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CONTENTS

PERSONAL TAX		**2**
Revised Mansworth Jelley guidance	***(Lecture P536)***	**2**
Tax credits and overseas dividends	***(Lecture P537)***	**3**
P11D expenses paid by employers		**3**
Furnished holiday lettings to go!		**4**
Genovese (SpC 741)		**6**
Tax on company vans—Information for employers and employees		**7**
Changes to the car benefit rules		**8**
Minimum wage and troncs		**9**
Pension contributions and the high rate relief restriction from 2011/12		**10**
CAPITAL GAINS TAX		**12**
Entrepreneurs' relief – interaction with holdover and rollover reliefs	***(Lecture P538)***	**12**
Entrepreneurs' relief – a helpful HMRC interpretation	***(Lecture P539)***	**14**
Smallwood and another v CRC		**15**
INHERITANCE TAX AND TRUSTS		**16**
New regime for agricultural property relief	***(Lecture P540)***	**16**
Mistake set aside?		**17**
ADMINISTRATION		**19**
Internal review system		**19**
BUSINESS TAX		**22**
Three-partner solicitors firm splitting into two		**22**
New First Year Allowances announced in Budget 2009	***(Lecture B537)***	**22**
Subsistence expenses for the self employed – anything changed?	***(Lecture B538)***	**23**
CORPORATION TAX		**25**
Double taxation relief and dividends	***(Lecture B539)***	**25**
Is it worth incorporating?	***(Lecture B536)***	**25**
VALUE ADDED TAX		**29**
VAT administration developments	***(Lecture B540)***	**29**
Tax implications of the Vehicle Scrappage Scheme		**33**
JD Wetherspoon plc v CRC (Case C-302/07), ECJ		**35**
R (appl. of TNT Post UK Ltd) v CRC (Royal Mail Group Ltd, interested party)		**35**

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Personal Tax

Revised Mansworth Jelley guidance

For Capital Gains Tax purposes, the grant or acquisition of an option and the transaction entered into on the exercise of that option are treated as a single transaction. That single transaction is the acquisition or disposal of the asset transferred when the option is exercised – section 144 of the Taxation of Chargeable Gains Act 1992 (TCGA).

Where shares were acquired on the exercise of an option before 10 April 2003 and the 'market value rule' (section 17 TCGA) applies, the market value of the shares when the option is exercised is used for calculating capital gains or losses instead of the amounts actually paid for the option and on its exercise.

We have previously published guidance relating to unapproved employee share options and Enterprise Management Incentive share options exercised before 10 April 2003. The guidance explains how HMRC considered the gain or loss should be calculated on the disposal of shares acquired by such options – by deducting from the disposal proceeds **both** of the following:

- the market value of the shares at the time the option was exercised
- any amount chargeable to income tax on the exercise of that option

We have now received legal advice that HMRC's guidance is incorrect. Where the shares are treated as having been acquired at market value, that value is the full measure of their deemed cost of acquisition. The cost is not augmented by any amount chargeable to income tax on the exercise of the option. Thus in computing any capital gain or loss accruing on a disposal of the shares no deduction falls to be made of, or in respect of, any amount that is chargeable to income tax on exercising the option. Our guidance will be amended accordingly.

The change does not affect most people disposing of shares acquired through approved SAYE option schemes and approved Company Share Option Plans. It may affect those who acquired shares through these schemes if the market value rule applies to the share acquisition and income tax was chargeable on the gain on exercise; for example, if the option was exercised early.

Neither does the change have any effect in relation to disposals of shares acquired on the exercise of options on or after 10 April 2003 where section 144ZA TCGA provides that the market value rule does not displace the consideration given when an option is exercised after 9 April 2003.

Those affected by the change may need to make or amend a Self Assessment return or loss claim provided they are in time to do so.

HMRC will apply our new understanding of the law in cases where there is an open enquiry or appeal.

Revenue & Customs Brief 30/09

Lecture P536 (13.41 Minutes)

Tax credits and overseas dividends

For 2009/10, dividends from UK companies received by UK-resident individuals are free of basic rate tax and are charged at an effective 25% in the hands of a higher rate taxpayer – this arises from a combination of the one-ninth tax credit and the 32.5% rate on the grossed amount of the dividend receipt.

In the past, the same rates of tax have applied to dividends from overseas companies, but the only credit was for foreign tax deducted at source (if any). Thus the tax liability for UK-resident individuals on their foreign dividends used to be at the rate of 10% or 32.5%, less any foreign tax.

With effect from 6 April 2008, a UK-resident individual with a shareholding in an overseas company has been able to benefit from a one-ninth tax credit in respect of any dividends received, provided that he owns less than 10% of the company's issued share capital (see Ss397A and 397C ITTOIA 2005 (as inserted by Para 4 Sch 12 FA 2008)). If the company has more than one class of share capital, the holder must have less than 10% of the class in respect of which the dividend is paid (S397C(1A) ITTOIA 2005 (as inserted by Para 6(3) Sch 19 FB 2009)).

Cl 40 and Sch 19 FB 2009 have extended this regime to dividends arising on or after 22 April 2009 where the shareholder has a stake of 10% or more in the overseas company, subject to certain conditions being satisfied. The main ones are set out in S397AA(4) ITTOIA 2005 to the effect that:

(i) the company paying the dividend must be resident in what FB 2009 calls a 'qualifying territory' at the time of the distribution; and

(ii) the dividend payment must not be part of a tax advantage scheme.

The term 'qualifying territory' is defined in S397BA ITTOIA 2005 as any non-UK jurisdiction with which the UK has a double taxation agreement containing a non-discrimination article (ie. a provision that, say, a UK citizen will not be subject to a more onerous fiscal regime in the overseas jurisdiction than a local citizen would be). A tax advantage scheme is an arrangement which has, as its primary purpose, the obtaining of a tax credit under S397A ITTOIA 2005 or some other form of tax relief (S397AA(5) ITTOIA 2005).

This is a welcome completion of the changes started last year.

Article by Robert Jamieson

Lecture P537 (6.17 Minutes)

P11D expenses paid by employers

Should the cost of a train ticket purchased by the employer to enable an employee to travel to a business event be shown on the form P11D. After all, the money has not gone through the employee's hands.

Reply by Scorpio

The guidance given in HMRC's 480 guide covering expenses and benefits and also their A to Z of expenses and benefits included on their website clearly indicates that such expenses are considered to be reportable on form P11D.

To the extent that these expenses are incurred 'wholly, exclusively and necessarily' in the performance of the employee's duties, the employee will be able to make a claim within their tax return under ITEPA 2003, s 336.

There is likely to be no income tax or Class 1A National Insurance contribution payable.

Dispensations

It would be worth submitting applications for dispensations so that the P11D information required each year can be restricted only to taxable items.

With one-man companies, HMRC may be reluctant to grant a dispensation if the sole director also deals with the checking and payment of expenses claims for themselves. You will need to satisfy HMRC that such claims are checked and dealt with by another officer or employee of the company.

Question in readers forum, Taxation

Furnished holiday lettings to go!

The announcement

Budget 2009 announced that from 6 April 2010 the special rules for FHLs were to go. Until then, the FHL rules will be extended to those qualifying furnished holiday lettings elsewhere in the European Economic Area.

What are furnished holiday lets?

The existing definition of an FHL has two legs:

1. the property must be let on a commercial basis with a view to the realisation of profits (ITTOIA 2005, s 323(2)); and
2. it must meet the relevant qualifying criteria (ITTOIA 2005, s 325).

Lettings to family and friends at reduced rates are not commercial and it is also likely to be harder to meet this test if there are very high borrowings on a property.

Fundamentally, if the purpose of the acquisition of the property is for someone to acquire a holiday home for themselves, then it is going to be hard to meet the requirements in s 323.

A loss in the first year of letting a property is quite usual (because of capital investment costs and lower occupancy and tariff rates) and it may be that losses occur in the second and possibly third year of a letting.

However, if losses are incurred for more than three consecutive years, then it is hard to see how the letting is going to be justified as being commercial.

Qualifying conditions

The property must be available for letting for at least 20 weeks, actually let to members of the public for at least 10 weeks and include a restriction to prevent continuous occupation for a period exceeding five months.

The rules do allow for averaging of occupation across multiple units and include special measures to deal with the calculation of the qualifying criteria in opening and closing years.

Tax treatment

Where the relevant requirements above are met, the following provisions apply.

- The activity is statutorily defined as a trade.
- Capital allowances are available on furniture and furnishings.
- The trading loss reliefs apply.
- Roll-over, hold-over, entrepreneurs' and TCGA 1992, s 253 relief apply for capital gains tax.

What happens in April 2010?

If all of the statutory rules relating to FHLs are repealed, then it will be necessary to consider whether or not the provision of FHL accommodation amounts to a trade under general principles.

Trade is defined in ITA 2007, s 989 as including 'any venture in the nature of trade'.

A case that is more relevant is that of *Gittos v Barclays* [1982] STC 390, a High Court decision. Justice Goulding stated that the central issue was whether or not the taxpayer's activities:

> 'were significant enough to make her a trader and not a mere landowner who derived an income by exploiting her property. It is not of course possible to give an answer to such a question in general terms. It is a question of fact and degree. I can quite see that there are forceful arguments on both sides'.

While Justice Goulding was equivocal, he did state that he felt that the activities of an hotelier did amount to a trade as they were more substantial than that of someone operating FHLs.

But things have changed

Today it is common to book hotels on a room-only basis and in towns such as Newquay we have surf lodges with shared bunk rooms and negligible services.

These are advertised on the internet alongside various types of self-catering accommodation, camp sites, holiday parks, guest houses and hotels.

Which ones are trades in the absence of ITA 2007, s 127? In addition, many coastal hotel companies that are carrying on trades also provide FHL accommodation.

Will this be treated as investment assets for the purposes of TCGA 1992, s 165 and s 169L such that more than 20% of the activities become non-trade?

Are HMRC prepared for the number of COP10 applications for rulings on trading status that are going to follow in April next year?

National Insurance

We have been conditioned by the self assessment return to view FHL income as being land and property income rather than self-employment income.

As such, it is never returned on the self-employment pages and so liabilities to Class 4 contributions do not arise.

However, potentially, the businesses concerned qualify as trades in their own right and so should be registered for Class 2 and Class 4.

