Tolley® Tax Training

FINANCE ACT 2009 AND TAX UPDATE

September 2009

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FINANCE ACT 2009

1 BUSINESS AND CORPORATION TAX CHANGES

Lecture B553 (14.18 Minutes)

1.1 Corporation tax rates

Section 7 sets the main rate of corporation tax for the Financial year 2010 at 28% once again.

Section 8 deals with the small company rate which remains at 21% for the Financial year 2009 (note – one year behind the main rate). The marginal relief fraction is 7/400. and the effective marginal rate on profits in excess of the lower limit (£300,000 for a small company) is 29.75%.

The Act makes no mention of the intention to increase the small company rate to 22% next year, but if this happens, the marginal rate will drop slightly to 29.5%.

1.1.1 Tax liabilities – sole trader vs limited company

This Table sets out the current tax differentials between the operation of the business as a sole trader and limited company based on the assumptions set out above. Depending on what the adviser believes are the additional costs borne through operating in a limited company, this will cause him to consider business structure carefully at anywhere from £10,000 up to £30,000 gross profit.

Different rates apply to "ring fenced profits" where the main rate is still 30% and the small company rate 19%.

Table 1 : Tax & NIC burden self employed to limited company 2009/10

Profit	Sole trader	Company	Saving
£10,000	£1,172	£899	£ 274
£15,000	£2,573	£1,949	£ 624
£20,000	£3,973	£2,999	£974
£30,000	£6,773	£5,099	£1,674
£40,000	£9,573	£7,199	£2,374
£50,000	£13,169	£9,459	£3,710
£75,000	£23,419	£19,647	£3,772

The tax savings could be expected to reduce in 2010/11 when the rate of corporation tax is expected to increase still further.

1.2 Temporary extended loss carry back

Lecture B551 (14.43 Minutes)

Section 23 introduces Schedule 6 which makes the changes to loss reliefs to permit a temporary three year carry back of trading losses.

1.2.1 An overview of the new relief for businesses

This new relief intended to help businesses during the current recession was announced at the Pre-Budget Report in November 2008, to commence with immediate effect. The relief announced at the time permitted a three year carry back of losses incurred in 2008/09 for unincorporated businesses and for companies the same carry-back effect for losses incurred in accounting periods ending between 24 November 2008 and 23 November 2009. In the Budget 2009 it was announced that the relief would be extended for an additional year, so that businesses would be more likely to benefit from the relief.

Therefore, in summary, the Finance Act 2009 allows trading losses to be carried back against previous profits. The extension will apply to trading losses made by companies in accounting periods ending between 24 November 2008 and 23 November 2010, and trading losses made in tax years 2008/2009 and 2009/2010 by unincorporated businesses.

The amount of trading losses which can be carried back to the preceding year remains unlimited. After carry back to the preceding year, a maximum of £50,000 of unused losses will be available for carry back to the earlier two years. The £50,000 limit or cap applies separately to the unused losses of each 12 month period within the duration of the extension. Therefore, businesses could potentially carry back an extra £100,000 of losses in addition to the unlimited carry back to the preceding year.

The provisions for losses incurred during the first four tax years, or during the final year in which a trade, profession or vocation is carried on, or for trading losses incurred in the final accounting period of a company remains broadly but not totally unchanged.

There are some key differences in the way the relief works for income and corporation tax, so they are now described separately in some detail.

1.2.2 Income tax trading losses

For income tax, the relief is available against the profits of the trade, rather than against total income. This is potentially quite good news for many small businesses, as if the taxpayer has a modest amount of other income this will remain in charge and use up the personal allowances; put another way, the claimant is not forced to use up losses against income which would not be taxable in any event. The legislation is in Sch 6, Finance Act 2009, and references are to paragraphs within the Schedule.

Conditions for relief

Paragraph 1 sets out the basic conditions for relief, which is made by a specific claim. The loss must first qualify for relief under s 64, Income Tax Act 2007 (ITA 2007), which means that the various conditions for general loss relief are imported, such as the trade being carried on on a commercial basis with a reasonable expectation of profit (ss 66 and 68, ITA 2007).

There must then be at least one claim for relief under s 64 for either the year of the loss or the preceding year, or alternatively there is no income in either year against which a claim under s 64 could be made. Relief given under s 64 must be deducted from the loss which is then claimed for relief, under a single claim affecting either two or three years (depending on whether a claim has been made under s 64 in the year preceding the loss).

Method of relief

When relief is given under para 1 the deductible amount, that is the remaining loss not claimed under s 64, is deducted from the trading profits of each of the preceding years working from most recent years first and moving back as the profits of each year are exhausted. Clearly if a claim under s 64 has been made for the year preceding the loss, the claim under para 1 will allow relief in the two preceding years, taking the later year first. If, however, no s 64 claim has been made in the preceding year then relief under para 1 will be given against trading profits of the three preceding years, taking the latest year first.

Restriction of additional relief

The relief is restricted to keep the cost to the Exchequer manageable. The amount set against the preceding year is not restricted, irrespective of whether the claim is made under s 64 against total income, or para 1 against trading profits only. Clearly, if the profits of the preceding year are substantial then additional relief under para 1 may not be needed. When the profits (or total income depending on the claim) of the preceding year are exhausted, carry back then proceeds to the earlier years. The restriction then comes into play, with a maximum of £50,000 of the loss available to carry back by more than one year.

Practical considerations

Because of the interplay between the new relief and other possible loss reliefs, there can be quite a complex decision to make regarding which relief will make the most appropriate claim. The opportunity to restrict the loss claim to trading profits only in the year preceding the loss will be very attractive to taxpayers with modest additional income in those years, such as a client with a buy to let yielding around £5,000 per annum. Allowing this income to remain in charge to tax and be covered by any available personal allowances can present the opportunity to carry additional amounts back to the earlier years and optimise relief, provided the £50,000 cap does not prevent it.

Advisers will also need to consider carefully the status of capital allowance claims which as well as increasing a loss (or reducing it by limiting the claim) may therefore also permit the loss to be tailored to the income available thus achieving in effect a partial offset of the loss – the remainder being carried forward – albeit in the capital allowances pool.

These issues are best illustrated with some practical examples.

Example 1

Adam has sold his buy to let property in October 2007 producing a capital gain of £11,000. Adam has net rental income of £6,000 in each of the tax years 2005/06 to 2007/08, and trading profits of £30,000 in each year. His business incurs a loss of £70,000 (including capital allowances) in 2008/09, and he has interest income in that year of £300. At present he expects to incur further modest losses in 2009/10.

Adam's options are :

- to claim relief in both 2008/09 and 2007/08 under s 64, and then make a claim under para 1; or
- to claim relief under s 64 in 2008/09 and then claim under para 1.

He is unlikely to make a claim to extend his loss relief in 2008/09 to be set against the capital gains arising in that year, as the gain is almost entirely covered by his annual exempt amount, and thus almost no benefit would be gained. This would also prevent any further amount of loss being claimed under para 1, as the full loss after relief under s 64 is converted to a capital loss.

Claim under s 64 for both years

2008/09	**£**	**Loss Memo**
Trading loss		70,000
Interest	300	
S 64 claim	(300)	(300)
Net income	Nil	
2007/08		
Trading profit	30,000	
Rent	6,000	
	36,000	
S 64 claim	(36,000)	(36,000)
Net income	Nil	

2006/07		
Trading profit	30,000	
Para 1 claim	(30,000)	(30,000)
Rent	6,000	
	6,000	
Personal allowance	(5,035)	
Net income	965	
2005/06		
Trading profit	30,000	
Para 1 claim	(3,700)	(3,700)
Rent	6,000	Nil
	32,300	
Personal allowance	(4,895)	
Net income	27,405	

Value received for loss	**Loss**	**Value**
2008/09		
Covered by personal allowance	300	Nil
2007/08		
Covered by personal allowance	5,225	Nil
At starting rate of 10%	2,230	223
At basic rate of 22%	28,545	6,280
2006/07		
At starting rate of 10%	1,185	118
At basic rate of 22%	28,815	6,339
2005/06		
At basic rate of 22%	3,700	814
	70,000	**13,774**

This is an effective rate of relief of 19.7%.

Claim under s 64 for 2008/09 only

2008/09	**£**	**Loss Memo**
Trading loss		70,000
Interest	300	
S 64 claim	(300)	(300)
Net income	Nil	
2007/08		
Trading profit	30,000	
Para 1 claim	(30,000)	(30,000)
Rent	6,000	
	6,000	
Personal allowance	(5,225)	
Net income	775	

2006/07		
Trading profit	30,000	
Para 1 claim	(30,000)	(30,000)
Rent	6,000	
	6,000	
Personal allowance	(5,035)	
Net income	965	
2005/06		
Trading profit	30,000	
Para 1 claim	(9,700)	(9,700)
Rent	6,000	Nil
	26,300	
Personal allowance	(4,895)	
Net income	21,405	

Value received for loss	**Loss**	**Value**
2008/09		
Covered by personal allowance	300	Nil
2007/08		
At starting rate of 10%	1,455	145
At basic rate of 22%	28,545	6,280
2006/07		
At starting rate of 10%	1,185	118
At basic rate of 22%	28,815	6,339
2005/06		
At basic rate of 22%	9,700	2,134
	70,000	**15,016**

The value of the relief has increased by £1,242, and the overall rate of relief is now 21.5%.

Where the taxpayer has a patchy history of higher rate liabilities, this will make a claim under para 1 very tricky, as it is a single claim to relief affecting all of the available years, and thus may involve taking relief at basic rate in order to benefit from some higher rate relief. If the taxpayer expects future profits to be substantial, then it may not be beneficial to claim under para 1, and to limit the claim to s 64 relief if there is a higher rate liability in the preceding year, allowing the balance of the loss to be carried forward to obtain the benefit of relief at higher rates of tax.

1.2.3 Example 2

Betty has incurred a loss for 2008/09. She has no income other than from trading in any year, but indicates that she expects to be a higher rate taxpayer in 2009/10 as a result of winning a new contract. Her profits are likely to be of the order of £100,000 per annum in the future. In 2008/09 she has incurred a loss of £100,000, which includes a capital allowances (AIA only) claim of £35,000. Her profits in 2007/08 were £25,000, and in 2006/07 were £45,000. In 2005/06 her profits were £20,000.

Options available to Betty

- to make claim(s) under s 64 followed by para 1 claim; or
- to make no current claims and carry forward losses to 2009/10; and
- she might consider amending capital allowance claims to alter the position.

Claim under s 64 followed by para 1 claim

2008/09	**£**	**Loss Memo**
Trading loss		100,000
No claim possible – no other income		
2007/08		
Trading profit	25,000	
S 64 claim (mandatory)	(25,000)	(25,000)
Net income	Nil	
2006/07		
Trading profit	45,000	
Para 1 claim	(45,000)	(45,000)
Net income	Nil	
2005/06		
Trading profit	20,000	
Para 1 claim (restricted)	(5,000)	(5,000)
	15,000	25,000
Personal allowance	(4,895)	
Net income	10,105	

Value received for loss	**Loss**	**Value**
2007/08		
Covered by personal allowance	5,225	Nil
At starting rate of 10%	2,230	223
At basic rate of 22%	17,545	3,860
2006/07		
Covered by personal allowance	5,035	Nil
At starting rate of 10%	2,150	215
At basic rate of 22%	31,150	6,853
At higher rate of 40%	6,665	2,666
2005/06		
At basic rate of 22%	5,000	1,100
	75,000	14,917
2009/10		
Anticipated c/f at higher rate of 40% 25,000	10,000	
	100,000	**24,917**

This is an effective rate of relief of 24.9%.

