion" is—

RAP
Y

where—

RAP is the number of days in the relevant accounting period, and

Y is 365.

(6) The reference in subsection (2C) of section 393A of the Income and Corporation Taxes Act 1988 to so much of the loss referred to in that subsection not falling within subsection (2B) of that section as does not exceed the amount of the allowance mentioned in subsection (2C)(b) ("the subsection (2C) loss") has effect in relation to a relevant accounting period as a reference to so much of the subsection (2C) loss as exceeds that which can be set off under section 393A of the Income and Corporation Taxes Act 1988 by virtue of this Resolution.

And it is declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

Treasury Technical Note, 28/04/2009

Lecture B533 (10.40 Minutes)

Corporation Tax

Corporation Tax Act 2009

You have to admire the dedication of the tax rewrite team and statutory draftsmen. They have produced lots to keep us busy in recent years. Their latest offering is the voluminous Corporation Tax Act 2009, which received royal assent on 26 March 2009 and runs to some 1,330 sections and four Schedules.

The purpose of this article is to provide a beginners' introduction to the new Act, concentrating on the areas that are likely to be of most interest to experienced corporate tax practitioners and advisers. All statutory references are to CTA 2009, unless stated otherwise.

Given our general penchant for lists and FAQs (frequently asked questions) that appear in so many media formats, I have based this article on 'ten key questions about the about CTA 2009'.

1. When do CTA 2009 provisions start to apply?

Corporation Tax Act 2009 (CTA 2009) applies to all corporation tax accounting periods ending after 31 March 2009. Thus, for example, it will cover a company's entire accounting year ended 30 April 2009, even though the full draft of the Act was only laid before Parliament in early December 2008. To this extent, it may be regarded as retrospective in nature since it does contain some minor changes in the law.

The fact that CTA 2009 applies for current accounting periods means any corporation tax advice should now be based on its provisions (although see the comments about the transitional rules in question 3).

2. Has CTA 2009 changed any areas of corporation tax law?

Rewrite Acts, like CTA 2009, seek to bring together the relevant separate strands of law in different Acts together in one place, as well as making the law clearer and easier to understand and use. The new Act does not change the effect of the law, however, and therefore should not affect the operation of the existing corporation tax rules.

However, there are a few subtle changes since CTA 2009 has taken the opportunity to modernise certain terms, remove some redundant legislation and correct some minor anomalies. For example:

- Section 44 now enacts the established HMRC practice of including rental income (and related expenses) from letting temporarily surplus 'business accommodation' within trading profits (rather than property business income).

- Section 1285(3) legislates the principle established in *Strand Options and Futures Ltd v Vojak* [2004] STC 64. While dividends and other distributions are generally exempt from corporation tax under s 1285(1), this does *not* prevent them 'from being taken into account in the calculation of chargeable gains'. Thus, while a share buy-back from a corporate vendor may give rise to an exempt distribution under s 1285(1), the relevant distribution will *not* be deducted from the vendor's (capital gains) disposal proceeds on the shares sold back to the company.

The Act also incorporates extra-statutory concessions C34 and C36 and statement of practice 11/81.

3. What happens if you are adversely affected by CTA 2009 legislation?

Since the new Act introduces some minor changes in the law, it is theoretically possible that a company might be disadvantaged by a change in the law in respect of a pre-1 April 2009 transaction.

In such cases, Sch 2 para 10 provides that the company may effectively elect to be governed by the old pre-CTA 2009 provisions instead. However, this is a temporary provision since the election only applies to accounting periods straddling 1 April 2009. This election must be made within two years from the end of the relevant accounting period.

Although the election offers temporary relief, companies must be alert to the fact that they cannot remedy any disadvantage caused by CTA 2009 provisions for accounting periods starting after 31 March 2009, although it is to be hoped such cases are likely to be relatively rare.

4. What has happened to the various taxing schedules and cases?

The historic use of schedules and cases to describe and deal with the taxation of different types of income is now firmly eliminated. They were effectively abolished for income tax purposes by the combination of the Income Tax (Earnings and Pensions) Act 2003, the Income Tax (Trading and Other Income) Act 2005 and the Income Tax Act 2007. Corporation Tax Act 2009 does the same job for corporation tax purposes.