For those looking to maintain trading status, the registration of owners as self-employed come next April is going to be an inevitable step.

Business property relief

IHTA 1984, s 105 is not reliant upon the definition of FHL within ITTOIA 2005, but rather on the definition of whether or not the activity amounts to a business.

HMRC have recently changed their view and indeed paragraph IHTM25278 of the *Inheritance Tax Manual* states:

> 'In the past, we have thought that business property relief would normally be available where:
>
> - the lettings were short term; and
> - the owner, either himself or through an agent such as a relative, was substantially involved with the holiday makers in terms of their activities on and from the premises.
>
> 'Recent advice from Solicitors' Office has caused us to reconsider our approach and it may well be that some cases that might have previously qualified should not have done so. In particular, we will be looking more closely at the level and type of services, rather than who provided them.

> 'Until further notice any case involving a claim for business property relief on a holiday let should be referred to the Technical Team (Litigation) for consideration at an early stage.'

The reference to 'the level and type of services' implies that the assessment is closer to that of whether or not a trade is being carried on than the traditional definition of business.

FHLs and the EEA

Meanwhile, there is an opportunity to make claims for FHL status to apply to properties within the EEA and there is the scope to go back and amend previously submitted computations.

For 2007 returns, HMRC have extended the amendment deadline to 31 July 2009 and full details are included in the technical note, including a list of EEA countries.

Summarised from an article by John Endacott writing in Taxation, 19 May 2009

Genovese (SpC 741)

The appellant, an Italian national, worked for an American bank in London from 1990 to 1995. He then moved to Switzerland before returning to work in the UK in 1998.

A year later his terms of employment were changed from expatriate terms and conditions to a local UK contract of employment. In 2002 he bought a property in the UK for his family to live in.

In his 2001-02 self assessment tax return he claimed to be not ordinarily resident in the UK. HMRC said that he was ordinarily resident that year and that his earnings were taxable under Case I of Schedule E.

The taxpayer appealed, contending that he had relied on booklet IR20 to self assess himself as resident but not ordinarily resident for 2001-02 and was therefore taxable under Case II. He said that he and his wife did not consider themselves as habitually resident in the UK.

Furthermore, he had needed to house his family in the short term and it made economic sense to buy a property rather than rent, although the actual purchase of the property was not completed until July 2002.

The Special Commissioner said that although there was no guidance as to the minimum period required to establish an individual from outside the UK and the Commonwealth to become ordinarily resident in the UK, in order for a pattern to be described as habitual it had to continue for a sufficient length of time.

A period of two years did not easily fit the description 'habitual', but if it continued into a third year it would begin to do so, although it would be unsatisfactory to apply the relevant test to a part year.

However, on the facts, it was not necessary to show that the appellant was ordinarily resident throughout the year of assessment, all that was needed was to show that he was resident 'in' that year.

On the basis of the common law test, the appellant was ordinarily resident in the UK in 2001-02. By the end of September 2001, the appellant had been living with his family in London under successive short-term tenancies for three years and had been working for the same banking group during the same period. This was enough to establish habitual residence.

The question to be answered was whether it had to be shown that the appellant was ordinarily resident for the whole of the year of assessment of 2001-02 or that he was ordinarily resident at some time during it. The distinction was between the status 'for' the year and ordinary residence 'in' the year.

The test under TA 1988, s 19 was whether the person was ordinarily resident in the UK 'in' the year of assessment. On the evidence, therefore, the appellant was ordinarily resident in the UK from the end of September 2001 and for the purposes of Cases I and II of Schedule E, he was ordinarily resident in the 2001-02 year of assessment.

The taxpayer's appeal was dismissed.

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Tax on company vans—Information for employers and employees

This HMRC factsheet combines the separate vans factsheets for employers and employees into one revised factsheet.

What is a company van?

A van is a vehicle built primarily to carry goods or other loads which has a maximum laden weight of up to 3,500 kilograms.

A company van is a van made available to an employee by reason of their employment and which they do not own.

When is there a tax charge on a company van?

Employees pay tax on a company van if they or a member of their family or household make private use of it. If the employee has the van mainly for work journeys (for example, delivering goods or making calls to customers), and the only private use is commuting, there is no tax to pay.

If there is other private use, tax is payable unless this private use is insignificant (see "What is insignificant private use?").

The tax is normally collected through the employee's Pay As You Earn (PAYE) tax code.

What if free or subsidised fuel is provided for private use?

Employees also pay tax if free or subsidised fuel is provided by the employer for private use in the van.

How much is the charge?

In 2008–09 and 2009–10, employees are charged tax for the year on:

- £3,000 for the van
- £500 for free or subsidised fuel for private use.

The current rates are on our website at www.hmrc.gov.uk/rates/travel.htm.

Employers pay Class 1A National Insurance Contributions (NICs) on the same amounts.

The tax charge is reduced if the employee does not have the van for the whole tax year, or if another employee also uses it for private travel (in this case, the charge is split between them on a just and reasonable basis).

The tax charge is further reduced if the employee pays something for their private use, but the fuel charge is not reduced further unless the employee reimburses the cost of all fuel provided for private use.

Full details can be found in booklet 480 Expenses and benefits a tax guide on our website at www.hmrc.gov.uk/guidance/480.htm.

What is insignificant private use?

Private use is insignificant if:

- it is very much the exception to the normal use
- it is intermittent and irregular, and
- it lasts only for short periods of time on odd occasions during the year.

Examples of insignificant use include an employee who:

- takes an old mattress or other rubbish to the tip once or twice a year
- regularly makes a slight detour to drop off a child at school or stops at a newsagent on the way to work
- calls at the dentist on the way home from work.

Examples of use which is **not** insignificant include an employee who:

- regularly uses the van to do the supermarket shopping
- takes the van away on a week's holiday
- uses the van outside of work for social activities.

How can an employee show that there is no other private use?

Their employer must be able to show us that this is the case.

This means that an employee could be asked to:

- keep mileage records
- sign an agreement about the use of the van
- have use of the van put into a contract of employment.

What records do employers need to keep?

If an employer considers that there is no tax to pay, they will need to keep sufficient records to show that the employee has the van mainly for work journeys and that private use is restricted to journeys between home and work. This may include making the conditions clear in employment contracts or asking employees to sign a statement acknowledging company policy on what is allowed and any disciplinary consequences. An employer may also want to keep mileage or other records showing how the vehicles are used to help with this.

If there is tax to pay, employers will need to identify each van used by an employee.

If an employer considers that an employee should pay tax on less than the full amount, they may also need to show:

- if a van is shared, by whom and in what proportions
- periods of 30 or more consecutive days when a van was incapable of use
- contributions paid by the employee who had private use of the van
- that private fuel has been fully reimbursed.

These notes apply from 6 April 2005. They are for guidance only and reflect the position at the time of writing. Further information can be found at www.hmrc.gov.uk/vans.

Tax on company vans HMRC 02/09

Changes to the car benefit rules

HMRC has published details of the various changes to the car benefit rules that were announced for 2009–10, 2010–11 and 2011–12.

The car benefit charge for a full year is obtained by multiplying the price of the car for tax purposes (in most cases, its list price plus accessories less capital contributions) by the "appropriate percentage". A more detailed guide is available for employees in the HS203 Self Assessment help20 sheet (www.hmrc.gov.uk/helpsheets/hs203.pdf) and for employers in booklet 480 (www.hmrc.gov.uk/guidance/480.pdf).

The following announcements were made at or before Budget 2009. It is possible that further changes will be made for years after 2009–10 in later Budgets.

Disabled drivers

This change only affects disabled drivers who hold a disabled person's badge (blue badge) and, if they want to drive at all, must drive an automatic as their company car.

From 2009–10, these employees will be entitled to use the list price (or, if their car has no list price, the notional price) of an equivalent manual car when their car benefit is calculated

Employers

For changes of car from 6 April 2009 onwards, a form P46(car) is no longer required where an employees car is withdrawn and replaced with another.

The P46(car) is still required when an employee is provided with a car for the first time, when they are provided with an additional car, or when a car is withdrawn without replacement. As at present, a form is also needed if an employee who has a company car begins to earn at a rate of £8,500 per year.

Changes to the rules for 2010–11

The lower threshold (the CO2 emissions figure which sets the 15% rate) will be reduced from 135 to 130 g/km.

Changes to the rules from 2011–12

The car benefit rules will be significantly simplified from 2011–12. From 6 April 2011—

- there will no longer be any reductions for alternative fuels (hybrids, bi–fuels and cars manufactured to run on E85 types H, B and G)
- the diesel surcharge will apply to all diesels (including type L diesels approved to Euro IV emissions limits and first registered before 1 January 2006)
- electric cars will still have an appropriate percentage of 9%, but this will be given directly by primary legislation and will therefore not need a reduction
- the £80,000 limit for the price of a car for car benefit purposes will no longer apply
- the lower threshold (the CO2 emissions figure which sets the 15% rate) will be reduced from 130 to 125 g/km

HMRC Notice 11 May 2009

Minimum wage and troncs

The Court of Appeal has ruled that tips, gratuities and voluntary service charges paid to workers by a troncmaster via a tronc do not count towards the national minimum wage in the case of Annabel's restaurant and night club and others.

The court ruled in HM Revenue & Customs' favour by upholding current national minimum wage legislation relating to tips, gratuities and discretionary service charges in the case of Annabel's restaurant and night club and others [2009] All ER (D) 54 (May).

The judgment confirmed that employers must pay their staff at least the national minimum wage regardless of any tips, gratuities, service charges or cover charges, providing they are not paid by the employer to workers through the employer's payroll. This means that Annabel's and others must now pay over £125,000 in arrears to its workers.

HMRC had argued that payment via a “tronc” (an independent distribution scheme) does not count towards the national minimum wage.

The Court determined that where restaurant or bar service charges are paid by the customer to the employer, but are then paid into a “troncmaster's” bank account for distribution in accordance with a “tronc” scheme agreed between the troncmaster and workers, the sums distributed to workers are not “paid by the employer” and so cannot be included in national minimum wage pay.

Rt Hon Stephen Timms, Financial Secretary to the Treasury said—

“The Government's priority is to ensure that all workers are paid at least the national minimum wage. I am extremely pleased that the court has recognised HMRC's commitment to ensuring that tips are correctly and fairly distributed to the people who earn them. This is good news for bar and restaurant workers across the UK.”