Carry forward the loss – no current claims

2008/09	**£**	**Loss Memo**
Trading loss		100,000
2009/10		
Trading profit	100,000	
Carry forward loss (s 83 ITA 2007)(100,000)	(100,000)	
Net income	Nil	Nil

Value received for loss	**Value**	**Loss**
2009/10		
Covered by personal allowance	6,475	Nil
At basic rate of 20%	37,400	7,480
At higher rate 40%	56,125	22,450
	100,000	**29,930**

This is £5,013 better than option 1, at a rate of relief of 29.9%.

Amending the 2008/09 capital allowances claim to nil

Claim relief under s 64 and para 1

	£	**Loss Memo**
2008/09		
Trading loss		65,000
No claim possible – no other income		
2007/08		
Trading profit	25,000	
S 64 claim (mandatory)	(25,000)	(25,000)
Net income	Nil	
2006/07		
Trading profit	45,000	
Para 1 claim	(40,000)	(40,000)
Net income	5,000	Nil
Personal allowance	(5,000)	
Taxable income	Nil	

The amount shown as capital allowances will gain tax relief at 40%, being allowed in future years as WDA.

Value received for loss	**Value**	**Loss**
2007/08		
Covered by personal allowance	5,225	Nil
At starting rate of 10%	2,230	223
At basic rate of 22%	17,545	3,860
2006/07		
Covered by personal allowance	35	Nil
At starting rate of 10%	2,150	215
At basic rate of 22%	31,150	6,853
At higher rate of 40%	6,665	2,666
	65,000	13,817
2009/10		
Anticipated c/f at higher rate of 40%35,000		14,000
	100,000	**27,817**

This has improved relief over option 1 but is not as attractive as option 2. The rate of relief of 27.8%.

Amending the 2008/09 capital allowances claim to nil

Carry forward the loss – no current claims

		£	Loss Memo
2008/09			
Trading loss			65,000
2009/10			
Trading profit		100,000	
Carry forward loss (s 83 ITA 2007)	(65,000)	(65,000)	
Net income		35,000	Nil

Capital allowances once again disclaimed so that they can be claimed in future only against higher rate liabilities.

Value received for loss		**Value**	**Loss**
2009/10			
At basic rate of 20%		8,875	1,775
At higher rate 40%		56,125	22,450
		65,000	24,225
2010/11 & subsequent			
Anticipated c/f at higher rate of 40%	35,000	14,000	
		100,000	38,225

This is the best option of all, providing relief at a rate of 38.2%.

1.2.4 Corporation tax losses

Companies are also permitted to carry trading losses arising in accounting periods ending between 24 November 2008 and 23 November 2010 back against total taxable profits of the three preceding years. The relief is very similar to that provided for income tax, with the legislation commencing at para 3 of Sch 6 to FA 2009.

The relief amends the current 12 month carry back provision in s 393A ICTA 1988 to provide that the time period to which the loss can be carried back is now the three years preceding the loss making period. Relief is given against total profits chargeable to corporation tax, thus extending the relief for companies to other income of all types and chargeable gains.

Losses are set against the most recent periods first, only going back to earlier periods when the profits of the later year have been exhausted, but this is a single claim to relief, affecting all three years – it is not possible to pick and choose which years are included in the claim.

The capping mechanism seen above also applies to corporation tax, with the cap being expressed separately in relation to the time periods as follows :

- for a loss in an accounting period (or periods) ending between 24 November 2008 and 23 November 2009 the limit is £50,000; and
- for a loss in an accounting period (or periods) ending between 24 November 2009 and 23 November 2010 the limit is £50,000.

Once again, the cap restricts only the additional relief introduced by FA 2009, with unrestricted relief given in the preceding year under the existing s 393A ICTA 1988.

For a company with an accounting date early in the window (such as 31 December) it is not possible to enhance relief by changing accounting date and preparing accounts for the 10 months to 31 October 2010 – the £50,000 cap would prevent any additional relief being available. Where an accounting period is less than a year in length the £50,000 is apportioned to the appropriate number of days.

1.2.5 Practical effect

In terms of planning to optimise loss relief, advisers will wish to consider competing claims, and how available profits are best used to relieve losses.. There are no issues in corporation tax of wasted personal allowances, and the impact of varying marginal rates of tax is likely to be minimal in practice, so planning to use the relief in corporation tax is a simple matter when compared to the same task for income tax.

1.3 First year allowances

Section 24 deals with the necessary amendments to CAA 2001 to reintroduce first year allowances for all businesses in relation to the main pool only. The rate of FYA is 40%.

FYA qualifying expenditure in incurred in 2009/10, for companies between 1 April 2009 and 31 March 2010, and for income tax businesses between 6 April 2009 and 5 April 2010. As usual, FYA will not be available on cars or on assets used for leasing, as the normal exclusions (there two plus others) in S 46(2) CAA 2001 are invoked. Special rate expenditure (as introduced by Finance Act 2008) is also excluded. Where plant is provided for leasing, FYA will be available if it is provided for leasing under an excluded lease of background plant and machinery for a building (ref s 70R of CAA).

1.4 Agreements to forgo tax relief

Section 25 introduces legislation to statutorily disapply certain automatic corporation tax reliefs if a company has agreed to forgo such relief under an agreement with the Treasury. This provides a statutory framework for the agreements made with the banks under the Asset Protection Scheme.

1.5 Contaminated and derelict land

Section 26 introduces Schedule 7 which makes amendments to Land Remediation Relief which is currently Part 14 of CTA 2009. The changes have been consulted upon, and in summary slightly amend existing land remediation relief, and introduce additional relief in relation to derelict land, which is intended to stimulate brown field development. They commence on 1 April 2009.

Para 5 of the Schedule sets out the new definition of contaminated land, which is now referred to as “land in a contaminated state”. This forms a replacement s 1145 of CTA 09. Land is in a contaminated state if and only if, because of something in, on or under the land, the land is in a condition such that :

- Relevant harm is being caused, or
- There is a serious possibility that relevant harm could be caused.

However, the presence of living organisms or decaying matter from living organisms, air or water, or anything present *otherwise* than as a result of industrial activity will not bring land into a contaminated state. This narrows the original definition of contaminated considerably.

Relevant harm means :

- Death of, or significant injury or damage to living organisms;
- Significant pollution of controlled waters;
- Significant adverse impact on the eco system, or
- Structural or other significant damage to buildings or other structures, or interference with the same which significantly compromises their use.

A new definition is then introduced as s 1145A, of land “in a derelict state”. This applies if and only if the land is not in productive use, and cannot be put into productive use without the removal of buildings or other structures. New s 1145B excludes nuclear sites from both definitions (with a definition included).

Section 1146 which currently sets out the definition of “relevant land remediation” and covers activities carried on for which relief will be available is amended to bring any terminology in line with the above, and is then mirrored in a new section 1146A which described “relevant derelict land remediation” in similar terms. This covers activities meeting conditions A and B (below) and relevant preparatory activities :

A. The activities comprise the doing of any works, the carrying out of any operations or the taking of any steps in relation to the land in question, and
B. The purpose of the activities is a purpose specified by Order made by the Treasury.

Reminder : the current relief, and therefore the new relief is restricted to expenditure on staffing costs, materials and sub contract expenditure, which would not otherwise have been incurred but for the state of the land and is not subsidised.. (See S 1141).

By Order, relief is given for expenditure incurred in removing the following structures left from previous occupation of the site:

- post tensioned concrete heavyweight construction
- building foundations and machinery bases;
- reinforced concrete pilecaps
- reinforced concrete basements
- below ground redundant services (gas, water electricity and telecommunications)

There are no restrictions on what the site was previously used for. This list is specific and does not work by analogy.

Qualifying expenditure includes the cost of establishing what redundant structures are present and the cost of removing the structures listed above. There is, however, no relief unless the work is carried out.

1.5.1 Relief for capital expenditure

The existing relief for capital expenditure in S1147 is extended to include derelict land, but the conditions for relief are much tighter. To qualify for relief (by election) in relation to capital expenditure which is remediation expenditure the land must have been acquired by the claimant for the purpose of a UK property business or trade. Whereas for contaminated land, the relief is available if the land is purchased in a contaminated state (condition B s 1147(3)), for derelict land the land must have been in a derelict state throughout the period starting with the earlier of :

- 1 April 1998, and
- The date on which the acquisition took place.

Similar conditions apply to the additional relief (the 50% uplift) on land remediation expenditure which is not capital in nature in s 1149.

1.5.2 No relief if contamination caused by claimant

The existing restriction on relief is amended to reflect the new derelict land terms, and amplified to further restrict relief when the state of the land is caused wholly or mainly by anything done or omitted to be done by anyone else who still has a relevant interest in the land.

1.5.3 Payable tax credit

There are no amendments to the tax credit measures in Ss 1151 to 1158. Accordingly, tax credit relief (a payable 16% tax credit on unrelieved losses) is also available in respect of expenditure on relevant derelict land in addition to relevant contaminated land.

1.5.4 Subcontractors

Some minor amendments have been made to the definitions of subcontractor payments, tidying up the terminology and excluding references to payments made to subcontractors who are not connected parties – thus there are no restrictions on these types of payment (which was already the case but the legislation was clumsy).

1.6 Group relief – preference shares

Section 28 and Schedule 9 amend the group relief definitions used in ICTA. For the purposes of determining the ownership of a company, tax law makes a distinction between equity and non equity shares.

Previously fixed rate preference shares have been excluded from the definition of equity capital used in the definitions for group relief, but Schedule 9 extends the exclusion to other preference shares, so that the exclusion is now for holders of “relevant preference shares”. Relevant preference shares must be issued for new consideration (so cannot include bonus shares) and must either carry no right to dividend or any dividend rights must represent no more than a reasonable commercial return on the shares and must meet one of the following conditions :

A. The dividends are a fixed amount or a fixed rate per cent of the nominal value of the shares, and the company cannot reduce the amount of the dividends,
B. The dividends are a variable rate per cent of the nominal value which fluctuates in accordance either with a standard published rate of interest or RPI or some similar published standard index, and the company cannot reduce the amount of the dividends, or
C. Where conditions A or B are not met it is because the company may reduce or not pay the dividends, but the conditions which permit this are limited to occasions when the company is in severe financial difficulties or following the recommendation of a relevant regulatory body.

These changes are intended to exclude from the consideration of ownership for group relief and other purposes shares which form part of the Tier 1 regulatory capital base for financial institutions. The intention to make the change was announced on 18 December 2008 by written ministerial statement.

1.7 Sale of lessor companies

The anti avoidance legislation in Schedule 10 of FA 2006 can be triggered in some unusual group structures which were never intended to be caught. Section 29 introduces Schedule 10 FA 2009 which makes some minor changes of detail to FA 2006, which ensure that there are no adverse tax consequence when companies carrying on a leasing business in partnership dissolve the partnership, or in certain consortia relationships. A company acquiring a larger share in a leasing partnership will benefit from an appropriate amount of relief.

1.8 Capital allowances on cars and motor cycles

Lecture B552 (10.08 Minutes)

Section 30 introduces Schedule 11 which deals with the amendments to capital allowances on cars and motor cycles.

1.8.1 Overview

Under the changes, the entire regime of capital allowances on cars has been replaced by a new system based on emissions.