So we now have property income (or property business profits), trading income (or trade profits), non-trading (loan relationship) profits, post-cessation receipts, and so on. Many experienced tax professionals may have to undergo some form of therapy to obliterate the use of Schedule A, Schedule D Case I, Schedule D Case VI and so on from their tax vocabulary!

5. How are property businesses taxed under CTA 2009?

Under the CTA 2009 regime, we now have the concept of a property business replacing the old Schedule A business, which had been introduced in 1998 for corporation tax purposes. All the income from a company's UK land interests is treated as a single business under s 205 (which includes the letting of furniture — s 248), although s 269 requires a separate carve-out calculation for furnished holiday accommodation profits.

A similar rule applies to bring together all income from overseas properties into a single overseas property business.

6. What areas of corporation tax does CTA 2009 cover?

It is impossible here to give a detailed exposition of CTA 2009. However, a summary of the main areas likely to be met by mainstream corporation tax specialists and advisers, together with useful notes, is shown in the my brief guide 'CTA 2009 at a glance' which is included in the website version of this article.

7. So CTA 2009 has not changed all the relevant corporation tax legislation?

This is correct. Most of the remaining corporation tax rules currently found within TA 1988, such as the computation of a company's tax liability, loss and group reliefs, and close company provisions etc, are dealt with in the second Corporation Tax Bill (Bill 6). This will become the Corporation Tax Act 2010, and is expected to apply from 1 April 2010.

There is also another Bill waiting in the wings that covers international and miscellaneous provisions which will deal with the relevant corporation tax aspects.

8. Is it now possible to carry (most) post-cessation receipts back to the date trade ceased?

The old TA 1988, s 108 contained an election which enabled a post-cessation receipt to be carried back to the date the trade ceased. However, this section was repealed when ITT OIA 2005 was published, when a similar rule was introduced for income tax purposes.

Sections 198 to 200 now reinstate for companies the ability to carry back receipts arising within, broadly, six years after the trade has ceased back to the accounting period of cessation. Such an election might be useful, for example, to enable the post-cessation receipt to be relieved against trade losses that might otherwise go unrelieved on cessation.

9. I heard there was a significant change to the 'control' definition for loan relationship purposes — is this true?

It is almost true. An unintended change crept into the Bill in relation to connected party loan relationships which would have caused a significant change in their treatment had it not been corrected.

Under the original FA 1996, s 87(3) rule, one of the 'connection' tests provided that two companies were treated as connected for loan relationship purposes where 'both (those) companies were under the control of the same *person*' (emphasis added). Under this rule, companies under the common control of an individual shareholder would be connected with each other as well as companies in a conventional group relationship.

When consolidated into CTA 2009 under clause 466, the corresponding loan relationship control definition became:

'There is a connection between a company (A) and another company (B) for an accounting period when … (c) A and B are both controlled by the same *company*" (emphasis added).

Had this subtle amendment not been spotted, it would have led to some unexpected consequences. For example, it would have been possible for a company to claim impairment relief on a funding loan made to another company, which was controlled by the same individual. HMRC picked this up and the Bill was changed during the joint committee stage; the final s 466(2) now incorporates the word 'person'. This proves the difference a single word can make to the effect of legislation.

10. Where are the announced changes to foreign profits, loan relationship late-interest rules, etc?

This is perhaps the question I am most frequently asked in the office at the moment. There are many prospective changes to the corporation tax rules, for example the proposed foreign profits regime, the relaxation in the late interest rules (for loan relationship purposes) and the alignment of the trade debt release rules within the loan relationship regime.

These are not currently in CTA 2009, which is now in general operation. However, such changes are likely to be incorporated within the Act by Budget 2009 proposals and the subsequent Finance Act, when it has received royal assent some time this summer.