Pension contributions and the high rate relief restriction from 2011/12

The Government has announced that, from 6 April 2011 onwards, it intends to restrict higher rate tax relief on pension contributions for individuals with an annual taxable income of £150,000 or more. In anticipation of this change, it proposes to introduce a special annual allowance charge for pension schemes from 2009/10 to prevent individuals bringing forward their pension contributions to obtain additional higher rate tax relief in those years.

The special annual allowance applies only in respect of individuals who:

- have an annual taxable income of £150,000 or more in any of the tax years 2007-08 to 2010-11,
- increase their pension savings from 22 April 2009 beyond their normal regular pensions savings,
- whose total annual pension savings, including any increases from 22 April 2009 > £20,000.

The special annual allowance is a maximum of £20,000 and the allowance for an individual is reduced to take account of their normal regular savings.

The special annual allowance will apply alongside the current annual allowance.

In practice this means that all increases in pension savings - 'pension input amounts' - will continue to be tested against the current annual allowance in the usual way. However, any pension input amounts that represent new saving that is taken out by, or in respect of, an individual in the period starting with 22 April 2009 and ending on 5 April 2011 will be tested against the special annual allowance as well.

Pension input amounts that represent normal, regular, ongoing contributions, or benefit accruals, under arrangements that were in place before 22 April 2009 will not be tested against the special annual allowance. Such pension inputs are called 'protected pension input amounts'. These pension input amounts will continue to be tested against the current annual allowance in the usual way.

Some forms of pension savings set up during the 2009/10 or 2010/11 tax years, despite being new, will still fall into the category of a protected pension input amount, for example where an employer's pension arrangements are changed as part of corporate restructuring.

Pension input amounts that are tested against the special annual allowance are called 'total adjusted pension input amounts'. These will be pension input amounts that were made only in the 2009/10 or 2010/11 tax years but they will not include protected pension input amounts.

Total adjusted pension input amounts that exceed the special annual allowance will be subject to the 'special annual allowance charge'. This tax charge for 2009/10 will be at a rate of 20% on the amount by which the total adjusted pension input amounts for the year exceeds the special annual allowance limit for the respective tax year and will be collected from the individual through their Self-Assessment return.

Total pension input amounts, whether consisting

- only of protected pension input amounts,
- only total adjusted pension input amounts, or
- a mixture of both,

that exceed the current annual allowance will continue to be subject to the current annual allowance charge. There will be still be the existing annual allowance tax charge (at 40% for 2009/10) based on the amount by which the total pension input amount that exceeds the current annual allowance for the tax year concerned.

The special annual allowance is much lower than the current annual allowance, given that the current annual allowance for 2009/10 is £245,000 and £255,000 for 2010/11. Therefore, it is possible that an individual could have adjusted pension input amounts that are liable to the special annual allowance charge but not be liable to the current annual allowance charge.

However, if an individual ever became liable to both the special annual allowance charge and the current annual allowance charge there will be a reduction to the special annual allowance charge to prevent double- charging.

It is possible that individuals might enter into new pension saving on or after 22 April 2009 without realising that the pension saving is an adjusted pension input amount and that the special annual allowance charge applies in respect of some, or all, of that input amount. To allow for this, tax rules for personal pension schemes (including such schemes as retirement annuity contracts) and for additional voluntary contribution arrangements will be extended to enable, if the scheme permits, a member who is potentially liable to the special annual allowance charge to receive a refund of non protected contributions as an authorised member payment. There will be a tax charge in respect of such a refund (40% for contributions made in 2009/10 and refunded in 2010/11) and the scheme administrator of the pension scheme paying the refund will be liable for the charge. Whether such refunds are permitted by the scheme will be a matter for those involved with the management of the scheme.

The following examples illustrate how the special annual allowance will apply:

Andrew has income of £55,000 in 2007/08, £58,000 in 2008/09, £59,000 in 2009/10 and £60,000 in 2010/11. Since his income is less than £150,000 in all years, he is not affected by the new special annual allowance.

Belinda has income of £158,000 in 2009/10 and has total individual and employer pension contributions of £15,000 in the year. Although her income exceeds the £150,000 threshold, her total contributions are less than £20,000 so she is not subject to the special annual allowance charge.

Christine has income of £158,000 in 2010/11 and makes pension contributions of £24,000 during the year of £2,000 per month, something she has done for the previous 2 years. Her income exceeds the £150,000 income threshold. Although her pension contributions are more than £20,000, they will not be subject to the special annual allowance charge because they only reflect her normal regular contributions.

David has income of £170,000 in 2010/11 and makes pension contributions of £50,000. The contributions reflect a regular monthly contribution of £2,000 (as for previous years) and a single payment of £26,000. David's income exceeds the £150,000 income threshold and his pension contributions are more than £20,000. The additional single contribution of £26,000 will be subject to the special annual allowance charge.

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Capital Gains Tax

Entrepreneurs' relief – interaction with holdover and rollover reliefs

Holdover relief

With effect from 6 April 2008, qualifying disposals of shares and other business assets are eligible for entrepreneurs' relief. However, where shares, for example, are disposed of by way of gift or sale at undervalue, a difficult question arises as to whether relief under S165 TCGA 1992 takes priority over entrepreneurs' relief (or vice versa).

In Para CG64137 of the Capital Gains Manual, HMRC argue that a holdover claim comes before entrepreneurs' relief. Thus, if shares are gifted and a claim is made under both sets of provisions, the entrepreneurs' relief claim will fail. The entire gain will be held over. It is worth pointing out that the legislation in S169N TCGA 1992 is by no means clear on this point and other interpretations are possible. Of course, if entrepreneurs' relief would be preferable (eg. because the taxpayer's gain after the 4/9ths reduction falls below his annual CGT exemption), it is easy enough not to make the holdover claim.

In the case of a sale at undervalue where a chargeable gain accrues, the entrepreneurs' relief restriction will kick in after the holdover claim – see Illustration 1 below.

Illustration 1

Steven owns the entire share capital of Smith Enterprises Ltd, a family trading company.

In May 2009 when Steven's shares were worth £900,000, he sold them to his son for £400,000. Steven's CGT base cost is £280,000.

The computation proceeds as follows:

	£
Market value	900,000
Less: Cost	280,000
	620,000
Less: Holdover relief (620,000 – (400,000 – 280,000))	500,000
	120,000
Less: Entrepreneurs' relief (4/9 x 120,000)	53,333
	66,667
Less: Annual CGT exemption	10,100
	£56,567
CGT @ 18%	£10,182

One final point relates to the disposal of an unincorporated business. If entrepreneurs' relief is claimed in relation to a gift of all or part of a business, it is not possible to have this relief on only *some* of the assets – it is all or nothing.

Rollover relief

Where a taxpayer claims business asset rollover relief under S152 TCGA 1992, he is treated as if the consideration for the disposal of the assets were 'of such amount as would secure that on the disposal neither a gain nor a loss accrues to him'. In this case, it is the consideration received for the disposal – and not the gain – which is reduced and the reduction is calculated so as to ensure that no gain arises on the disposal. Because it is the consideration which is reduced, the relevant gains taken into account under S169N(1) TCGA 1992 for the purposes of computing entrepreneurs' relief are the gains reduced by the rollover claim. Thus rollover relief under S152 TCGA 1992 takes precedence over a claim for entrepreneurs' relief.

If S153 TCGA 1992 is in point, HMRC sum up the position in Para CG64136 as follows:

> 'If however only part of the gain accruing upon the disposal of the old asset is rolled over against the acquisition cost of the replacement asset, then a chargeable gain will remain at that time and a claim to entrepreneurs' relief may be made in respect of the amount of gain that remains chargeable.'

Incorporation relief

Where a business is transferred to a company as a going concern in exchange for shares, a form of rollover relief is available under S162 TCGA 1992. The aggregate net gains arising on the disposal of the assets in the unincorporated business are automatically deducted from the value of the shares in the new company. Thus a similar question must be asked: where the sole trader or partners would be eligible for entrepreneurs' relief on the sale of their business, which relief takes precedence? Is it entrepreneurs' relief or incorporation relief?

Rather strangely, the Capital Gains Manual does not provide the official HMRC view of this interaction. It is understood, however, that they believe that the relief under S162 TCGA 1992 comes before entrepreneurs' relief. In other words, if the gains on incorporation can be rolled over in full, there is nothing left against which entrepreneurs' relief can be set.

It is probably in this area that there is the greatest degree of dispute over the interpretation of the legislation. Unlike HMRC, many practitioners are of the opinion that entrepreneurs' relief should take priority over relief under S162 TCGA 1992. Their argument is that the relevant gains against which entrepreneurs' relief is set are not 'chargeable gains' – see, again, the wording in S169N TCGA 1992. It is 'chargeable gains' which are rolled over under S162 TCGA 1992.

Illustration

Trevor incorporates his established sole trader business and receives 100 shares in Trevor Ltd. His aggregate gains on the disposal of the unincorporated business amount to £360,000 before any relief.

Trevor would appear to have two options. He can either:

(i) obtain relief under S162 TCGA 1992 for the whole £360,000; or

(ii) claim entrepreneurs' relief of £160,000 (4/9 x £360,000) and roll over the remaining £200,000.

HMRC do not accept this analysis. However, it is significant that, when the entrepreneurs' relief material was recently added to the Capital Gains Manual, they were not prepared to set out a definitive view. At the very least, this suggests that there is a not inconsiderable degree of uncertainty about the meaning of this part of the CGT code.

It is of course possible to disapply the effect of S162 TCGA 1992 by making an election under S162A TCGA 1992. In most cases, this is unlikely to be an appropriate solution given that it will still leave 5/9ths of the gains on incorporation in the charge to tax.

Another factor is that S162 TCGA 1992 does not always allow a full rollover. If part of the consideration for the sale of the unincorporated business to the company is in non-share form, there is an immediately taxable gain. If the HMRC position prevails, this gain could presumably be reduced by an entrepreneurs' relief claim. However, the alternative contention (ie. that entrepreneurs' relief comes first) means that the new relief, if claimed, would have to be set, on a pro rata basis, against both the rolled over and the taxable gains.