- The rules about cars costing more than £12,000 have all been abolished, as have any special rules in relation to hire cars, including cars used as taxis.
- Cars emitting no more than 160g/km are to be included in the main plant and machinery pool, attracting writing down allowance of 20%. Pooling, will however, ensure that there are no balancing allowances on the disposal of cars in future.
- Cars emitting more than 160g/km are to be included in the special rate pool, with rate of WDA of 10%. Once again, the loss of balancing allowance will be the key issue for businesses.
- Cars which are purchased under the old rules will remain within the old capital allowances regime until the accounting period commencing first on or after 1 or 6 April 2014.
- The rules on allowances for hire charges (leasing charges) are to be replaced by a single rate of add back of 15% for cars emitting more than 160 g/km.
- Motor cycles are excluded from the definition of a car with effect from the date of then new rules.

1.8.2 Technical summary

The amendments are made to Capital Allowances Act 2001, and are dealt with in the order they arise in the Schedule.

First old Sections 81 (Definition of a car) and 82 (Definition of a qualifying hire car) are deleted. References to Section 81 in the list of items which do not qualify for AIA (S 38B), general exclusion from first year allowances (S46(2)) and cases in which short life asset treatment is ruled out (s84) are all replaced by a cross reference to the new definition of a car in new s 268A.

The definition of special rate expenditure which attracts 10% WDA is amended to include cars which are not main rate cars, in relation to expenditure on or after 1 April 2009 or 6 April 2009 for income tax.

1.8.3 New definitions

New S 104AA defines a main rate car as

- A car first registered before 1 March 2001
- A car with low emissions (defined as one which when registered has a qualifying emissions of no more than 160g per kilometre driven, or
- A car which is electrically propelled.

Note that this means that all older cars will qualify for allowances at 20%, irrespective of engine size.

New S 268A defines a car as a mechanically propelled road vehicle other than :

- A motorcycle,

- A vehicle of construction primarily suited for the conveyance of goods or burden of any description, or
- A vehicle of a type not commonly used as a private vehicle and unsuitable for such use.

This, then reproduces the definition which was formerly in s 81, but with the additional exclusion of motor cycles. Motor cycles assume the definition in s 185(1) of the Road Traffic Act 1988.

New S 268B defines an electrically propelled vehicle as one that is propelled solely by electrical power and that power is derived from a source external to the vehicle or a battery which is not connected to any source of power when the vehicle is in motion(!).

Hire cars for disabled persons are also a new definition which is in new s 268D. This definition will cover cars provided to those in receipt of mobility benefits and similar, and permits such cars to qualify for allowances as normal plant.

1.8.4 Anti avoidance

Para 9 sets out anti avoidance legislation applicable to the leasing industry. It introduces new s 104F which controls the amount of the balancing allowance available when a company leasing special rate cars ceases trading but other members of the group (using the group relief definition) also carry on the business of leasing cars within a 6 month period after the cessation of trade. The balancing allowances on the special rate pool are excluded from relief on cessation, and the resulting orphaned expenditure passed to the other group member, which is treated as incurring it on the day after the end of the final chargeable period of the other company.

1.8.5 Hire charge restriction

The restriction on tax relief for hire charges for “expensive cars” has also been revised in line with the new emissions based regime. This is dealt with by Part 2 of Schedule 11, which amends section 48 of ITTOIA 2005 for income tax and section 56 of CTA 2009 for corporation tax (similar provisions in ICTA 1988 covering insurance companies are also amended).

First, in common with the changes to capital allowances, motorcycles are excluded from any restriction on hire charges. Then the restriction is limited to cars other than those :

- First registered before 1 March 2001,
- With low CO_2 emissions (meaning a “main rate” car)
- That are electrically propelled, or
- Qualifying hire cars.

New Section 50A deals with short term hiring in and long term hiring out. Short term hire of a car is excluded from the adjustment to the hire charge – this is defined as a period (or linked periods) of no more than 45 consecutive days. Periods of hire are linked if they are separated by 14 days or less.

The adjustment also does not apply to a long term hire (or lease) by a business which hires the cars out to arm’s length customers for *more than* 45 days consecutively (using the linking principle again). This eliminates the adjustment in the hire business, as it will be dealt with in the customer business.

1.8.6 Commencement

The new rules on capital allowances apply to expenditure incurred on or after 1 or 6 April 2009. However, expenditure on cars for which an unconditional written contract was made after 8 December 2008 but under which the car is not to be made available until after 1 August 2009 (6 August for income tax) is also treated as within the new rules. The changes also affect expenditure incurred before the date of change in relation to chargeable periods beginning on or after 1 April 2014 or 6 April 2014.

The changes to the rules on disallowed hire charges in relation to agreements entered into on or after 1 or 6 April 2009. Where a person has entered into a binding written agreement to hire (or lease a car) on or before 8 December 2008 and the hire period begins before 1 April (or 6 April) 2010 they can make an election to disapply the changes and be taxed under the old regime if they prefer. Such an election is irrevocable and must be made within the period allowed for amending the tax return in income tax and within 2 years of the end of the chargeable period for corporation tax (using as a reference the first period in which any expenditure under the agreement is incurred).

1.9 Groups of companies – Capital Gains

Section 31 and Schedule 12 deal with chargeable gains in groups of companies.

1.9.1 Overview

When companies within a CGT group make disposals of assets outside the group, legislation permits the companies to jointly elect that the assets disposed of are to be deemed to have been transferred between them immediately prior to sale. This measure replaced the **actual** transfer of assets which previously was required to offset gains and losses within a group.

The requirement for a sale outside the group does not, however, provide relief if, for example an asset becomes of negligible value. So this rule has been amended to allow for a joint election to transfer gains and losses, rather than the assets producing them, which will reinforce the group relief mechanism for chargeable gains.

1.9.2 Technical summary

Section 171A of TCGA 1992 is replaced in its entirety by para 1 of Schedule 12. The new section applies when :

- A chargeable gain or allowable loss accrues to a company (referred to as company A) in respect of an asset,
- At the time of the accrual, company A and company B are in the same CGT group, and
- Had company A disposed of the asset to company B immediately before the accrual, this would have been a no gain no loss transfer,

Companies A and B may then make a joint election to transfer the chargeable gain or allowable loss (or such part of it as is specified in the election) from company A to company B. The election must be made by notifying an officer of HMRC no later than two years after the end of the accounting period of company A in which the accrual falls. The maximum amount that may be subject to the election is the amount of the gain or loss.

The effect of the election (given by new S 171B) is that company B is treated as accruing the gain or loss at the time that it would have accrued to company A. Where company B is non resident, the gain or loss is treated as accruing on an asset that would be in charge to corporation tax on company B. Payment between company A and company B for the gain or loss is ignored for tax purposes provided it does not exceed the amount of the gain or loss transferred.

The election will not apply to the reallocation of a gain or loss on a degrouping charge, as s 179A already deals with that scenario. S 179 has some minor consequential amendments as a result but is essentially unchanged.

1.10 Stock lending arrangements

A stock lending arrangement is a loan backed by collateral of securities which are transferred to the lender but then transferred back to the borrower once the loan is repaid. CGT recognises the short term nature of this transaction, as although full title is passed to the lender, no chargeable gain accrues to the borrower on the initial transfer, nor to the lender on completion of the arrangement.

Where it becomes apparent during the arrangement that the securities will not be transferred at the end, the parties are treated as making a disposal at market value at the time this becomes apparent. Section 32 and Schedule 13 have been introduced to provide relief where the failure of the arrangement is due to the insolvency of the borrower; it is normal that replacement securities are offered by a third party who is acting to protect the borrower, but this is treated as a disposal at that time – even though the replacement securities put the lender in the same position.

The Schedule makes the necessary changes to ensure that the lender incurs no inappropriate tax charge in this situation. Where the collateral offered is of less value than the loan, the change allows the lender to book an immediate loss – even though some funds may eventually be recovered from the insolvent borrower. Such a recovery would be taxable on receipt.

Section 83 and Schedule 37 make similar changes in relation to Stamp taxes.

1.11 Taxation of foreign profits

Sections 34 to 37 inclusive, and Schedules 14 to 17 implement the primary legislation to deal with the taxation of foreign profits for corporation tax purposes, and related changes.

1.11.1 Overview

In outline the changes provide the following :

- Dividends and other distributions for foreign companies are exempt from corporation tax in the UK from 1 July 2009. Their treatment has been aligned with that of dividends from UK companies. There are some anti avoidance rules which mean in rare situations dividends from both the UK and abroad could be liable to tax, but these are expected to be very unusual.
- Relief for interest and other finance costs payable by UK companies will be restricted; a cap will apply equal to the consolidated gross finance expense of the group. This debt cap will apply to accounting periods beginning on or after 1 January 2010.
- Two exemptions have been removed from the CFC regime, these are the Acceptable Distribution Policy rule (as the dividends are no longer taxable in the UK) and the holding company exemptions. Subject to transitional relief for the holding company rule available to some companies, these exemptions have been removed for corporation tax accounting periods starting on or after 1 July 2009. There will also be rules applying to straddling periods.
- Rules that require advance approval from HM Treasury prior to certain transactions being undertaken have been repealed (these are known as “Treasury consents”) and replaced by a post transaction information reporting requirement.

1.11.2 Technical summary

The legislation deals with each subject separately, and apart from Section 39, all of the changes are in the Schedules, which are each introduced by the relevant section.

Foreign dividends

Schedule 14 introduces a new Part 9A into CTA 2009, starting at Section 931A running through to S 931W.

New S 921A sets out the basic premise that dividends and other distributions by companies are chargeable to corporation tax as income unless they are exempt, or are distributions which are capital in nature. The exemptions are then dealt with separately for small and non small companies.

A small company is defined in new S 931S as a micro or small enterprise for the purposes of the Annex to the Commission recommendation 2003/361/EC of 6 May 2003. However, the following cannot be small companies :

- Open ended investment companies;
- Authorised unit trust schemes;
- Insurance companies, and
- Friendly societies.

The exemption for small companies is set out as follows :

- The paying company is resident of (and only of) the UK or other qualifying territory at the time the distribution is received;
- The dividend is not of a kind dealt with by para (d) or (e) of section 209(2) ICTA 1988 which deals with certain non dividend distributions;
- No deduction is allowed to a resident of any territory outside the UK in respect of that dividend, and
- The distribution is not made as part of a tax advantage scheme.

A qualifying territory (new S 931B) is a place which has a double taxation agreement with the UK which contains a non discrimination provision, although this definition is capable of being overridden in either direction by order of the Treasury. The term “resident” used here means a company liable to tax in that territory by reason of its domicile, residence or place of management, but not solely in respect of income arising there or capital situated there.

The exemption for non small companies is more complex. New s 931D provides a threefold test :

- The distribution falls into an exempt class;
- The distribution is not of a kind dealt with by paras (d) or (e) of section 209(2 ICTA 1988, and
- No deduction is allowed to a resident of any territory outside the UK in respect of the distribution.

The exempt classes are then listed in Ss 931E to 931I. These are not dealt with in detail here but in outline are as follows :

- S 931E – distributions from controlled companies, with a definition which includes control by the recipient and one other party, both meeting the 40% test in S733D of ICTA 1988.
- S 931F – distributions in respect of non redeemable ordinary shares.
- S 931G – distributions in respect of portfolio holdings (in which the recipient has a less than 10% holding – taking share ownership of each class, distribution of profits

available to shareholders and entitlement to assets in a winding up available to shareholders);
- S 931H – dividends derived from transactions not designed to reduce tax; this introduces the term "relevant profits" and excludes any profits earned from a transaction or series of transactions which were undertaken with the purpose (and to a more than negligible extent, the result) of achieving a deduction in UK tax.
- S 931I – dividends in respect of shares accounted for as liabilities.