Peter Rayney writing in Taxation on 23 April 2009

Value Added Tax

New standard method

Following the consultation on simplifying the rules of partial exemption that started in 2008, changes have been announced to the standard method to take effect from 1 April 2009. Given that the new rules are to apply to the first return period commencing after 31 March 2009, it is perhaps a little surprising that the changes were only announced on 1 April.

Consultation responses can be viewed on the HMRC website at http://tinyurl.com/dg8n54. The details of the changes to the scheme are set out in an Information Sheet and are:

- in-year provisional recovery rate;
- early annual adjustment;
- use-based option for new partly exempt businesses; and
- widening the scope of the standard method.

The first three are optional, and do not require any special permission from HMRC for businesses to start to use them; the fourth is compulsory.

In-year recovery rate

The new "default rule" is that a business will use the previous longer period's overhead recovery rate during the following longer period rather than having to work out "T over T plus E" for each period. At the end of the year, it will make an annual adjustment by calculating the recovery rate for the current longer period and comparing it to the amount already recovered.

A business can continue to use the old procedure if it wishes. The only condition is that it must apply one procedure or the other consistently throughout the year.

The previous year's percentage should still be used even if the business was in the end de minimis in that longer period. Presumably the recovery percentage would be so close to 100% that it would probably continue to be de minimis in the current period, but this will not necessarily follow.

If the standard method override applied in the previous period, the recovery percentage before the override should be used (because the override usually arises when unusual and unrepresentative events take place). The override will still have to be considered at the end of the current longer period.

Early annual adjustment

The annual adjustment has up to now been required to be entered on the VAT return for the period following the last return of the longer period. For longer periods ending on or after 30 April 2009, it will be possible for businesses to enter the annual adjustment on the final return of the longer period rather than waiting for the next return.

This will continue to be optional, so presumably a favourable adjustment will be routinely advanced, and an unfavourable adjustment will be routinely delayed.

Use-based option

HMRC have recognised that "T over T plus E" can be unrepresentative in the early years of a business, or when there is a change in activity so that exempt input tax is incurred for the first time.

Businesses using the standard method will therefore be allowed to calculate input tax recovery according to the "use of the inputs" (in effect, using a "fair and reasonable" calculation rather than one based on turnover) in the following three situations:

1. During its registration period. This is the period running from the date a business is first registered for VAT to the day before the start of its first tax year (normally, 31 March, 30 April or 31 May depending on the periods covered by the VAT returns).

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2. During its first tax year (normally the first period of 12 months commencing on 1 April, 1 May or 1 June following the end of the registration period), provided it did not incur input tax relating to exempt supplies during its registration period.
3. During any tax year, provided it did not incur input tax relating to exempt supplies in its previous tax year.

The VAT manual at V1–15 provides in-depth discussion of how "the principles of use" can be applied. HMRC say that it is up to the business to choose a method, probably based on cost accounting principles; "provided this is logical, objective and transparent it will invariably form an ideal basis for a fair recovery of input tax".

If the principles of use are used for individual returns within a longer period, the same method must be used to carry out the annual adjustment.

This will avoid the need for a business to apply for a special method where the standard turnover-based method gives an unfair result for a short period, but will be suitable in the longer term.

Widening the scope of the standard method

The old rules, which required a separate reg.103 calculation on the basis of use for making foreign and specified supplies, have been replaced. In effect, the decision in *Liverpool Institute of Performing Arts* has been overruled, and "outside the scope taxable supplies" will be treated as taxable supplies for the purpose of the overhead recovery percentage calculation. However, it will remain necessary to calculate recoverable input tax on *financial* "specified supplies" (i.e. financial supplies that would normally be exempt) on the basis of use. The Information Sheet includes the following examples:

Example 1: A business provides consultancy services to customers within the UK and outside the UK. Under the current rules the business is required to calculate a recoverable amount of input tax relating to its services to customers outside the UK by way of a separate regulation 103 calculation or alternatively seek approval of a special method. The new rules simplify this by requiring residual input tax to be recovered by reference to the values-based calculation which includes the consultancy services irrespective of their place of supply.