CGT deferral relief

Where a gain arises on a business asset disposal and entrepreneurs' relief is claimed, it is possible that a claim may also be made under a provision which postpones the CGT charge until the occurrence of some future event (eg. CGT deferral relief under Sch 5B TCGA 1992). In these circumstances, the amount of the postponed gain is the gain *after* any entrepreneurs' relief has been given – the new relief takes priority over CGT deferral relief. This follows from the wording of S169N(4) TCGA 1992.

Article by Robert Jamieson

Lecture P538 (15.08 Minutes)

Entrepreneurs' relief – a helpful HMRC interpretation

As was the case with retirement relief, an 'associated disposal' can attract entrepreneurs' relief. In brief, an associated disposal is the disposal of an asset owned by an individual and used for the purposes of a trade carried on by:

(i) a partnership in which he is a partner; or

(ii) a company which is his personal company (ie. a company where he has at least 5% of the ordinary shares and voting power – see S169S(3) TCGA 1992).

However, there are three additional conditions which must all be satisfied before the disposal can qualify:

(i) the individual must be disposing of his partnership interest or his shares or securities;

(ii) the asset disposal must be made as part of a process of the individual withdrawing from involvement with the partnership or the company; and

(iii) the asset disposed of must have been used for the purposes of the trade of the partnership or the company throughout a period of at least 12 months ending with the earlier of:

- the date of the disposal of the individual's partnership interest or of his shares or securities; and
- the cessation of the trade of the partnership or the company.

In Para CG63995 of the Capital Gains Manual, HMRC confirm that withdrawing from involvement with the business is a reference to a reduction in equity interest and not to time spent in the business (which can continue to be full-time). Given that the disposal of the partnership interest or the shares and the associated disposal must be, as HMRC put it, 'part and parcel of one single withdrawal from participation in the business', there should not normally be any significant interval of time between the two transactions.

Illustration

Richard owns a freehold shop from which he trades in partnership with his friend, Francis. The capital asset sharing ratio for the partners is 60:40.

Richard subsequently wishes to reduce his involvement with the business, as a result of which the partners' capital asset sharing ratio is altered to 25:75. At the same time, Richard sells the premises to Francis.

As a result of Richard's reduction of his partnership interest, any gain on the associated disposal, ie. the sale of the business premises to Francis, will be eligible for entrepreneurs' relief.

The interesting question which follows from this interpretation is how substantial the reduction in the partnership interest (or shareholding) should be. HMRC have indicated that a 1% reduction will suffice, although a number of commentators take the view that, to be on the safe side, the reduction should be at least 10%. In Richard's case, it is 60% – 25% = 35%.

Article by Robert Jamieson

Lecture P539 (7.47 Minutes)

Smallwood and another v CRC

In 1989 Mr Smallwood settled shares in two companies for the benefit of himself and his family. He had the power to appoint the trustees.

By 2000 the shares had increased substantially in value and it was decided that they should be sold. A scheme was devised to mitigate the capital gains tax under TCGA 1992, s 86 to which the taxpayer would be liable as a resident settlor having a beneficial interest under the trust.

Under the scheme, new trustees were appointed to replace the Jersey trustee. The new trustees were in Mauritius, a country which did not tax capital gains and which had a double tax agreement with the UK.

These trustees sold the shares and then resigned; UK trustees (the taxpayer and his wife) were subsequently appointed before the end of the tax year in which the shares were sold.

Relevant tax returns were submitted. HMRC however charged Mr Smallwood to capital gains tax on the share sale. The taxpayers appealed.

The Special Commissioner found for HMRC, so the taxpayers appealed to the High Court.

Mr Justice Mann in the High Court said that under UK capital gains tax legislation, gains were taxable in the UK if the assets were sold in the UK.

In this instance, there had been three periods of successive residence in the relevant UK tax year: Jersey, Mauritius and finally the UK.

Article 13(4) of the Double Taxation Relief (Relief to Taxes) (Mauritius) Order SI 1981 No 1121 gave the right to tax capital gains to the state in which the trustees were resident at the time of the sale.

The shares were sold when the trustees were resident in Mauritius. Mauritius therefore had the right to tax and the UK did not.

The taxpayers' appeal was allowed.

Inheritance Tax and Trusts

New regime for agricultural property relief

In January 2009, the EC made a formal request to the UK that the scope of agricultural property relief should be widened to include property situated outside the UK, the Channel Islands and the Isle of Man. In response to this, the Government have announced that the relief will now apply to all qualifying agricultural property in the 29 other countries of the EEA (Cl 121 FB 2009).

The term 'agricultural property' includes:

(i) agricultural land or pasture;

(ii) farmhouses, cottages and buildings which are used for agricultural purposes and are proportionate to the nature and size of the farming operations;

(iii) woodland and buildings used for the intensive rearing of livestock or fish;

(iv) growing crops transferred with the land;

(v) stud farms which are breeding and rearing horses, together with the land on which the horses graze;

(vi) short rotation coppice, ie. trees which are planted and harvested at least every 10 years;

(vii) land which is actively not being farmed in order to help preserve the countryside for wild animals and birds under one of the Government's Habitat Schemes;

(viii) the value of land where the value includes the benefit of a milk quota; and

(ix) controlling interests in farming companies.

In most cases, relief is given at the rate of 100% on the agricultural value of the land. However, agricultural property which was rented out before 1 September 1995 usually only qualifies for a 50% relief.

The extension of this relief to agricultural property in any EEA state has effect for all occasions where IHT (or any IHT instalment) would be payable on or after 22 April 2009. In addition, retrospective claims can be made for earlier events where tax on such property was due or paid on or after 23 April 2003.

Where IHT paid on or after 23 April 2003 in connection with newly qualifying agricultural property becomes repayable, a claim for repayment must be made. The deadline for making this repayment claim is the later of:

(i) six years after the date on which the original payment was made; or

(ii) 21 April 2010.

The existing statutory regime for agricultural property relief contains various eligibility conditions – for example, there is a minimum length of time for which the property must have been owned before it can attract relief. These requirements will be equally in point for property in other EEA jurisdictions. Where the relief is dependent on terms and restrictions which have meaning in the UK, Cl 121 FB 2009 ensures that non-UK property will only qualify for relief to the extent that the equivalent terms and restrictions are applied. To take one instance, agricultural property relief at

100% depends on the transferor having vacant possession of the land in question or the right to obtain it within the next 12 months. This new provision is intended to ensure that the relief will work satisfactorily in other EEA countries, provided that a right to obtain something equivalent to vacant possession exists.

Woodlands relief

Cl 121 FB 2009 also extends the existing woodlands relief. Provided that an election is made by the person liable for the IHT which would otherwise be due, the full value of trees and underwood can be excluded from the calculation of a deceased person's estate. When the timber is sold at a later date, an IHT charge may then arise. As was the case with farmland, woodlands relief was previously limited to trees and underwood growing on land located in the UK. The relief has been widened to include land in other EEA states, but this is subject to a proviso that, on the date of death, the country in question was a member of the EEA.

CGT holdover relief

The new provision for non-UK agricultural property means that overseas farmland will also qualify for holdover relief under S165 TCGA 1992 where it is given away (or sold at an undervalue) on or after 22 April 2009 if it has been farmed by someone other than the owner. Property farmed by the owner already attracts holdover relief, regardless of where it is located.

In addition, relief for earlier transactions has become available. Under existing statutory provisions for claims and amended returns, gifts made on or after 23 April 2003 are retrospectively eligible for relief. In respect of a gift in 2003/04, a claim can still be made until 31 January 2010. However, following the reduction to the time limits for making claims which was legislated in FA 2008, the deadline for 2004/05 and 2005/06 will be 1 April 2010.

Conclusion

It will be interesting to see how useful the wider agricultural property relief may prove to be in practice. Although the relief for farmland has hitherto been subject to territorial limits, the business property relief requirements have never been similarly constrained. Therefore, a client who owned a vineyard in Bordeaux or an olive farm in Spain need not have missed out in earlier years, given that business property relief at 100% would usually have served him just as well. Indeed, following the recent decision in *HMRC v Nelson Dance Family Settlement (2009)*, the number of occasions when agricultural property relief is available but the business property equivalent is not will presumably be few and far between.

Article by Robert Jamieson

Lecture P540 (15.06 Minutes)

Mistake set aside?

The claimant's husband died in 2003 leaving a will under which she was the sole executrix. A property formed the main part of the deceased's estate.

The claimant, who had limited command of English, and her husband had initially been beneficial joint tenants but the tenancy had been severed in 2003.

The claimant's tax agent advised that the claimant put her late husband's share of the property in trust for her children and that she make a new will.

However, it subsequently transpired that the transaction would have adverse tax consequences for the claimant and the children, so she sought to have it set aside as a mistake.

She said she had mistakenly agreed to the transaction in the belief, first, that she needed to take steps to reduce exposure to inheritance tax, although there was no need to do so on account of the surviving spouse exemption; second, that inheritance tax would be avoided on her death; and third, that she could continue to live in the property and sell it without having to obtain anyone else's permission.

The High Court agreed that, on the evidence, the claimant had unwittingly entered into a transaction which had no inheritance tax advantages for her or her children, and which had divested her of control of the property.

The transaction should be set aside, subject to HMRC having reasonable opportunity to contest the outcome.

Bhatt v Bhatt and others, Chancery Division, 3 April 2009

Administration

Internal review system

HMRC's internal guidance to review officers has recently been published in its *Appeals, Reviews and Tribunal Guidance* to cover the internal review process which is effective from 1 April 2009.

Why have internal reviews?

Internal reviews are not intended to be a substitute for tribunal hearings, rather they will be better used to avoid unnecessary and costly hearings before the new tribunals.

In many cases I suspect it will not advance matters greatly, but at least this possible approach to dispute resolution will have been given a chance to succeed and the taxpayer will have a better idea as to what he is up against if he wishes to take the matter to the tax tribunal.

Which cases?

The system will be best suited to 'nuts and bolt' cases rather than challenges to contrived artificial tax avoidance schemes.

Here the outcome of the review will seldom be in doubt because the review officer will be required to follow the formal stance of HMRC.

However, where HMRC officials do not believe what the taxpayer is saying, the case will seldom be resolved by an internal HMRC review and a hearing before a tribunal may well be the only sensible way ahead.

What does a review comprise?

The review officer will review the decision made by the case worker, objectively checking whether the disputed decisions are in line with HMRC's legal and technical guidance, policy and current practice (see ARTG4080).