There follows a number of anti avoidance rules, which again are not dealt with in any detail here. They are as follows :

- S 931J – schemes involving manipulation of the controlled company rules;
- S 931K – schemes involving quasi preference or quasi redeemable shares;
- S 931L – schemes involving manipulation of the portfolio holdings rule;
- S 931M – schemes in the nature of loan relationships
- S 931N – schemes involving distributions for which deductions are given;
- S 931O – schemes involving payments for distributions
- S 931P – schemes involving payments not on arm's length terms, and
- S 931Q – schemes involving diversion of trade income.

Recipients may elect that an exempt distribution will not benefit from the exemption. The election must be made within 2 years of the end of the accounting period in which the distribution is received. This may be helpful when the Controlled Foreign Companies (CFC) rules are in point, as it will exclude the changes made by this Act from applying in that case.

Finally Section 931W gives priorities where income falls both within new Part 9A and other parts of CTA 2009 :

- Chapter 2 of Part 3 – Income taxed as trading profits - takes precedence over new Part 9A;
- Chapter 3 of Part 4 – Profits of a property business - takes precedence over new Part 9A, but only in relation only to a UK property business, and
- Chapter 1 of Part 12 of ICTA 1988 – taxation of insurance companies takes precedence over new Part 9A.

There are a number of consequential changes, for example to the calculation of double taxation relief.

The change takes effect for distributions paid on or after 1 July 2009, but there are transitional provisions in relation to sections 931H and 931J.

Financing costs and income

Schedule 15 sets out the legislation for the so called "debt cap" which only applies to worldwide groups of companies. If a group is a wholly UK group then these provisions have no relevance. The application of the provisions are therefore dealt with in broad detail only. The legislation applies if the UK net debt of the group exceeds 75% of the worldwide gross debt of the group.

When the legislation applies, some of the financing expenses within the group may be disallowed in computing profits, but in return a similar amount of financing income of UK companies can be exempt from corporation tax, and there is a parallel exemption where the cost of debt finance is not allowable for tax by provisions other than Sch 15 FA 2009. There are anti avoidance rules to accompany the provisions. The change applies in the main to periods of account starting on or after 1 January 2010 but there are transitional and anti avoidance provisions relating to the commencement date.

Controlled foreign companies – acceptable distribution policy

The Controlled Foreign Company (CFC) legislation seeks to impose a charge to UK corporation tax on profits which the legislation deems to have been transferred to a subsidiary based in a tax haven. The legislation includes an exemption when most of the profits have been paid back to the UK as dividends which until FA 2009 would have been taxable in the UK as foreign dividends, thus making the charge under the CFC legislation redundant. This exemption is termed the "Acceptable Distribution Policy" (ADP).

This exemption has now become redundant as any profits repatriated will not now be subject to UK corporation tax as they are likely to be exempt under Sch 14, so the exemption has been abolished. This is achieved by Part 1 of Schedule 16, which includes (at para 7) detailed rules for accounting periods spanning 1 July 2009, which is when the change takes effect.

Controlled foreign companies – special rules for holding companies

The CFC rules also include some exemptions for holding companies, as part of the exempt activities rules, profits of which are not subject to the CFC regime. The exemption has been abolished in relation to ultimate holding companies and non local holding companies, leaving them in place only in respect of local holding companies. This is achieved by Part 2 of Sch 16, commencing on 1 July 2009. There are complex transitional provisions at paras 14 to 17.

Controlled foreign companies – reduction in chargeable profits for certain financing income

Part 3 of Sch 16 makes an adjustment when the CFC rules bite to allow for financing costs which have been disallowed under the debt cap provisions in Sch 15. When the CFC profits include financing income and the corresponding financing expense has been disallowed on the group, an application may be made to reduce the CFC profits by the relevant disallowed amount.

International movement of capital

Sch 17 abolishes the existing rules about movement of capital within and outside Europe, which were previously in Ss 765 to 767 ICTA 1988. The old regime is replaced by a post transaction reporting requirement imposing an obligation to report to HMRC within 6 months of a reportable event. The obligation is placed on UK corporate bodies which are reporting bodies.

Sch 17 sets out the purpose of the report at para 4(3) : to enable HMRC to consider whether the event or transaction results, directly or indirectly, in an advantage for any person in respect of corporation tax, or any other tax or duty. Sch 17 the proceeds with detailed definitions of reporting body and reportable events and transactions, which relate to international movements of capital in excess of £100 million. Reports are required in relation to transactions and events on or after 1 July 2009.

1.12 Losses denominated in foreign currency

Schedule 18 makes the changes to provisions regarding the translation of profits into and from sterling for tax purposes. The provisions are quite long and involved, but essentially require that losses which are either carried forward or back are carried in the reporting currency and re-translated at the point of use, so that the losses and profits against which they are set are translated at the same rate.

Where a company changes its functional (reporting) currency, losses carried across the date of change (either back or forwards) will be converted at the spot rate for the last day of the relevant accounting period. They will then be converted into sterling on the basis set out above.

These changes will apply to accounting periods commencing on or after 29 December 2007, unless an election is made to defer the commencement until the first accounting period commencing on or after Royal Assent to the Finance Act 2009, which is 21 July 2009. Such an election must be made within 30 days after the start of the first accounting period after 21 July 2009, and is irrevocable.

The commencement provisions are quite complex, and cover a variety of situations under which losses incurred post commencement are carried back to periods pre commencement and also losses incurred pre commencement being carried forward to set against profits in periods after commencement. These provisions do not apply if an election is made to defer the commencement date.

1.13 Loan relationships : connected parties

Schedule 20 makes some amendments to the loan relationship regime in Part 5 of CTA 2009. The changes affect connected party situations, and essentially amend the late paid interest disallowance for corporate connected parties.

The amendments remove the disallowance for late paid interest where the connected party due to receive the interest is resident in a qualifying territory. The change applies to a simple connected company debt, but also to the provisions affecting participators in close companies, to the extent that the participator is a company rather than an individual. The late paid interest disallowance therefore remains in place for individual participators in close companies and offshore companies in non qualifying territories. The rule has never applied when both companies are within charge to UK corporation tax as the interest charge will be both taxed and allowed on the same basis.

The change applies to accruals of interest in accounting periods starting on or after 1 April 2009, but a company may elect within the corporation tax return that the first accounting period covered by these rules shall remain on the old basis. This will allow any disallowed interest under the old rules to be paid over and attract a deduction – after which the rules must apply on an accruals basis.

1.14 Release of trade debts

Trade debts are not covered by the loan relationship rules, except to the extent that interest is payable in relation to those debts. The loan relationship rules have been amended to bring the release of trade debts and property business debts within them, so that the release of such debts between connected parties does not create a tax anomaly. For the release of debts on or after 22 April 2009 there is equality of treatment between connected parties, so that there is no tax charge on the beneficiary of the release of the debt, nor is there tax relief on the loss.

1.15 Anti avoidance – transfer of trade to obtain terminal loss relief

This late change to the Act in Section 62 is designed to prevent artificial cessations of trade which are designed to access terminal loss relief. The change introduces a condition as s 393A(2E) ICTA 1988 excluding relief under ibid (2A) if :

- On the cessation, any of the activities of the trade begin to be carried on by a person who is not (or persons all of whom are not) within the charge to corporation tax, and
- The cessation of trade is part of a scheme or arrangement to access terminal loss relief.

This would include the scenario where a company ceases trading and the trade is subsequently carried on by a sole trader or partnership of individuals, but with the motive test should not present a practical problem for smaller businesses now wishing to disincorporate. The availability of the temporary three year loss carry back should in any event present ample relief for small companies, but the £50,000 cap would make terminal loss relief more attractive for larger businesses.

1.16 Corporate intangibles regime

Section 70 makes some changes to the corporate intangibles regime in relation to goodwill, in response to claims by some companies in respect of what HMRC believes is excluded expenditure.

The definition of an intangible asset is expanded to include internally generated intangible assets, and the reference to goodwill is amplified by including internally generated goodwill. Further clarification is provided by new s 715(4) which states that goodwill is treated as created in the course of carrying on the business in question.

There is then some slight amplification of the “pre 2002” rule, which previously stated that “internally generated goodwill is treated as created before (and not on or after) 1 April 2002 if the business in question was carried on at any time before 1 April 2002 by the company or a related party.” This has been amended to remove the term internally generated, so that it covers all goodwill, and by the addition of “on or after 1 April 2002 in any other case”. Similar changes are made to the same legislation dealing with internally generated assets.

The legislation commenced on 22 April 2009 and is treated as always having had effect. The consequence of this is that no further deductions would be allowed in respect of pre 2002 goodwill acquired from a related party before 22 April 2009, but previous deductions are not reversed.

1.17 Corporation tax anti avoidance measures

Anti avoidance legislation considered too specialist to cover within these notes is as follows : (Most of these are a reaction to disclosed avoidance schemes)

- Section 43 and Schedule 21 relating to exchange gains and losses arising from loan relationships and derivative contracts;
- Section 58 and Schedule 29 relating to manufactured overseas dividends;
- Section 61 and Schedule 30 relating to financial arrangements avoidance (also affects income tax);
- Section 63 and Schedule 31 relating to sale of lessor companies;
- Section 64 and Schedule 32 relating to leases of plant and machinery (mainly long funding leases);
- Section 65 and Schedule 33 relating to long funding leases of films, and
- Section 66 and Schedule 34 relating to Real Estate Investment Trusts.

1.18 Other business tax changes not dealt with

Some of the other changes made by the Act are also too narrow in nature to be dealt with in a general course. The areas not covered by these notes are :

- Changes to the tax regime affecting insurance companies; (Ss 46,47, Sch 23);
- Changes in duty rates on alcohol, fuel, gambling, vehicle excise, air passenger duty and landfill tax; (Ss 11- 22, Schs 4 & 5);
- Simplification of the taxation of disguised interest for companies, bringing returns within the loan relationship scheme (replacing piecemeal anti avoidance measures) (s 48, Sch 24);
- Sale or disposal of an income stream – new legislation to bring a principles based approach to the sale of a future right to income without disposal of the underlying

asset, bringing the proceeds within the charge to tax on income rather than capital gains (s 49, Sch 25);

- Save as You Earn Schemes – simplification of the administrative arrangements for SAYE schemes, but no changes to the principles underlying the legislation (s 50, Sch 26);
- Amendments to the operation of the “mixer cap” to companies necessitated by the recent reduction in the main rate of corporation tax (s 57);
- Payments between companies for foreign tax – limiting the double tax relief to recognise the payment (s 59);
- Anti fragmentation – affecting double taxation relief for banking groups (s 60)
- Changes to the oil taxation regime (ss 84 – 91 and Schs 38 to 45)
- Changes to gaming duty (ss114 – 116)
- Changes to climate change levy (ss 117 -118 & Sch 59)
- Changes to landfill tax (s 119 and Sch 60)

1.19 Changes not included in FA 2009

1.19.1 Furnished holiday lettings

The furnished holiday lettings regime provides a number of distinct tax advantages to businesses, including trading loss relief, capital allowances, CGT reliefs (including Entrepreneurs’ relief) and possibly IHT BPR. As a result of EC issues, the relief has been extended to properties in the EEA, and this extension is retrospective. However, the FHL rules will be withdrawn with effect from April 2010, but no detail of the legislation effecting this change is currently available.

1.19.2 Charities – substantial donors

Special rules apply to charities which receive substantial donations from individuals to prevent abuse of the Gift Aid regime. The definition of a substantial donor is two fold, and looks both at the cumulative value of gifts in a total of six tax years, and large individual gifts.