Example 2: A business makes supplies of insurance, shares and bonds to customers located inside and outside the EU. Under the current rules, the business would be required to calculate input tax recoverable as attributable to these supplies to customers located outside the EU by way of a separate regulation 103 calculation. The new rules simplify this so that while input tax relating to shares and bonds, irrespective of their place of supply, must be recovered on the basis of use (for example on a transactions count basis), input tax relating to insurance can be recovered by reference to the values-based calculation which includes the supplies of insurance irrespective of their place of supply.

Example 3: A business makes supplies of management services from an establishment located within the UK and outside the UK. Under the current rules the business would be required to recover input tax relating to its supplies to customers outside the UK using a regulation 103 calculation. The remaining input tax would be recovered using the values-based calculation including supplies made to customers in the UK from the establishment located outside the UK, which could be distortive. To reduce this risk of distortion, the new rules require input tax relating to supplies made from establishments located outside the UK to be recovered on the basis of use. The remaining input tax is recovered using the values-based calculation (excluding supplies made from the establishment located outside the UK).

This new rule is compulsory for VAT return periods commencing on or after 1 April 2009. This means that traders will complete their last longer period (to 31 March, 30 April or 31 May 2009) using the old rules and will carry out an annual adjustment on the same basis; they will then be subject to the new rule for the next return.

SI 2009/820; Information Sheet 04/09; R & C Brief 19/09

Article by Mike Thexton

Lecture B534 (21.25 Minutes)

Summary of Revenue & Customs Brief 27/09

HMRC have published Revenue & Customs Brief 27/09 explaining the changes to be made to the tour operators' margin scheme (TOMS) in order for it to comply fully with EU law.

The changes are to take effect from 1 January 2010.

Following legal advice, the UK has accepted that aspects of the scheme were not implemented properly and gave a commitment to amend it.

The first change relates to supplies to business customers for resale (the 'opt in').

As a concession (set out in paragraph 3.2 of Notice 709/5), HMRC has allowed tour operators who occasionally sell to other travel businesses for onward resale the option of accounting for tax on the latter in the special scheme.

The UK has had to accept that the VAT Directive refers to supplies made to the traveller, i.e. the person who consumes the travel, and so the scheme should not be used when the travel service is sold to a person other than the traveller.

From 1 January 2010 the normal VAT rules will apply. In some cases, this may give rise to a requirement to register for VAT in other Member States.

The next change concerns supplies to businesses for their own consumption and the provision of school trips ('the opt out').

Tour operators have been allowed to opt out of the scheme in respect of travel services which are supplied to other businesses for their own consumption. This has meant that business customers have been able to recover VAT charged on those supplies subject to the normal rules.

HMRC has also treated the provision of school trips as a non business activity for VAT purposes and allowed them also to be excluded from the special scheme, enabling local authorities to recover the VAT charged in relation to local education authority schools.

The Commission has clarified that the term 'traveller' should not be restricted to the physical person who consumes a travel package, but also covers legal persons who consume the travel package - for example, businesses that pay for employee travel - and the supply of school trips to local authorities.

Accordingly, Article 3(3) of the Value Added Tax (Tour Operators) Order 1987 will be revoked with effect from 1 January 2010.

This means that from that date businesses receiving supplies of travel services from tour operators will no longer be able to recover VAT on such supplies.

Schools that previously took advantage of the concession will no longer be able to recover VAT on UK school trips purchased from tour operators.

Non-LEA schools (including grant maintained and foundation schools) and youth clubs or colleges were not entitled to claim the concession, and are unaffected by this change.

The final change concerns market values. The current UK TOMS calculation requires the margin to be apportioned with reference to the actual costs incurred by the operator in putting together the package.

However, the European Court of Justice decision in the case of MyTravel (C-291/03) ruled that, where it is possible to establish an appropriate market value for the part of the selling price, which corresponds to the in house supplies, this should be used to apportion the selling price between in house and bought in components.

The margin can then be calculated on each of these elements, and the tax computation completed accordingly.The court also said, that the cost based method could be used where this accurately reflected the actual structure of the package.

The ECJ left it to the member state to assess whether it is possible to identify the part of the package corresponding to the in house services on the basis of their market value and, in this context, to determine the most appropriate market.