The internal review will establish whether HMRC:

- should stand by the decision reached by the case worker and proceed to a formal hearing;
- should back down and accept the taxpayer's arguments; or
- should propose a course involving modification of their stance while still rejecting, or rejecting in part, the taxpayer's interpretation of the position;

The review officer

Review officers will have past experience of the subject matter of the appeal and will be independent of the decision maker and the decision-maker's line management.

Guidance to review officers

The published guidance to review officers recognises that in some instances they may wish to discuss a case with case work/decision makers during review. When doing so they must remain independent in their approach.

They do not have discretion to go outside current policy and practice.

It is possible that as a result of a review, HMRC may change their policy or practice.

The guidance tells review officers that any departure from the normal policy and practice should only take place with the prior knowledge and approval of the relevant policy and technical teams.

Officers must consider whether the case is one which HMRC would want to defend at tribunal:

- whether the facts have been established, and any disagreement about them;
- the technical and legal merits of the case;
- materiality and proportionality;
- the likelihood of success; and
- any wider implications.

Divided loyalties

I would like to think that HMRC will be careful in the selection process when it comes to finding a review officer for a particular case, choosing confident and experienced HMRC tax professionals to undertake this important role.

Objectivity

It has to be realised that it will be no easy task for an official to go from being a case worker to review officer without special training.

It is to be hoped that the trainers will receive proper training themselves, as a cynical trainer will only produce inferior review officers.

Feedback to officers

Let us assume that in a case, a taxpayer agrees to have the matter reviewed by the review officer and the case worker's position is upheld. The taxpayer lodges an appeal which proceeds to the First-Tier Tribunal and which he wins convincingly.

It is to be hoped that those hearing the case will have been made aware of the internal review and will not miss the opportunity to utter words of admonishment, possibly in the guise of expressions of surprise, if it can be seen that the review officer seems to have fallen down on the job.

Likewise, should the issue of costs arise in a case where the review officer can be seen to have acted in a buccaneer manner supporting his colleague, it is to be hoped that the tribunal will say that the level of costs awarded has been influenced by the disappointing work of the review officer.

Your first review

Ensure each client's case is reviewed and presented fully and accurately, leaving nothing out.

Present the full picture in a clear and concise manner, almost as if the officer is from the planet Mars and so knows nothing of the client's affairs or of the legislation.

The case worker goes first

Practitioners need to be aware that ARTG4330 states that the case worker should prepare a report for the review officer.

The guidance states that the report should clearly summarise:

- the decision the review officer is required to review;
- the facts;
- the relevant legislation and guidance;
- the decision maker's reasoning;
- the customer's argument and evidence; and
- the decision maker's argument and evidence.

The guidance goes on to say to say that the case worker should make sure that all information necessary for the review officer to carry out a review is provided.

In other words, the case worker presents the case the way he sees it first! The presentation to the review officer by the case worker immediately puts the case worker at an advantage.

While it is to be hoped that such reports will, in time, be copied to the taxpayer as a matter of record, it is important not to overlook the fact that the review officer is encouraged to receive and consider representations made to him during the process (in reality, due to the 45-day time limit in which the review officer is to complete his task, this means at the early stages of the process).

Your own report

It would therefore seem that there is no reason why practitioners should not present their own report to the review officer clearly spelling out their view of the matter in dispute. Such a report should first and foremost clearly set out the taxpayer's arguments and the basis for them and then seek to distinguish the taxpayer's case from that previously advanced by the case worker.

Summary of an article written by Kevin Slevin, Taxation, 12 May 2009

Paulden Activities Ltd and others, petitioners, Outer House, Court of Session

HMRC issued notices to the 14 petitioners under TMA 1970, s 20(1) requiring various documents and information from them in respect of their tax affairs.

The companies shared the same registered office, directors, company secretary and auditors, and were all limited by guarantee. Eight were bond-issuing companies, the others were trustee companies.

The inspector had written to each company saying that an investigation was to be carried out under code of practice 8, i.e. serious fraud was not suspected.

He had obtained the General Commissioners' consent to issue the s 20(1) notices as the information required had not been provided.

The companies argued that there was no basis on which the General Commissioners who gave consent could reasonably have been satisfied that HMRC were justified in seeking that consent.

The Court of Session ruled that the companies' complaints were not sufficiently relevant for the notices to be reduced.

The matters highlighted by HMRC and the points of association between the bond-issuing and trustee companies was sufficient justification for the s 20(1) proceedings in relation to all the companies.

The companies' petitions were dismissed.

Business Tax

Three-partner solicitors firm splitting into two

An interesting scenario was the subject of debate in the readers forum of Taxation, 19 May 2009.

Partners A, B and C are in partnership sharing profits equally.

Partner A is taking his criminal section to a new limited company and plans to sell his 'share' of goodwill to the limited company at a value that is acceptable to him and his co-shareholder, a former employee.

Partners B and C are taking the civil section of the practice.

Capital gains

In the absence of any agreement to the contrary, partnership assets, including goodwill, will be owned by the partners in their capital-sharing ratios.

Statement of practice D12 tells us that unless partners are otherwise connected with one another (e.g. father and son), HMRC will accept whatever value is put upon a transaction between partners themselves.

The partners agree that A's share of partnership goodwill is fairly represented by the criminal practice. This is purely a matter to be agreed amongst the partners, and HMRC will not impose another value.

A will be disposing of his share of partnership goodwill, but acquiring at an equal value the goodwill represented by B and C's share of the goodwill in the criminal business.

Similar reasoning applies to B and C.

Claims for rollover relief under TCGA 1992, s 152 will be in point and no capital gains tax is due.

Money changing hand

If A is paid, say £10,000 over and above the value of net assets, which he takes with him and which are credited to his account (to represent goodwill), he will have made a part disposal which will not be entirely covered by rollover relief and a capital gains tax charge will arise.

Generally, if A did not pay anything for goodwill on entering the partnership, there will be no base cost and so no need to apply the part disposal formula A/A + B to determine the base cost of the part disposed of. It is only in an exceptional case that the value of the continuing goodwill be required in order to determine the part of the cost of goodwill disposed of.

Incorporation

If A now incorporates his criminal practice, the company will generally be a connected party and market values will need to be applied.

The value placed on this has little relevance to the previous partnership, although A's base cost on this disposal will be that originating from the partnership.

New First Year Allowances announced in Budget 2009

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 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'.

Illustration 1

Darling Limited draws accounts to 30 September each year. In the year ended 30 September 2009, the company incurred the following capital expenditure;

		Cost
		£
1 December 2008	Production equipment	45,000
1 May 2009	Tools & machinery	60,000
1 August 2009	New air conditioning system	15,000

The general pool brought forward at 1 October 2008 was £12,000.

- Total expenditure on plant is £120,000 so the AIA will not cover the full amount;
- Production equipment not eligible for new FYA as it was acquired before 1 April 2009;
- The new air conditioning system is an integral feature so does not qualify for the new FYA of 40%. The AIA should be allocated to this expenditure first;

The capital allowances computation will therefore be:

Y/e 30.9.09	AIA @ 100%	FYAs @ 40%	General Pool	Total
	£	£	£	£
B/fwd			12,000	
Additions:				
Production equipment	35,000		10,000	
Tools & machinery		60,000		
Air conditioning	15,000			
	50,000	60,000	22,000	
AIA @ 100%	(50,000)			50,000
FYA @ 40%		(24,000)		24,000
WDA @ 20%			(4,400)	4,400
			17,600	
Transfer to pool	NIL	36,000	36,000	
C/fwd at 30.9.08			53,600	
CA claim for year				£78,400

Lecture B537 (8.08 Minutes)

Subsistence expenses for the self employed – anything changed?

The cost of travelling in the course of the business activities is allowable but not that of travelling between home and the place at or from which the business is conducted. For this see *Newsom v Robertson CA 1952, 33 TC 452* in which the expenses of a barrister between his home and his chambers were refused and contrast *Horton v Young CA 1971, 47 TC 60* in which a 'self-employed' bricklayer was allowed his expenses between his home and the sites at which he worked as, on the evidence, his business was conducted from his home. In *Jackman v Powell Ch D, 76 TC 87*, a milkman was not allowed the costs of travelling between his home and the dairy-owned depot from which he collected his supplies and to which his milk round was adjacent. Any expenses of an employment ancillary to a profession that are not allowable against employment

income may not be deducted in computing the profits of the profession (*Mitchell & Edon v Ross HL 1961, 40 TC 11*).

The 'dual purpose rule' entails the disallowance of *all* travelling expenses with a material private purpose, i.e. the part attributable to business purposes is not allowable. Thus the expenses of a solicitor in travelling abroad partly for a holiday and partly to attend professional conferences were disallowed in *Bowden v Russell & Russell Ch D 1965, 42 TC 301* (but the expenses of an accountant to attend a professional conference abroad were allowed in *Edwards v Warmsley, Henshall & Co Ch D 1967, 44 TC 431*). Similarly the expenses of a dentist in travelling between his home and surgery were disallowed even though he collected dentures from a laboratory on the way (*Sargent v Barnes Ch D 1978, 52 TC 335*). The expenses of a farmer in visiting Australia with a view to farming there were held inadmissible (*Sargent v Eayrs Ch D 1972, 48 TC 573*). Car expenses are normally apportioned if the car is used partly for private purposes. Parking and other motoring fines are normally disallowed in their entirety either under the 'dual purpose rule' or under the general principles applicable to allowable trading deductions (see *CIR v Alexander von Glehn & Co Ltd CA 1920, 12 TC 232*, in which penalties for breach of wartime regulations were disallowed), although reimbursement of employees is normally allowable.

The 'dual purpose rule' also requires the disallowance of costs of food, drink and accommodation. The extra cost of lunching away from home was disallowed in *Caillebotte v Quinn Ch D 1975, 50 TC 222*.

However, by law for **2009/10** onwards and in practice for earlier tax years (see HMRC Business Income Manual BIM47705), a deduction is allowed for any reasonable expenses incurred on food or drink for consumption by the trader at a place to which he travels in the course of carrying on the trade, or while travelling to a place in the course of carrying on the trade, but only if conditions A and B below are met.