The cumulative six year limit has increased to £150,000 (from £100,000) in relation to donations on or after 23 April 2009. The single gift limit of £25,000 is unaffected.

2 PERSONAL INCOME TAX

Lecture P553 (15.03 Minutes)

2.1 Tax rates and bands

Lecture P551 (14.01 Minutes)

Section 1 confirms that the basic rate of income tax for 2009/10 is 20% and the higher rate 40%. Section 2 overrides the statutory indexation of the basic rate band limit, replacing it with a figure £800 higher than would otherwise have been the case. This follows through an announcement made in Gordon Brown's last Budget in 2007.

Table : income tax bands and rates 2008/09 and 2009/10

	Upper limit	
	2008/09	**2009/10**
Savings starting rate 10%*	£2,320	£2,440
Basic rate 20%	£34,800	£37,400
Higher rate 40%	N/A	N/A

*Only applies if the taxable non savings income is below the limit shown.

Section 6 introduces the new 50% rate of tax, which will apply in 2010/11. The 50% rate will be known as the "additional rate", while 40% continues to be referred to as the higher rate. Schedule 2 makes a number of consequential changes in relation to the additional rate.

The additional rate will apply to taxable income of more than £150,000. The dividend rate within this band will be 42.5% (known as the dividend additional rate); this is an effective rate of 36.11% on the net dividend.

The rate applicable to trusts will similarly change to 50%, with a trust dividend rate of 42.5%. Pension tax charges are also expected to be made at 50% rather than 40%, but the legislation (in Sch 2 Part 2) presently only provides that the rate applicable to a variety of taxable pension events may be varied by Order.

2.2 Personal allowances

Section 3 over-rides statutory indexation to bring the main personal allowance (applicable to those aged under 65) to £6,475.

Table : Personal allowances 2008/09 and 2009/10

	2008/09	**2009/10**
Personal allowance	£6,035	£6,475
Personal allowance age 65 – 74	£9,030	£9,490
Personal allowance age 75 and over	£9,180	£9,640
Married couples allowance age 74	£6,535	N/A
Married couples allowance age 75 +	£6,625	£6,965
Married allowance – minimum	£2,540	£2,670
Income limit: age related allowances	£21,800	£22,900
Blind person's allowance	£1,800	£1,890

Section 4 makes the necessary changes in preparation for the planned abatement of the personal allowance for those with income of more than £100,000. The change will commence in 2010/11 and will apply to those with "adjusted net income" of £100,000. At this level, the personal allowance will be reduced by £1 for every £2 of income until the allowance is removed completely. The adjusted net income is calculated in the same way as for the abatement of the age allowance, by deducting losses from gross income and then deducting the grossed up pension premiums and gift aid payments. Pension contributions made gross are also deducted.

Where a taxpayer entitled to age related personal allowances has adjusted net income in excess of £100,000, the normal age related abatement will be made at the age allowance income limit, and the allowances will be further abated when income reaches £100,000, so those entitled to age related allowances are treated in the same way as other taxpayers.

This makes the payment of pension contributions in 2010 onwards particularly tax efficient as follows : (using current year rates and allowances)

		£
Gross income		110,000
Personal allowance		
Maximum amount	6,475	
Abatement	(5,000)	(1,475)
Net taxable income		108,525
Tax at basic rate		7,480
Tax at higher rate		28,450
Total tax liability		**£35,930**

	£
Gross income	110,000
Less pension contribution	(10,000)
Net adjusted income	100,000
Personal allowance	6,475
Net taxable income	93,525
Tax at basic rate	7,480
Tax at higher rate	22,450
Total tax liability	**£29,930**

Tax saved by pension contribution£6,000

Personal allowances and reliefs are also to be abolished for certain non residents. This is dealt with by Section 5 and Schedule 1. Where a non resident taxpayer is entitled to personal allowances ONLY by virtue of being a Commonwealth citizen, then from 6 April 2010 their personal allowances and reliefs are withdrawn. Many of those who could be affected by this are in reality granted personal allowances under the terms of a double taxation treaty, so there are expected to be few who are directly affected by this. The following nationals are likely to be the only ones affected :

- Bahamas;
- Cameroon;
- Cook Islands;
- Dominica;
- Maldives;
- Mozambique;
- Nauru;
- Niue;
- St Lucia;
- St Vincent & the Grenadines;
- Samoa;
- Tanzania;
- Tonga; and
- Vanuatu

2.3 Pensions limits

The pensions limits for 2009/10 are as follows – as announced in 2004 when the legislation was introduced :

	2008/09	2009/10
Annual allowance	£235,000	£245,000
Lifetime allowance	£1,650,000	£1,750,000

The allowances will rise again next year, again as previously announced. It was announced in the 2009 Budget that the allowances will then be frozen for a period of five years.

2.4 Venture capital investment schemes

Section 27 introduces Schedule 8 which makes a number of improvements to venture capital investment schemes to make them more attractive to investors.

2.4.1 Enterprise Investment Scheme (EIS)

The restrictions over the carry back of EIS investments to the preceding tax year have been removed. Carry back of an amount invested to the preceding year is permitted in respect of any amount invested in a year, with the only restriction being that the maximum relief in any year will be subject to the investment limit, which is currently £500,000. This change applies in relation to shares issued in the tax year 2009/10 and subsequent years. (para 6 Sch 8)

The time period allowed for investment of the funds raised for the purposes of a qualifying trade has been amended to provide that all of the money be employed within two years of the issue of the shares, or if later within two years of the commencement of the qualifying activity (para 7). This change applies to investments made on or after 22 April 2009, and the change had also been reflected across into TCGA deferral relief by paras 2 and 3).

Para 4 amends the CGT legislation to correct an anomaly which arose when a share for share exchange of EIS shares takes place. This will ensure that only deferral relief is recovered, but that no other gains arise (as would be usual in a share for share exchange). This applies to share for share exchanges where the new shares are issued on or after 22 April 2009.

2.4.2 VCT and CVS

The changes to the rules about investing the funds raised in a qualifying activity also apply to monies raised through the Venture Capital Trust (VCT) scheme, and the Corporate Venturing Scheme (CVS). Para 8 makes the amendment in respect of CVS and para 9 in respect of VCT. The rules now require that all of the funds raised are employed in a qualifying activity within 2 years. The change applies to investments made on or after 22 April 2009 for CVS and to funds raised by VCT's on or after 22 April 2009.

2.5 Financial services compensation scheme

Section 33 makes the changes necessary to ensure that payments under the Financial Services Compensation Scheme (FSCS) which represent interest are to be treated for all purposes as if they were interest.

Where paid "net of income tax" (which may be a notional rather than an actual deduction) the amount treated as income is the amount of the payment plus the tax notionally deducted, and the tax credit is taken into account in determining the amount of tax due by the recipient.

This change applies with effect from 6 October 2008, in relation to payments made on or after that date.

2.6 Taxation of offshore fund distributions

The income distributed by offshore funds is normally classed as a dividend. Section 39 provides that certain distributions will be taxed as interest rather than a dividend. Section 40 and Schedule 19 then provide that any distributions which remain to be taxed as such will attract a non repayable tax credit of one ninth.(See para 2.7)

The distribution by an offshore fund is to be taxed as interest when the fund fails to meet the qualifying investments test at any time in the relevant period. This test is failed if the market value of the fund's qualifying investments (interest bearing investments) exceeds 60% of the assets of the fund excluding cash awaiting investment.

2.7 Taxation of foreign dividends

Schedule 19 widens the availability of a tax credit on non UK dividends introduced last year to include almost all foreign dividends, including those from offshore funds which were previously excluded. The tax credit was previously only available to holders of less than 10% of the shares.

The tax credit will be available if one of the following conditions is met :

A. The relevant distribution is made by a company with share capital and at the time the person receives the dividend he is a minority shareholder in the company,
B. The company that makes the relevant distribution is an offshore fund, or
C. The company that makes the distribution is a resident of a qualifying territory at the time the relevant distribution is received and the distribution is not part of a tax avoidance scheme.

The definition of qualifying territory follows the established definition used elsewhere in the Act. The change applies to distributions on or after 22 April 2009.

2.8 Tax treatment of participants in offshore funds

Schedule 22 sets out a new definition for offshore funds, which have been subject to some modernisation through FA 2009. The Schedule then sets out a new TCGA treatment for participants in certain offshore funds.

An offshore fund is :

- A mutual fund constituted by a body corporate resident outside the UK;
- A mutual fund under which property is held on trust for the participants where the trustees of the property are not resident in the UK, or
- A mutual fund constituted by other arrangements that create rights in the nature of co-ownership where the arrangements take effect by virtue of the law of a territory outside the UK.

The change to the CGT treatment deems the fund (which is not constituted by a company) to be treated as a company and the participants in the fund to own the notional shares in the company. This will replace the previous CGT treatment when the participants were treated as owning the underlying assets of the fund. They will now only be liable to CGT on changes in the ownership rights of the fund, and not on changes in the underlying asset base.

2.9 Remittance basis – minor amendments

Section 51 and Schedule 27 make some minor changes to the remittance basis, largely based on comments from those advising on the legislation over the last year since it was introduced. Points to note are :

- An individual automatically entitled to the remittance basis on the grounds that his unremitted income and gains are less than £2,000 is not required to file a tax return to establish that fact;
- Where UK tax is less than the tax retained on Gift Aid and a tax charge arises, any income covered by the charge (levied under s 424 ITA 07) is excluded when nominating foreign income and gains to be covered by the remittance basis (ensuring that a double charge to tax does not arise on that income);
- If an individual's UK income and gains are less than £100 in taxed investment income only, they may access the remittance basis without making a claim, again keeping these cases out of self assessment, as they are further not required to file a tax return to access the remittance basis;

There are also some anti avoidance changes in the definition of a "relevant person", and in the treatment of assets remitted which are part of a set.

Section 52 introduces a new exemption from the remittance basis rules. This provides an exemption for those with employment income in the UK (which is subject to tax in the UK). If they also have foreign earnings of less than £10,000 taxed at home, and a small amount (no more than £100) of unremitted foreign income which has been subject to foreign tax, and have no other foreign income or gains, and further if they have a liability to UK tax at either basic or starting rate (ignoring the foreign earnings), and no other reason to file a tax return, then the remittance basis will not produce a tax charge on them, and they will have no need to file a tax return to deal with it.

All of these changes apply to 2008/09, so have been backdated to the start of the new remittance basis legislation.

2.10 Tax on company cars

Section 53 introduces Schedule 28, which gives advance changes to the benefit in kind charge on company cars for 2011/12.

- The cap on list price of £80,000 will be abolished, meaning that those with very high value benefit in kind cars will pay more tax on them as a result;
- The lower threshold to which the 15% rate of benefit applies will be reduced from the 2010 level of 130g/km to 125g/km (it is currently 135g/km).
- Discounts for alternative fuel vehicles will all be abolished (although the Finance Act makes no changes to effect this at present – the discounts appearing in secondary legislation), and replaced by a single new rate of 9% applying to electrically propelled cars registered from 1998 onwards.

Section 54 amends the calculation of list price of a car for a disabled driver (who is a holder of a blue badge). The list price is taken as the list price (or notional list price) of an equivalent model with manual transmission when the driver's disability means that he is required to use an automatic car. This brings the computation of list price in line with the CO2 basis which already recognises this need. The change takes effect from 2009/10.

2.11 Benefit in kind of health screening or medical checkups

In 2007, HMRC used regulatory powers to bring a concession regarding benefit in kind of medical checkups and screening into legislation. However, the Regulations made did not completely reflect the non statutory exemption and there was much confusion. In the interim, HMRC announced that no benefit in kind charge would arise in 2007/08 or 2008/09 on provision of health screening and check ups that would have been exempt under the concession.