- Condition A is that a deduction is available for the associated travelling costs (or, in a case where such costs are not incurred by the trader, a deduction would be available if they were so incurred).
- Condition B is that either:
  - (i) at the time the expenses on food and drink are incurred, the trade is by its nature itinerant (for example a commercial traveller); or
  - (ii) the trader does not visit the place more than occasionally in the course of the trade and the travel is undertaken otherwise than as part of a normal pattern of travel in the course of the trade.

[*ITTOIA 2005, s 57A; SI 2009 No 730, art 3*].

The above legislation deals only with food and drink and not with overnight accommodation. However, in practice, where a business trip necessitates one or more nights away from home (and away from the business base), the hotel accommodation is deductible (HMRC Business Income Manual BIM47705).

Lecture B538 (12.20 Minutes)

Corporation Tax

Double taxation relief and dividends

In general, UK companies are taxed on all their income and gains, wherever in the world they arise. However, if the income or gain has a foreign source, Ss788 – 816 ICTA 1988 provide relief for any double taxation which may occur as a result of tax becoming due in both jurisdictions.

Where a dividend is received from an overseas company, relief is available for any foreign tax paid directly on that dividend and, in certain circumstances, for tax on the profits out of which the dividend was paid – this latter is referred to as 'underlying tax'. The amount of any double taxation relief is subject to a limit imposed by the so-called 'mixer cap'.

The purpose of the mixer cap is to restrict the relief for any underlying tax suffered by reference to the amount of corporation tax due on the foreign dividend. Recently, it has been noted that there is a mismatch in that foreign dividends paid to large companies on or after 1 April 2008 but in accounting periods straddling that date would suffer tax at the average corporation tax rate (ie. somewhere between 28% and 30%), whereas the mixer cap used in the double taxation relief calculation would be limited to 28%, ie. the rate of corporation tax on the date when the foreign dividend was paid. In other words, the recipient company is out of pocket.

This problem came about because of the cut in the main rate of corporation tax for the financial year 2008 and so the anomaly has had to be corrected with full retrospective effect (Cl 57 FB 2009). The mixer cap is now tied to the actual average rate of corporation tax suffered for the period in which the dividend was paid.

Article by Robert Jamieson

Lecture B539 (4.23 Minutes)

Is it worth incorporating?

There are a number of changes taking place to income tax and corporation tax rates:

- From 6 April 2009 the personal allowance for tax increased to £6,475, Classes 1 & 4 National Insurance applies to incomes exceeding £5,715;
- The Small Company Rate for corporation tax increases to 22% from 1 April 2010;
- From 6 April 2010 the personal allowance will be phased out for those earning in excess £100,000 creating a marginal tax rate of 60% for income between £100,000 and £113,000. In addition, a new higher rate of income tax of 50% will be applied to those earning in excess of £150,000.

So, with these changing rates in mind it is time to consider whether incorporating a sole trader into a limited company remains a worthwhile exercise. Indeed, we also need to ask whether we ought to start disincorporating clients that have already transferred their trade into a limited company.

Computational comparisons

The tables below set out the potential tax and NI savings to be made by incorporating a trade. However, the calculations are based on a very simple scenario that assumes that the accounting and tax profits are equal. They are an indication only and it is always advised that any calculations performed for clients are prepared individually and take into account all the relevant facts, including the client's ability to withdraw profit by way of a legally declared dividend (see section 3.4 below).

In the calculations shown in the tables below the following assumptions have been made:

a) Tax and national insurance bands and allowances are increased next year by 2.5%. Rates remain unchanged;

b) A salary equal to the personal allowance (£6,475 for 2009/10 and £6,635 for 2010/11) is withdrawn from the company resulting in a Class 1 NIC liability of which the secondary amount is deductible by the company. However, where profits exceed £113,000 next year it is assumed that no salary will be withdrawn given the phased withdrawal of the personal allowance for incomes exceeding £100,000 from 2010/11 onwards.

2009/10

Profit	**Sole Trader**	**Company**	**Saving**
	£	**£**	**£**
£15,000	2,573	1,951	622
£20,000	3,973	3,001	972
£25,000	5,373	4,051	1,322
£30,000	6,773	5,101	1,672
£40,000	9,573	7,201	2,372
£50,000	13,161	9,463	3,698
£75,000	23,411	19,650	3,761
£100,000	33,661	29,838	3,823
£125,000	43,911	40,025	3,886
£150,000	54,161	50,213	3,948
£175,000	64,411	60,400	4,011
£200,000	74,661	70,588	4,073
£250,000	95,161	90,963	4,198

2010/11

The savings reduce at lower profit levels next year due to the increase in the corporation tax rate from 21% to 22%. However, at higher profit levels the savings increase significantly as the effective combined rate of tax & national insurance on self employed income is 51% whereas the higher rate of tax on dividends is 42.5% (translating to 36.11% of the net dividend).

Profit	**Sole Trader**	**Company**	**Saving**
	£	**£**	**£**
£15,000	2,530	2,004	526
£20,000	3,930	3,104	826
£25,000	5,330	4,204	1,126
£30,000	6,730	5,304	1,426
£40,000	9,530	7,504	2,026
£50,000	12,988	9,704	3,284
£75,000	23,238	19,898	3,340
£100,000	33,488	30,273	3,215
£125,000	46,392	43,258	3,134
£150,000	56,642	53,633	3,009
£175,000	69,392	64,174	5,218
£200,000	82,142	76,716	5,426
£250,000	107,642	101,799	5,843

Is this the answer?

As is mentionted in the introduction to this course in paragraph 1.1, the "one size fits all" approach is dangerous as Rebecca Benneyworth points out in her article "No easy answer to the incorporation question" published in Tolley's Practical Tax" in 2007 which has been updated to take into account the announcements made in Finance Bill 2009.

Comparing the tax saved on identical profits is one step to developing a strategy for advice, but this is by no means the end of the story. All of those advising smaller businesses will know that running a small business through a company often costs more than running the same business as a sole trader. These additional costs will need to be factored into any calculations to allow a straight comparison to be made. And given that we may be looking at those on the margin of tax credits, is there any difference in the position when the impact of a tax credit claim is taken into account?

Peter and Paul

To illustrate the position, we shall consider two businesses, run by twins Peter and Paul. Peter is a joiner and Paul a general handyman/gardener and they have been making identical profits each year.

Peter decided to incorporate his business some five years ago. Peter is disappointed about the increased corporation tax rates coming through for the next few years, and is now sitting down in the lounge bar of the Dog and Duck with Paul, trying to work out who is and will be better off.

Administration costs

Before considering the headline rates of tax, the twins decide to compare the profits which are subject to tax. Although they were both making £30,000 pa before motoring costs prior to Peter's incorporation, Peter's profit and loss account now shows a different cost base. His professional fees have risen fairly steeply, and he is now paying around £1,000 more a year than Paul for help with dividend minutes and vouchers, the company accounts and tax return and various other statutory requirements, including payroll, in addition to his personal tax return.

Peter was advised to keep his car out of the company when he incorporated, so the only motoring costs showing are the mileage allowance that he draws towards business motoring costs. He drives an eight-year old Ford Mondeo, travelling 6,000 miles a year for business, exactly the same as Paul. Peter's accounts therefore show a deduction for £2,400 which he draws from the company to pay for his business miles. So from a start point of £30,000, Peter's company's annual profit before director's salary is (30,000-1,000-2,400) = £26,600.

Peter extracts a salary of £6,475 and the balance by way of quarterly dividends.

Paul's sole trader accounts show a deduction for the actual cost of running the car for 6,000 miles a year. This amounts to 60 per cent of his annual mileage. The business element of costs other than fuel and depreciation is £720; fuel costs for business miles are 14p per mile, totalling £840, and capital allowances (business element) are currently £500.

Paul's accounts show a taxable profit after capital allowances of (30,000-720-840-500) = £27,940.

Assuming inflation does not affect either the profits earned or the costs borne by the brothers, their tax position over the next few years is as shown overleaf.

Peter — limited company		Paul — sole trader	
2009/10	£	2009/10	£
Company's profit before salary	26,600	Taxable profit	27,940
Salary + Ers NI of £77	6,572	Personal allowance	6,475
Taxable	20,028	Liable to tax	21,465
Corporation tax at 21%	4,206	Income tax at 20%	4,293
Net profit = dividend	15,822	Class 4 NIC	1,778
		Class 2 NIC	125
Post-tax income		Total tax and NIC	6,196
Salary less Ees NI of £84	6,391		
Mileage allowance	2,400		
Dividends	15,822	Post-tax income	
Total	24,613	Profit	30,000
		Less tax and NIC	6,196
		Net income	23,804

2010/11	£
Taxable profit as above	20,028
Corporation tax at 22%	4,406
Net profit = dividend	15,622
Post-tax income	24,413

All motoring costs are therefore borne out of post tax income by both brothers

So, by 2010/11, the brothers have calculated that Peter will still have the advantage over Paul, in that his post tax income will be £24,413 as against Paul's £23,804. A saving of more than £600 per year, after paying for his accountant, satisfies him that the company is the right structure for him.

Tax credits

For tax credit purposes, in 2009/10 Peter has income of £24,055 (salary plus dividend and tax credit), and Paul has £27,940. This provides a further potential advantage to Peter of up to £1,515 (the income differential at 39 per cent). This tax credit advantage depends on the personal circumstances of the brothers, and to be of any relevance it is likely that the brothers would have to have three children, or be incurring childcare costs in respect of at least one child.

Motoring costs

Part of the reason that the company structure still provides a benefit is that the motoring costs are relatively modest. Running an older car means that the impact of depreciation is minimal, so the 40p per mile available from the company more than covers the running costs of the car, which are estimated at 34p per mile. If the car were a newer model so that depreciation was significant (and the insurance costs higher) the benefit could be reversed. A new Ford Mondeo would cost around 56p per mile to run, at which point Peter would be bearing an additional £960 per year in business motoring costs — which would then be borne out of taxed income and eliminate the benefit of incorporation completely.

Lecture B536 (13.23 Minutes)

Value Added Tax

VAT administration developments

This article reviews a number of developments in VAT administration.