Finance Act 2009 now resolves the situation for 2009/10 onwards by providing primary legislation to amend ITEPA 2003 as follows :

Section 55 inserts new S 320B into ITEPA which states that no liability to income tax arises in respect of the provision for an employee, on behalf of the employer, of a health screening assessment or medical check up.

The exemption is qualified to limit it to one health screening in a tax year provided by any one employer or number of persons who are employers of the employee at the same time (so two check ups – the second following a change of employment would still be exempt).

- Health screening assessment is defined as and assessment to identify employees who might be at particular risk of ill health, and
- Medical check up means a physical examination of the employee by a health professional for (and only for) determining the employee's state of health.

Section 55 makes similar changes to section 266(3) ITEPA which deals with the benefit arising through the provision of non cash vouchers, and s 267(2) which deals with provision by way of credit token. Such a provision will remain taxable if the employee pays for it and is reimbursed by the employer as no exemption has been introduced into s 336.

2.12 MEP's pay and allowances

Section 56 makes two changes to the taxation of MEP's for 2009/10 onwards:

- Double taxation relief will now be available in respect of EC tax deducted from MEP's pay, allowances and pensions, and
- Transitional allowances paid to MEP's under Article 13 of the Statute for Members of the European Parliament (transitional allowances) will be taxed as termination payments under S 291(2)(c) ITEPA 03.

2.13 Anti avoidance : Benefit in kind on living accommodation

Where living accommodation provided to an employee is rented by the provider the benefit in kind charge is the amount of rent paid. This rule has been manipulated by the payment of substantial lease premiums on the property, keeping the residual rent low, and thus reducing the benefit charge.

Section 71 now changes the taxation of benefit in kind rules in relation to living accommodation by recognising lease premiums. The change deems any lease premium paid in respect of a lease term of 10 years or less to be additional rent for the purpose of the benefit in kind charge. The tax charge will therefore be the rent actually paid by the provider, plus the lease premium spread over the life of the lease (less any amounts made good by the employee). The legislation also covers leases with break clauses and premiums in Scotland which may be termed "grassum".

The change applies to leases entered into or extended on or after 22 April 2009.

2.14 Pensions – limiting tax relief for the high paid

Lecture P552 (14.26 Minutes)

From April 2011, pension relief for then higher paid will be restricted so that ultimately they only benefit from basic rate relief on their premiums. The restriction will commence at £150,000 at the point the 50% rate of income tax bites, but will gradually taper tax relief on the contributions so that at £180,00 of income the relief obtained is 20%. However, the legislation to implement this change has not yet been prepared, and in the meantime Government has been concerned to prevent affected taxpayers from accelerating payments into the regime applying presently to maximise current relief.

Section 72 therefore introduces Schedule 35 which creates the new (temporary) special annual allowance charge which will apply during 2009/10 and 2010/11 until the change described above commences.

2.14.1 Overview

The special annual allowance charge is modelled on the annual allowance change in the existing legislation. The main points are as follows :

- The charge will only apply to those with “relevant income” in the relevant year of more than £150,000, although if income in either of the two preceding years exceeds this limit the individual is within the legislation, in order to prevent them manipulating their income downwards in the two affected years;
- Affected individuals will always be able to contribute £20,000 to a pension in 2009/10 and 2010/11 irrespective of their past history of contributions;
- Affected individuals will be able to continue to make pension contributions equal to the amount they have previously contributed by way of regular contributions under contracts which commenced before 22 April 2009;
- Those who have made annual or other irregular (less often than quarterly) contributions will be limited to either the average of their last 3 years contributions or £30,000, whichever is lower (but subject always to £20,000 minimum);
- Contributions by employers to defined contribution schemes are included in the pension input amount which is tested against the limits;
- Contributions to defined benefit arrangements are not tested, but enhancement of benefit is the measure of “pension input amount” used for the legislation;
- Pension inputs are not liable to both the annual allowance charge and the special annual allowance charge – the annual allowance charge takes precedence, as it is calculated at 40%;
- The tax charge arises on any excess contribution at a rate of 20% in 2009/10; this is likely to increase to 30% in 2010/11, and
- The tax will be collected through the self assessment system.

2.14.2 Technical summary

Schedule 35 para 1 sets out the basis of the special annual allowance charge, which is a charge to income tax arising when the “total adjusted pension input amount” for a tax year in the case of a “high income individual” who is a member of one or more registered schemes exceeds the amount of the “special annual allowance”. Each term in quotes is defined in the legislation.

The charge arises at 20% on the amount by which the total adjusted pension input amount exceeds the special annual allowance.

Definitions

A **high income individual** is an individual who has “relevant income” of £150,000 or more in the year, or in either of the preceding two tax years;

The **special annual allowance** is £20,000, but is amended in the case of irregular contributions (see below).

Relevant income is defined as

- Step 1 total income for the year
- Step 2 add any deductions made from employment income under s 193(2) FA 2004 or parallel legislation in ITEPA 2003. These are deductions made in arriving at total income in relation to net pay arrangements, and the deduction is reversed by step 2;
- Step 3 deduct reliefs other than for pension contributions permitted under section 24 ITA 2007, which covers relief against total income for various losses;
- Step 4 deduct the aggregate amount of any relevant contributions up to a maximum of £20,000;
- Step 5 add back any salary sacrifice scheme entered into after 22 April 2009 in favour of pension contributions
- Step 6 deduct gift aid deductions (gross amount) including payments brought back from the subsequent year.

Any scheme or arrangement which is designed to reduce income to below the limit will result in the deeming of £150,000 in any event.

Relevant contributions are contributions paid in the tax year which are either relievable contributions, contributions in respect of which the individual is entitled to a tax reduction under s 788 ICTA 1988, and contributions paid by the individual for which a deduction is given under Chapter 2 of Part 5 of ITEPA 2003.

Total adjusted pension input amount

This is calculated in the same way as for the normal annual allowance test with some amendments. The starting point is the total pension input amount as defined by ss 229 to 237 of FA 2004, and thus includes all pension savings that receive UK tax relief as follows :

- savings in all registered pension schemes including
    - defined benefit schemes, and
    - money purchase schemes (also known as defined contribution schemes);
- contributions paid both by individuals and anyone on their behalf and by employers, and
- savings in non-UK pension schemes that benefit from UK tax relief.

The rules in Ss 229 to 237 of FA 2004 are modified as follows :

- Use tax year basis not pension input period (para 5)
- Pension input amounts in year in which benefits are taken are *included* (para 4) with two exceptions :
    - Defined benefit pension arrangement with more than 20 active members, and not part of a scheme to avoid pension tax charges, (see para 4(2)) or
    - Occupational, public service arrangements and group personal pension schemes when retirement is due to ill health and not part of a scheme to avoid pension tax charges. (para 4(3))

From the total pension input amount as calculated above, deductions are then made for :

- “Protected pension input” amounts;
- “Relevant refunded amounts”, and
- Any pre 22 April 2009 pension input amount.

These three deductions allow relief for regular pension contributions and contributions made before Budget day, at which point the contributor was not aware of the impact of the legislation. However, in both cases the amount so deducted from the pension input amount is also deducted from the annual allowance, reducing the permitted level of contributions. Relevant refunded amounts are provided for by the legislation and arise when an individual has fallen foul of Sch 35 and decides to reverse the contributions and have them repaid, thus reversing the tax effect – this can be done in the following tax year (see below).

Protected pension input amounts

The definition of protected pension input is quite complex as it provides separately for the following types of existing arrangement :

- Defined benefit arrangements – where the measure is one of increased benefit entitlement post April 2009 rather than amounts contributed (which are driven by actuarial valuation) (para 8)
- Cash balance arrangements (para 9)
- Other money purchase under occupational and public service schemes (para 10)
- Hybrid arrangements (para 11)

It also deals with new and re-activated arrangements – this will largely cover situations where there is a change in group pension arrangements or a member re-starts contributions to an existing pension arrangement.

For members of defined benefit occupational schemes any increase arising only due to a pay rise or a promotion will be protected pension inputs. For those in a final salary arrangement, all contributions will be a protected pension input provided that the way benefits are calculated under the scheme does not change on or after 22 April 2009. If there is a material change in the rules under which benefits are calculated the amount will still be protected pension input if it affects at least 50 active members of the scheme. The rules on increased benefit entitlement and the corresponding input amounts are in FA 2004.

For a money purchase arrangement, and for AVC’s in other arrangements including defined benefit schemes the protected pension input will be:

- the annual amount of total contributions (including any employer contributions) to the arrangement providing that the contributions are payable under an agreement dated before 22 April 2009 under which payments are to be made at least quarterly, plus
- any increase in contributions that was agreed before 22 April 2009.

The anti avoidance rules prevent any amount from being protected pension input if the individual is party to a scheme whose purpose is to avoid or reduce the special annual allowance charge, the annual allowance charge or the lifetime allowance charge.

Refunds of contributions

In certain circumstances, individuals can ask their scheme for a refund of their contributions, depending on the type of contributions they have made. Trustees of schemes will need to decide whether or not they want to offer this option, but the scheme must deduct tax before any contributions are refunded. Any refund will be paid as a lump sum and can only be paid in the year after the contributions were made, and is referred to as a relevant refunded amount, being deducted in the computation of total adjusted pension input amount.

Refunds will be due only in the following circumstances:

- The contributions must have been paid by the individual, who is a high earning individual (as defined), and
- The contributions were non regular contributions paid to personal pension schemes (including such schemes as retirement annuity contracts) and AVCs paid into occupational schemes, and do not benefit from protected pension input status.

The member will already have been entitled to tax relief at their marginal rate on any contributions being refunded. The tax deducted from the refund is therefore designed to recoup the rate of tax relief given on these contributions. For contributions paid in 2009-10, tax will be deducted from refunds at 40%. Any special annual allowance charge already declared on a tax return in respect of these contributions would have to be amended. Para 18 of Sch 35 ensures that the refunded amount is not subject to the unauthorised payment rules, which would potentially trigger scheme sanction charges and other unwanted tax effects.

There is an issue for those whose employer contributions to defined contribution and cash balance schemes exceed the special annual allowance for the year, as it is not possible for these to be relevant refunded amounts and it is unlikely that the employer can recoup the contributions, leaving the employee with a tax liability.

Increased special annual allowance

The legislation was amended during report stage to provide more relief for those affected by the legislation who had previously only paid annual or other irregular contributions, who therefore do not benefit from the protected pension input rules.

If an affected individual, or his employer has made irregular pension contributions (less regular than quarterly) then find the mean contribution (capped at the annual allowance) for 2006/07, 2007/08 and 2008/09 is computed (i.e. sum the three years and divide by 3). If this exceeds £20,000 then the special annual allowance is the lower of :

- The mean contribution so calculated, and
- £30,000.

2.14.3 Practical approach

If you consider that clients may be affected by these rules, the approach to take is as follows :

STEP 1 – perform income test to determine whether rules in play

STEP 2 – calculate “total pension input amount” as defined above

STEP 3 – calculate “adjusted pension input amount” by deducting :

- Protected pension input amounts,
- Relevant refunded amounts and
- In 2009/10 pension inputs prior to 22 April 2009.

STEP 4 – compute the special annual allowance by adjusting either £20,000 or the amount arrived at for irregular contributions by any protected pension input amounts and pre 22 April 2009 inputs

STEP 5 - compare the “adjusted pension input amount” from **STEP 3** with the special annual allowance from **STEP 4**

The excess is subject to tax at 20%.

This amount is known as the special annual allowance charge. The excess contribution is not treated as income, but the charge arises under step 7 of the tax computation for an individual (see s 23 ITA 2007). This is the last step in determining an individual's income tax liability for a year and is the step where any claw back of gift aid tax would arise, in addition to other pension tax charges. The 2009 tax return will include relevant boxes for making the disclosure.

2.14.4 Advice

If clients have already exceeded the income limit in 2007/08 or 2008/09 then there is little that can be done to avoid the charge except careful consideration of the pension contributions made by the client and his employer. If the income rule has not been exceeded, then care should be taken to consider carefully any dividends, bonuses etc which may be under the control of the individual.

Note that as the contributions paid by the employer are not treated as income under these rules, and individual with consistent income of £100,000 could have contributions of £200,000 per annum paid by his employer without triggering a tax charge on him. This may not be the case once the new regime starts in 2011 – it is not possible to comment at this point in the absence of any detailed information.

The rules will be amended in 2010/11 to increase the tax charge to 30% when the tax rate of 50% is introduced, so it is better to trigger a charge in 2009/10 than 2010/11 if one is to trigger at all.

The effect of an employer making an excessive contribution is particularly punishing because it is not generally possible to refund this amount to avoid the tax charge, nor is any deduction made from gross income for the contributions. The tax charge falls on the employee concerned, who may not be in funds to pay it.

Payment of a gift aid donation in the following year and carrying back can be particularly tax efficient, and will deal with increases in income to just over £150,000 but only where the two preceding years do not exceed that amount .

Example	**£**
An individual has the following :	
Income	172,000
Pension contributions – regular (£4,000 per month)	48,000
Extra contributions in 2009/10	25,000
Special annual allowance charge computation	
"Relevant income" is	172,000
Less pension contributions but maximum	(20,000)
	£152,000
Pension input amount	48,000
	25,000
	73,000
Less : protected pension inputs	(48,000)
Adjusted pension input	25,000
Special annual allowance	20,000
Less protected pension inputs	(48,000)

Adjusted special annual allowance	NIL

Special annual allowance charge arises on

Adjusted pension input – special annual allowance =	25,000
Tax at 20%	£5,000

Planning advice

Pay a gift aid donation of £1,650 in 2010/11 and elect to carry back :

Relevant income above	152,000
Less Gift aid (gross amount)	(2,063)
Relevant income	149,937

So the special annual allowance rules do not apply (provided the income does not exceed £150,000 in either of the two preceding years).

Tax saving : Higher rate liability (on gross gift)	413
Tax on special annual allowance charge	5,000
Total tax saved	5,413

Net cost of donation = £1,650 - £5,413 = £(3,763)

2.15 Occupational pensions – financial assistance scheme

Where the Financial Assistance Scheme (FAS) steps in to take over pension liabilities in an insolvent scheme, section 73 introduces amendments to tax law to ensure that payments are treated as if they were made by a registered pension scheme for all tax purposes. Similar changes are effected by section 74 in relation to the Financial Services Compensation Scheme in connection with pension arrangements.

2.16 Income tax anti avoidance legislation

Anti avoidance legislation developed in response to disclosed schemes which is not of sufficient interest to cover in detail in these notes is as follows :

- Section 61 and Schedule 30 relating to financial arrangements avoidance (also affects corporation tax);
- Section 67 – deductions for employee's liabilities concerning manipulation of the allowance for payment of a liability of an employee in s 346 ITEPA 2003 by contriving deliberate defaults (taking effect from 12 January 2009);
- Section 68 – the claiming of employment losses against general income, which is linked to schemes closed down by s 67 – when the deduction is claimed it can result in an employment loss, which is then set against general income. There is a motive test to protect claims which do not arise from avoidance (also taking effect 12 January 2009);
- Section 69 – excluding loss relief from offshore life policies, life annuities and capital redemption policies;

3 VAT CHANGES

Lecture B554 (17.11 Minutes)

3.1 Standard rate

Section 9 confirms that the standard rate of VAT will revert to 17.5% on 1 January 2010. The current legislation lasts only for 12 months as this is the time permitted when the change is made by secondary legislation (as was the case in November when the rate was reduced

3.2 Change in rate – anti avoidance

Schedule 3, which is introduced by section 9 includes anti forestalling legislation to prevent businesses which suffer a VAT input tax block from manipulating supplies forward to the period when the 15% standard rate applies.

Schedule 3 essentially imposes a supplementary charge to VAT in relation to supplies treated as made on or after 25 November 2008 when certain conditions are present. The charge is made if :

- The supply spans 1 January 2010;
- The supply is liable to the standard rate of VAT;
- The supply is made to a person who cannot obtain full credit or repayment of all of the VAT that he bears (this would cover both partially exempt and un registered businesses, and members of the public), and
- A “relevant condition” is met.

The supplementary charge is treated for all purposes as VAT charged on the supply.

The schedule then provides various detailed definitions explaining the “relevant conditions” in two separate sets of circumstances :

- Para 2 deals with a supply of good or services, and
- Para 3 deals with a grant of a right to goods or services.

3.2.1 Supply of goods or services

The supply is treated as spanning the date of change of rate when :

- By virtue of the operation of the taxpoint rules the date of the supply is before the date of change (through the issue of a tax invoice or receipt of payment), but
- The basic time of supply (normally the date the goods are supplied or the services performed) is after 1 January 2010.

This will clearly prevent advance invoicing or payment from creating a VAT saving, but each must meet the “relevant conditions” for the supplementary charge to apply. Where the taxpoint is fixed by early issue of the tax invoice, there are four relevant conditions – A to D, and where the taxpoint arises through receipt of payment the conditions are A to C.

Conditions :

A. The supplier and recipient of the supply are connected with each other at any time between the day on which the supply is treated as being made and 1 January 2010.
B. The aggregate value of the supply and all related supplies is in excess of £100,000;
C. The prepayment (advance payment – not debtor) for the supply is financed by the supplier or a connected person, and
D. The full payment for the amount on the VAT invoice is not due within 6 months of the date of issue of the invoice.

There are similar provisions in relation to the grant of a right to goods or services which are not dealt with in detail here – the detail is in para 3 of Schedule 3.

The supplementary charge does not apply to the letting or hiring of assets provided the advance amount is for no longer than 12 months, and any invoice issued or payment received is in accordance with normal commercial practice. There is also no charge when condition B (connected persons) is met and all other aspects of the supply, including invoicing and payment terms are in accordance with normal commercial practice.

The supplier is liable to the supplementary charge to VAT, which is due on 1 January 2010 rather than at the time of the supply, but in relation to supplies which are a grant of a right to a good or service, the charge is due on the first exercise after 1 January 2010. The amount of the charge is the difference between the VAT charged and the charge at 17.5%. Where the actual supply (the delivery of the goods or the performance of the services) spans 1 January 2010 then the consideration is apportioned on a just and reasonable basis so that only the supplies actually made after 1 January are liable to the supplementary charge.

Part 4 of the Schedule deals with what are termed “listed supplies”, for which special “basic time of supply” rules are set out within the Schedule rather than using the normal basic taxpoint rules. Listed supplies comprise the following :

- Supplies of services;
- A supply arising from a grant of a major interest in land;
- Supplies of mains water;
- Supplies of coal gas, producer gases and similar and petroleum gases;
- Supplies of power, heat, refrigeration or ventilation;
- Supplies of goods together with services in the course of the construction alteration, demolition, repair or maintenance of a building or civil engineering work.

Generally, the basic time of supply in relation to all of these supplies is the end of the period covered by the invoice or prepayment. If the supply relates to a premium due on the grant of a lease or tenancy the basic time of supply is the date of the grant.

3.3 Place of supply of services

The new rules on intra community supplies of services will come into force on 1 January 2010, as a result of an EC wide alignment of the VAT rules. This has necessitated a number of involved changes to the VAT place and time of supply rules, and will also entail suppliers of cross border EC services making EC Sales list reports from 1 January 2010. The changes are mainly in Sch 36, which is introduced by section 76.

3.3.1 Basic place of supply rule

Para 4 of the Schedule introduces a new section 7A, entitled “Place of supply of services” into VATA 1994.

A supply of services is made :

- In the case when the recipient of the services is a relevant business person, in the country in which the recipient belongs, and
- Otherwise in the country in which the supplier belongs.

A supply of a right to services, including any option or priority with respect to the services is supplied in the place where the supply of the services would be made.

A relevant business person is a person who is

- A taxable person within the meaning or Art 9 of Council directive 2006/112/EC;
- Is registered for VAT;
- Is identified for VAT in accordance with the law of a member state other than the UK, or
- Is registered under an Act of Tynwald for the purposes of any tax imposed by or under an Act of Tynwald which corresponds to value added tax,

and who receives the services otherwise than wholly for private purposes.

The reverse charge on services received from abroad legislation is then amended. It now requires a reverse charge to be accounted for by the recipient of a supply of services (as if he had made a supply of those services) when the supply is made by a person outside the UK to a recipient who is a relevant business person belonging in the UK and the place of supply of those services is the UK. However, this provision does not apply to any of the services listed in Sch 9 to VATA 1994.

3.3.2 Belonging

Section 9 of VATA 1994 is replaced in its entirety. This covers the "belonging rule", and now provides the following rules to determine where either the supplier or the recipient of a service belongs.

A relevant business person is treated as belonging in the relevant country. This means :

- If the person has a business establishment, or some other fixed establishment in a country and none in any other country, that country;
- If a person has business establishments or other fixed establishments in more than one country, the country in which the relevant establishment is (that is, the establishment most concerned with the supply or receipt of the services), and
- Otherwise the country in which the person's usual place of residence is.

A person who is not a relevant business person is treated as belonging in a country in which their usual place of residence is – this would include VAT registered individuals acting in a wholly private capacity.

3.3.3 Special rules

As under the existing rules, there are special rules affecting the place of supply, depending on what the nature of the supply is. These are now dealt with by new Schedule 4A VATA 1994, introduced by para 11 of Sch 36.

Services relating to land

This rule follows the existing rule by placing the supplies in the country in which the land is situated. Para 1(2) sets out the services affected by this rule as follows :

(a) the grant, assignment or surrender of any interest in or right over land,
(b) the grant, assignment or surrender of a personal right to call for or be granted any interest in or right over land,
(c) the grant, assignment or surrender of a licence to occupy land or any other contractual right exercisable over or in relation to land (including the provision of holiday accommodation (including beach huts, chalets, caravan, houseboat or tent held out as holiday accommodation or suitable for holiday or leisure use), seasonal pitches for caravans and facilities at caravan parks for persons for whom such pitches are provided and pitches for tents and camping facilities),

(d) the provision in an hotel, inn, boarding house or similar establishment (whether with or without the provision of facilities) of sleeping accommodation or of accommodation in rooms which are provided in conjunction with sleeping accommodation or for the purpose of a supply of catering,
(e) any works of construction, demolition, conversion, reconstruction, alteration, enlargement, repair or maintenance of a building or civil engineering work, and
(f) services such as are supplied by estate agents, auctioneers, architects, surveyors, engineers and others involved in matters relating to land.

Passenger transport

The transport of passengers (or luggage and motor vehicles accompanying passengers) is treated as being made in the country where the transportation takes place and in the case of more than one country, in proportion to the distances covered in each. However, transport which takes place outside the territorial jurisdiction of a country takes place wholly in that country if :

- it takes place in the course of a journey between two points in the country (whether or not as part of a longer journey involving travel to or from another country), and
- the means of transport used does not stop (except in emergency) or put into land in another country in the course of that journey.