Repayment claims

Putting the cap on *Marks & Spencer…*

After the ECJ found comprehensively in favour of the taxpayer's version of the arguments about the five questions referred to it on the introduction of the 3-year cap, it was inevitable that Marks & Spencer would at last receive the repayments that were denied to them by the Court of Appeal following the first reference to the ECJ in 2002. The House of Lords, in re-hearing the case after it was returned by the ECJ this time, commented that the answers to the third and fifth questions had raised the possibility of further issues having to be decided by the national court. However, after 13 years of litigation, HMRC had decided that they did not wish to pursue those matters, so the matter could be disposed of by allowing the appeal at last.

House of Lords: *Marks and Spencer plc v HMRC*

…and recognising the principle

HMRC have published a Revenue & Customs Brief accepting the finding of the ECJ that it was unacceptably discriminatory to apply the unjust enrichment rule to payment traders but not to repayment traders. This was a defect in the law up to 26 May 2005, when it was corrected.

Claims made before 26 May 2005 that were refused by HMRC on the grounds of unjust enrichment and have still not been settled will now be paid, subject to verification. Claims where the unjust enrichment defence was not challenged or was upheld, in the courts, may be resubmitted for consideration, subject to the relevant time limits.

R&C Brief 05/09

Direct tax on repayments

HMRC have issued a Brief to explain their views on the direct tax treatment of VAT repayments arising under "Fleming claims" (and, by extension, other claims). Apparently some have suggested that a VAT repayment is outside the scope of corporation tax.

HMRC say that they do not accept this. VAT originally overpaid and recovered would in the earlier period have been excluded from turnover: customers would have paid it to the trader but it would have been treated as not belonging to the business. If it is recovered from HMRC, it becomes turnover, and is taxable accordingly. The Brief does not say when the recovery should be treated as taxable – the normal principle for timing of such receipts is that the accounting policy of the company is followed, which would put the receipt in the period in which it became reasonably certain that the money would be recovered. Although there may be an ingenious argument in favour of excluding such receipts from direct tax, HMRC's position seems very strong.

HMRC also state their view that interest paid on repayments of VAT is also chargeable to corporation tax. Although it does not arise on a "loan relationship", which is normally required for a charge to arise, it is deemed to do so by s.81 FA 1996. In this case, there is a specific reference to the timing of the charge and the relevance of Generally Accepted Accountancy Practice (GAAP – which most accountants think stands for Generally Accepted Accounting Principles).

The loan relationships rules do not apply to income tax traders. Perhaps someone will attempt to argue that interest paid by HMRC does not fall within the income tax provisions, although no-one has done so on previous occasions when repayments have been common (e.g. when opticians won their landmark case in 1995).

R&C Brief 14/09

Monthly returns

Traders who expect to make regular repayment claims are generally allowed to file monthly returns. This has led to the standard VAT planning manoeuvre of separately registering a zero-rated company (e.g. an exporter) within a group of companies so that it can file monthly repayment returns while the rest of the group accounts for output tax quarterly, including output tax on supplies to the zero-rated company. This creates a significant cash flow benefit.

In Business Brief 12/05, HMRC warned traders that they might require associated businesses to align their return periods if they suspected manipulation of returns to achieve cash flow benefits. This power would be exercised under SI 1995/2518 reg.25, under which there is no right of appeal to the Tribunal. When BMW received such a ruling in 2006, it therefore had to apply for judicial review, contending that the decision was not rational or reasonable.

The High Court held that the benefit actually enjoyed by virtue of the arrangement in this case was substantially equivalent to the benefit that the manufacturing company would enjoy if it was the direct exporter. The group as a whole enjoyed no new benefit from the arrangement, so denying it was not rational. It appears that the decision letter simply assumed that there was a VAT planning motive behind the arrangements, and no questions were asked by HMRC about possible other motives or administrative advantages of making monthly returns.

As a matter of principle, it was reasonable for HMRC to treat differently an exporter that was associated with its suppliers and one which was not, particularly if the associated exporter was deliberately manipulating the stagger groupings to obtain an unfair cash advantage. However, the High Court judge did not believe that this applied in this circumstance.

The Court of Appeal has overturned this ruling and allowed HMRC's appeal. As the judge had accepted the lawfulness and reasonableness of the overall policy of requiring traders to align their return periods, it was unreasonable of him then not to apply it.

HMRC had the power to determine return periods under reg.25 SI 1995/2518 and art.252 Directive 2006/112/EC. If that power was applied differently to different taxpayers, that might be discriminatory unless it could be shown that there were valid reasons for the distinction which were objectively justified in the exercise of the powers of tax management. HMRC had put forward valid reasons (the cash flow advantage enjoyed where the supplier and customer were associated) and it was not for the court to overturn HMRC's judgement, unless it was manifestly unreasonable.

HMRC were not required by the law to consider whether there would be a different benefit in different circumstances. There was a cash flow benefit from the use of different accounting periods, at the expense of the Exchequer; the policy of denying such a benefit was rational; the application of that policy to these companies was therefore lawful.

Court of Appeal: *R (oao BMW AG and others) v HMRC*

Default surcharge

Successful default appeals

A large trader was partly successful in appealing against default surcharges arising on two balancing payments under the payments on account regime. It had put forward three excuses:

- it did not believe that it had received the surcharge liability notice – non-delivery of the SLN renders subsequent defaults invalid;
- it was not aware that the 7-day extension of time does not apply to payments under the POA regime;
- it had suffered an internet connection breakdown which caused one of the returns and the related payment to be delayed from 4pm in the afternoon to 7.30am the following morning.

The Tribunal thought that it was more likely that the company had mislaid the SLN. The failure to know the rules was not an excuse. HMRC argued that the breakdown in the internet connection was not an excuse because the company should not have left filing so late in the day; however, the Tribunal considered that the previous reliability of the connection meant that the trader had acted reasonably in expecting it to work without problem. The surcharges were reduced to reflect the effect of striking out this default.

VAT Tribunal (20,938): *LVG Ltd*

The Tribunal came to the rescue of a trader who offered three different defences against a default surcharge at 15%: he claimed that his son was told on the telephone that even if part of the VAT was paid on time the surcharge would be based on the full amount. His next ground was that the surcharge was disproportionate and against the principles of the Human Rights Act. His third ground was that he had not been advised of the cash accounting scheme.

All of these defences were rejected, but the Tribunal still found a reasonable excuse. There was an acrimonious dispute between the trader and a Customs officer over what had been said in a conversation with the helpline; the officer's notes did not refer to the issue of a default surcharge being raised, while the trader was adamant that it had been specifically discussed. However, the record did show that the officer had mentioned the date on which a BACS transfer would have to be initiated, without explaining that a CHAPS payment two days later would solve the problem. In the circumstances, this constituted a reasonable excuse for the trader.

VAT Tribunal (20,902): *Mediaid Training Services Ltd*

Unsuccessful default appeals

The Tribunal dismissed an appeal against a default surcharge at the 15% rate in circumstances in which the trader might have expected to succeed. The VAT return was filed on time, and a payment was attempted using the Lloydslink electronic payment system on the 7-day extended deadline. The system failed for reasons which could not be identified; in spite of repeated calls to the bank's helpline, it could not be rectified in time for a payment to be made that day.

The Tribunal considered that the trader had not done all that a reasonable trader would do to make the payment. There had apparently been problems with the Lloydslink system the previous day, which might have put the trader on notice that the VAT payment should be attempted earlier than about 90 minutes before the deadline for same-day CHAPS transfers; similarly, its history of defaults – leading to the 15% rate applying – should have led to greater efforts being made. The penalty was confirmed at £32,365.

VAT Tribunal (20,971): *Datapoint Global Services Ltd (Formerly Touchbase Communications Ltd)*

A restaurant business claimed that it had suffered "unforeseeable and inescapable" cash flow difficulties because its general manager had left and the new general manager had over-ordered stock. The Tribunal held that this was not unforeseeable: the directors had experience of the business and should have given more guidance to the new manager.

VAT Tribunal (20,975): *Ricecooker Ltd t/a Liquorish*

A solicitor claimed a reasonable excuse for late payment of VAT on the grounds that HMRC had been late paying him an income tax refund arising from an investment in a film partnership. The Tribunal held that the income tax matter was wholly unconnected with the taxable trade; it was not clear whether the repayment should in fact have been made earlier than it was, but even if it was late, the trader should have made sure that he had sufficient funds to pay his VAT on time. He was using the cash accounting scheme and therefore only had to pay VAT to HMRC when he had received it from his clients.

VAT Tribunal (20,937): *D Walker*

A trader tried to convince the Tribunal that the failure to pay VAT on time arose because his financial officer had unnecessarily paid other creditors early, leaving insufficient funds to pay the VAT. If the other creditors – who had agreed not to press for payment – had not been paid, it would have been possible to pay the VAT.

The Tribunal did not accept that it would have been possible, even if the surprising account of the financial officer's actions was true. The numbers and dates did not show that the VAT liability could have been paid on time: there was a shortage of funds, and that could not be a reasonable excuse without a more convincing explanation.

VAT Tribunal (20,939): *City AM Ltd*

A trader was late paying two successive quarters' VAT, and received surcharges at 10% and 15% as a result. In respect of the first quarter, it had notified HMRC that it would be adversely affected by a postal strike which would delay receipts from its customers. However, the Tribunal considered that the effect was unlikely to be significant as the strike started on 4 October and the VAT was due on 7 October.

In respect of the next quarter, the trader's bank had changed the payment arrangements offered to the customer. It had previously accepted faxed CHAPS instructions; now the customer was required to use online banking to give BACS instructions, and a limit of £30,000 was placed on such payments. The company sent a fax anyway, and when it discovered that this was no longer accepted, it was too late for the BACS transfer (and the £4,000 cheque, as the total liability was £34,000) to arrive in time. The Tribunal did not accept that this confusion constituted a reasonable excuse.

In deciding whether the trader acted reasonably, the Tribunal may have been influenced by the fact that the trader did not turn up to the hearing; on being contacted by telephone, the responsible employee said that she had received notice of the hearing and had intended to attend, but had forgotten all about it.

VAT Tribunal (20,932): *UCS Building Division Ltd*

A trader gave instructions to his bank to transfer funds to HMRC on 4 April and 4 July, but as these were BACS transfers the money only arrived on 8 April and 8 July. His appeal against the resulting surcharges appeared mainly to be a complaint that he had paid the money, so where was it before it got to HMRC? The Tribunal was unable to answer this mystery, but confirmed that he needed to pay by CHAPS to achieve same day transfer.

VAT Tribunal (20,954): *Wolfe Ware Ltd*

Other admin developments

Paper returns to go

VAT Notes 4/2008 has confirmed that one of the proposals of the Carter Review will be implemented from April 2010 – the phasing out of paper VAT returns. From that time onwards all newly registered traders, and all traders with an annual turnover of over £100,000, will be required to file online and make payments electronically.

Paper returns will remain an option for the remainder of traders, but this will be reviewed by 2012.

VAT Notes 4/2008

Changing banks

HMRC have announced that they are changing their banking arrangements during 2009. Instead of the Bank of England holding HMRC's accounts, the business will be transferred to Royal Bank of Scotland and Citi. Traders who make direct electronic payments will have to change the account numbers and sort codes that they use, but this information will be provided when it is needed – there is no need to take any action until then.

www.hmrc.gov.uk

Time to pay

Help from HMRC with "time to pay" was launched by the Chancellor of the Exchequer at the PBR in November 2008. HMRC have announced that 60,000 businesses have agreed "time to pay" arrangements with the Business Payment Support Service, representing a deferral of one billion pounds of tax due. The following points are included in the announcement:

The Business Payment Support Service (BPSS) offers enhanced support to businesses finding it difficult to make tax payments on time, including corporation tax, VAT, PAYE, income tax and national insurance contributions.

The majority of businesses have agreed repayment timetables spread across 3 to 6 months.

The service is supporting those businesses hardest hit by the economic circumstances. Construction firms account for a quarter of those benefiting from these new arrangements, with many retailers and manufacturers also agreeing payment schedules they can afford.

Businesses can call HMRC and in the majority of cases get a decision within 10 minutes on the help they can receive.

The BPSS is open to all businesses in temporary financial difficulties and can be used to spread tax due now over a period which reflects the business' circumstances.

Businesses that have already entered into a time to pay arrangement, but whose circumstances change for the worse, should contact HMRC. In many cases HMRC will be able to revise or extend the time to pay arrangements, depending on individual circumstances.

An earlier announcement, on 14 January, stated the figures at 20,000 businesses and £350 million.

www.hmrc.gov.uk/pbr2008/business-payment.htm ; HMRC Press Release 16 February 2009

An article in *Taxation*, 8 January 2009, points out the crucial confirmation that agreeing a "time to pay" arrangement will avoid default surcharges (as long as the trader then sticks to the terms of the agreement). This is not the usual rule: normally, a trader who agrees to pay VAT late has only put off the arrival of the bailiffs, and is still subject to surcharges.

Article by Mike Thexton

Lecture B540 (26.41 Minutes)

Tax implications of the Vehicle Scrappage Scheme

The government announced at Budget 2009 the introduction of a temporary vehicle scrappage scheme. It is a voluntary scheme which will be administered by participating motor manufacturers and dealers, along with the Department for Business, Enterprise and Regulatory Reform (BERR). Information about it can be found on the BERR website and at Directgov–Motoring. You may also contact BERR's enquiry unit on Tel 020 7215 5000, or email the BERR Automotive Unit with "scrappage" entered in the subject heading.

A. VAT and direct tax profits implications

Vehicles supplied under the scheme will be subject to the normal VAT and direct tax rules. The purpose of this brief is to explain how those rules apply to the £1,000 subsidy payable by BERR on qualifying supplies made under their scheme, plus the £1,000 discount paid by the manufacturer.

Manufacturers

If you are a manufacturer participating in the scheme you will be providing a £1,000 subsidy to the final consumer (over and above any other subsidy or discount you might provide), even though you have no direct contractual relationship with them. You may treat the VAT on your contribution as a discount to the output tax you have paid to HMRC on your sale of the car. You may therefore reduce your output tax by the appropriate VAT amount (which on a gross payment of £1,000 and the current standard rate of VAT of 15% means £130.43). Any such adjustment should be made in the period in which it takes effect in the business records of the manufacturer. This treatment is in accordance with the decision of the *European Court of Justice in Elida Gibbs Ltd v Commissioners of Customs and Excise* [1996] STC 1387 and *Commission v Germany (Taxation)* [2003] STC 301. Guidance on the VAT treatment of such payments by manufacturers was given previously in Revenue and Customs Brief 08/07

You must not reduce your output tax in respect of BERR's £1,000 contribution. Under the terms of the scheme, BERR will pay you £1,000, but you must pass it on to the dealer within 14 days who, in turn, is obliged to ensure that the final consumer receives the benefit of that sum. You are thus acting as a conduit, receiving and passing on BERR's third party payment to the dealer. The £1,000 subsidy provided by BERR is not a discount on the value of your supply, and so you should make no adjustment in respect of that payment.

For direct tax purposes BERR's £1,000 contribution has no overall effect on the trading profits of the manufacturer. The corresponding £1,000 payable by the manufacturer to the dealer will be an allowable deduction for the purposes of computing the profits of the manufacturing trade.

Dealers

If you are a dealer participating in the Scheme and the manufacturer uses the arrangements above, the cost of the new vehicle received by you is unaffected, and you should make no adjustments to the VAT you pay to the manufacturer, or claim from HMRC as input tax. As explained above, the manufacturer is not providing a £1,000 (or greater) discount to you as part of the Scheme–they are providing it to your customer. Your selling price for the vehicle has not changed and you must not reduce your output tax. Whatever your final VAT–inclusive ('On The Road ') selling price of the new vehicle is, under the Scheme your customer pays £2,000 less, with the balance of the consideration being made up of the two £1,000 subsidies. Under the Scheme, it is important that it is clear to your customer that they are paying £2,000 less than would otherwise be the case–see Directgov–Motoring (www.direct.gov.uk/en/Motoring/BuyingAndSellingAVehicle/AdviceOnBuyingAndSellingAVehicle/DG_177693)

The effect of the Scheme on the dealer is neutral for the purposes of computing trading profits. The £2,000 reduction in the sale proceeds received from the customer is matched by the £2,000 trade receipt received in the form of the subsidies paid to the dealer under the scheme.

Customers

Customers buying a new vehicle under the scheme will pay £2,000 less for the vehicle, since BERR will be paying £1,000, and the vehicle manufacturer will be paying £1,000 towards the cost of the purchase. The subsidies will be settled between the manufacturer, dealer and BERR so you will not physically be paid these amounts.

If you are VAT–registered and buy a new car or van under the scheme, you may need to reduce your input tax in respect of the manufacturer's discount. However, you only need to consider this if you are entitled to claim VAT on the purchase of a vehicle–for example, on certain commercial vehicles, or a car that is intended to be used primarily as a taxi; driving instruction car, or self–drive hire (but see paragraph 3.1 of VAT Notice 700/64 "Motoring expenses"). If, under the normal VAT rules, you are entitled to reclaim the VAT you are charged on the purchase of a new vehicle and you buy one under the Scheme, you must reduce the input tax you claim in proportion to the manufacturer's discount. This is because, at the beginning of the chain of transactions culminating in your purchasing the vehicle, the manufacturer will have reduced its output tax. Therefore, since the manufacturer contributes £1,000 and the standard rate of VAT is 15%, you must reduce your input tax by £130.43. You will not receive an amended invoice or credit note. This is the normal VAT treatment for business customers receiving such manufacturer's discounts–see Revenue and Customs Brief 08/2007

B. Capital allowances

A business purchaser of a vehicle under the scheme will only be able to claim capital allowances on the net cost to it (after the two subsidies have been deducted). However, the vehicle surrendered by the business consumer will be scrapped and therefore it has no value as a vehicle, in terms of the scrappage scheme. The two subsidies given as deductions from the purchase price will not constitute taxable disposal receipts for capital allowances purposes.

If you need further advice and are a large business with an allocated Customer Relationship Manager, you should consult them. Otherwise you should contact our National Advice Service Helpline on Tel 0845 010 9000, or by Enquiries.estn@hmrc.gsi.gov.uk, or by writing to—

HM Revenue & Customs, National Advice Service, Written Enquiries Section, Alexander House, Victoria, Avenue, Southend, Essex, SS99 1BD

Please include your VAT registration number and the name and address of your business in any correspondence. If you are not VAT registered please include your name and address.

Supplies made for a consideration see *De Voil Indirect Tax Service* **V3.152**

HMRC Brief 31/2009 14 May 2009

JD Wetherspoon plc v CRC (Case C-302/07), ECJ

The subject in dispute in this case was whether rounding of VAT amounts was permissible under EU law.

The claimant, Wetherspoon plc, operated pubs in the UK. It rounded down VAT to the nearest tenth of a penny at line level for each separately identified product and aggregated those amounts, rounding down to the nearest penny for each transaction with the customer.

In this way the company reduced the amount of VAT it paid to the HMRC. The department did not allow the rounding down of VAT on each transaction.

The matter was referred by the VAT tribunal to the European Court of Justice for a preliminary hearing.

The ECJ said that where prices were fixed exclusive of VAT, the VAT collected would be the amount paid to the state, regardless of rounding.

Where VAT was included in the sale price, the amount collected would be higher than that paid over, which had been rounded down.

In effect, the UK was under no obligation to allow rounding down for retailers who sell at VAT-inclusive prices.

Furthermore, requiring those retailers to round the VAT amount arithmetically would not offend the EU principle of equal treatment and fiscal neutrality.

R (appl. of TNT Post UK Ltd) v CRC (Royal Mail Group Ltd, interested party)

Following the liberalisation of the UK's postal services in 2006, TNT Post had been granted a licence to operate a business postal service in the UK.

TNT Post's supplies were subject to VAT, but those of the Royal Mail were exempt under the provisions of VATA 1994 (as amended by the Postal Services Act 2000) transposing the exemption in article 13(A)(1)(a) of the Sixth Directive for services supplied by public postal services.

The company sought a judicial review of Royal Mail's exemption. The High Court referred the matter to the European Court of Justice for a preliminary ruling as to the meaning of public postal services, and if not all such services were exempt, what were the criteria for identifying them.

The European Court of Justice said that according to article 13(A)(1)(a) of the Sixth Directive, in order to be exempt the service had to be performed by a body which could be described as the public postal service in the organic sense. Such operators could be public or private. However, not all supplies would be exempt.

The principle of fiscal neutrality meant that only services supplied in the provider's capacity as universal service provider would exempt.

The exemption would not apply to services or goods incidental to those supplies for which the terms had been individually negotiated.