A pleasure cruise is regarded as transport of passengers and all services provided as part of the cruise follow the place of supply rules given here. This includes a cruise wholly or partly for education or training.

Hiring means of transport

The short term hire of a means of transport is to be treated as made in the country where the transport is put at the disposal of the customer. Short term is a continuous period not exceeding 30 days, unless the transport is a vessel, in which case 90 days.

Where such a supply is effectively made in the UK but the services are to any extent effectively used and enjoyed in a country which is not a member state, then the supply is treated as made to that extent in that other country. Similarly, where such a supply would be treated as made in a country which is not a member state, but the supply is to any extent effectively used and enjoyed in the UK then the supply is treated as made to that extent in the UK.

Cultural, educational and entertainment services

A supply of such services is treated as supplied in the country in which the services are physically carried out. This applies to :

(a) services relating to cultural, artistic, sporting, scientific, educational, entertainment or similar activities (including fairs and exhibitions), and
(b) ancillary services relating to such activities, including services of organisers of such activities.

Restaurant and catering services

Supplies of restaurant and catering services, other than EC on-board restaurant and catering services (see below) are made in the place where they are physically carried out.

EC on-board restaurant and catering services

The provision of restaurant or catering services on board a ship, train or aircraft in connection with the transportation of passengers during an intra EC journey is treated as made in the country where the relevant point of departure (that is the first place in the journey at which passengers can embark) is located.

An intra EC journey is more formally referred to as an "intra EC passenger transport operation" which starts and ends in EC member states, and does not stop in a place outside the EC for embarkation or disembarkation.

A return stage of a return passenger transport operation is regarded as a separate passenger transport operation. A return operation is one that takes place in more than one country but is expected to end in the country in which it began, and the return stage is the stage which ends in the final destination and begins with the last stop in a place at which there has not been a previous stop during the operation.

Hiring of goods

Hiring of goods other than means of transport is covered by the basic rule. However, if a supply is treated as made in the UK, but the goods are to any extent effectively used and enjoyed in a country which is not a member state then the supply takes place to that extent in that country.

Similarly, if the supply is treated as made in a non EC state, but the goods are to any extent effectively used and enjoyed in the UK then the supply is treated as made in the UK to that extent.

Telecommunication and broadcasting services

This supply again follows the basic rule, with a "effectively used and enjoyed modification" as above.

Broadcasting includes both radio and television broadcasting.

Telecommunication services means services relating to the transmission, emission or reception of signals, writing, images and sounds or information of any nature by wire, radio, optical or other electromagnetic systems, including :

(a) the related transfer or assignment of the right to use capacity for such transmission, emission or reception, and
(b) the provision of access to global information networks.

3.3.4 Exceptions in relation to supplies made to a relevant business person

Some supplies have separate rules for when they are made to a relevant business person. When made to any other person they fall under the normal rules.

Electronically supplied services

This place of supply rule has an effective use and enjoyment adjustment as described above. The services affected are :

(a) website supply, web-hosting and distance maintenance of programmes and equipment,
(b) the supply of software and the updating of software,
(c) the supply of images, text and information, and the making available of databases,
(d) the supply of music, films and games (including games of chance and gambling games),
(e) the supply of political, cultural, artistic, sporting, scientific, educational or entertainment broadcasts (including broadcasts of events), and
(f) the supply of distance teaching

Where the parties to a supply communicate by email, this does not of itself make it an electronically supplied service.

3.3.5 Exceptions in relation to supplies made other than to relevant business persons

Intermediaries

A supply of intermediary services is treated as made in the same country as the supply to which it relates. Supplies affected by this rule are supplies to persons who are not relevant business persons consisting of the making of arrangements for a supply by or to another person or of any other activity intended to facilitate the making of a supply.

Transport of goods

The supply of transport of goods to a person who is not a relevant business person is treated as made in the country in which the transportation takes place, or if in two countries, in proportion to the distances travelled in each. If a journey takes place partly outside the territorial jurisdiction of a country takes place wholly in that country if :

- it takes place in the course of a journey between two points in the country (whether or not as part of a longer journey involving travel to or from another country), and
- the means of transport used does not stop (except in emergency) or put into land in another country in the course of that journey.

This rule does not apply to the transport of goods between two member states (see below).

Intra- community transport of goods

A supply of the transport of goods from one member state to another to a person who is not a relevant business person is treated as made in the country where the transportation begins.

Ancillary transport services

When made to a person who is not a relevant business person, these services are supplied where the service is physically performed. Services covered by this rule include loading, unloading, handling and similar activities.

Valuation services

These services are treated as supplied where physically performed, when supplied to a non business customer. This includes the valuation of goods and the carrying out of work on goods.

Electronic services

The supply by a person who belongs in a country which is not a member state (other than the Isle of Man) of electronically supplied services (as defined above) to a person who is not a relevant business person, but belongs in a member state is treated as made in the country where the recipient belongs.

Other services supplied to non EC recipients

Any of the services listed below are treated as made where the recipient belongs when made to a recipient who is not a relevant business person who belongs in a country which is not a member state(other than the Isle of Man).

(a) transfers and assignments of copyright, patents, licences, trademarks and similar rights,
(b) the acceptance of any obligation to refrain from pursuing or exercising (in whole or in part) any business activity or any rights within paragraph (a),
(c) advertising services,
(d) services of consultants, engineers, consultancy bureaux, lawyers, accountants, and similar services, data processing and provision of information, other than any services relating to land,
(e) banking, financial and insurance services (including reinsurance), other than the provision of safe deposit facilities,
(f) the provision of access to, and of transport or transmission through, natural gas and electricity distribution systems and the provision of other directly linked services,
(g) the supply of staff,
(h) the letting on hire of goods other than means of transport,
(i) telecommunication services (as defined above),
(j) radio and television broadcasting services, and
(k) electronically supplied services (as defined above)

These rules, taken together obviate the need for Schedule 5 (Reverse charge service supplies) so Sch 5 VATA 1994 is therefore deleted by para 12.

3.3.6 Changes coming into force in 2011

Some of the changes will have a delayed effect, with some supplies changing in 2011 and some in 2013. The changes for 1 January 2011 are :

Admission to cultural, educational and entertainment activities and related supplies

When supplied to a relevant business person, these are treated as made in the country in which the event takes place. This affects :

(a) services in respect of admission to cultural, artistic, sporting, scientific, educational, entertainment or similar events (including fairs and exhibitions), and
(b) ancillary services relating to admission to such events

When supplied to a person who is not a relevant business person, the following are treated as supplied in the country where the activities take place. This affects :

(a) services relating to cultural, artistic, sporting, scientific, educational, entertainment or similar activities (including fairs and exhibitions), and
(b) ancillary services relating to such activities, including services of organisers of such activities."

3.3.7 Changes coming into force in 2013

Long term hire of means of transport

The supply to a person who is not a relevant business person of services consisting of the long term hire of means of transport is treated as taking place in the country in which the recipient belongs, unless the means of transport is a pleasure boat.

In the case of a long term hire of a pleasure boat to a non business person, where the boat is put at the disposal of the recipient at the suppliers place of business, the supply is treated as made in that place.

Long term hire is defined by reference to the definition of short term hire above – that is it exceeds 30 consecutive days (90 for vessels).

3.4 Cross border reclaims of VAT

Cross border reclaims of EU VAT will be simplified in 2010 when the rules change to permit reclaims to be made to HMRC electronically rather than on paper to the member state concerned (as now). The change will apply to claims made from 1 January 2010, and is likely to mean that smaller businesses will be able to make EU VAT reclaims in future, due to the simplification in the procedure.

The relevant change to UK VAT legislation has been made by section 77 FA 2009, which introduces new section 39A "Applications for forwarding of VAT repayment claims to other member states" into VATA 1994. These merely requires the Commissioners to "make arrangements" for dealing with such applications, and for forwarding them on. Section 77 also provides for interest on late payment to overseas businesses and a right of appeal in relation to the new rules.

3.5 EC sales lists : supplies of services

Section 78 amends the current requirement for EC sales lists to include information in relation to cross border supplies of services which are treated as made in a member state other than the UK and in respect of which the recipient is liable to pay VAT that member state.

3.6 VAT on gaming participation fees

Sections 113 exempts participation fees for games of chance from VAT with effect from 27 April 2009.

3.7 Other Budget changes made by secondary legislation

3.7.1 Registration and deregistration thresholds

VAT registration threshold increased from £67,000 to £68,000 with effect from 1 May 2009, a rise of 1.5%.

VAT voluntary deregistration threshold increased from £65,000 to £66,000 with effect from 1 May 2009, a rise of 1.5%.

3.7.2 Fuel scale charges

VAT fuel scale charges which provide an output tax charge to be paid when VAT on fuel used privately is subject to input tax recovery increased with effect from 1 May 2009. These rise by an average of 9.6%

3.7.3 Reduced rate supplies

Reduced rate of 5% VAT currently applying to children's car seats and related wheeled framework and booster cushions will be extended so that it also applies to car seat bases. Takes effect on 1 July 2009.

3.7.4 Option to tax

There is a simplified procedure for those opting to tax a building which has been used to make exempt supplies with effect from 1 May 2009. This will mean that property owners will be less likely to have to contact HMRC for permission to exercise the option to tax. Related concessions will be withdrawn from 2010.

4 CAPITAL TAXES

4.1 CGT annual exemption

The annual exemption for individuals rise by the rate of inflation from £9,600 to £10,100. The amount available to trustees rises from £4,800 to £5,050.

4.2 IHT threshold

As previously announced the IHT threshold for 2009/10 will be £325,000, up from £312,000.

4.3 Inheritance tax Agricultural property relief

Hitherto, Agricultural property relief has applied only to agricultural property in the UK. The European Commission has challenged this approach, and as a result APR is now extended to the EEA by section 122 FA 2009. This brings the relevant assets within the scope of CGT hold over relief. The woodlands relief (which is deferral relief) is also be extended to the EEA.

This is quite a complex measure in terms of time periods as there is partial backdating. The IHT relief is available in respect of IHT liabilities due or paid on or after 23 April 2003, with claims available for a limited period until 21 April 2010. The revised time limits reducing claims periods to four years will not apply to this area until 1 April 2011.

Woodlands relief will also be available in respect of deaths before 22 April 2009, but the two year time limit means that only deaths on or after 23 April 2007 will be affected, with once again claims necessary by 21 April 2010.

Hold over relief has a five years ten months claim period, so claims for 2003/04 should be made by 31 January 2010 – from 1 April 2010 the time limit will reduce to four years in accordance with the Finance Act 2008, so claims for 2004/05 and 2005/06 must be made by that date.

4.4 SDLT – temporary increase in residential threshold

The increase in the residential threshold for stamp duty land tax was due to expire on 2 September 2009. Section 10 extends the date to 31 December 2009. Until then, no stamp duty land tax is payable in respect of chargeable consideration (or chargeable rent treated as consideration) for residential property of no more than £175,000. From 1 January 2010 the nil rate band will return to £125,000 or £150,000 in disadvantaged areas.

4.5 SDLT measures not dealt with in detail

SDLT legislation has been amended to correct some anomalies and the detail of this is beyond the scope of this course. The areas affected are :

- Acquisition of property through the exercise of leasehold enfranchisement rights – section 80, and now referred to as “exercise of collective rights by tenants of flats”;
- Certain acquisitions by registered providers of social housing – section 81, and
- New provisions in relation to SDLT on rent to shred ownership contracts – section 82.

5 TAX ADMINISTRATION

Lecture P554 (13.06 Minutes)

5.1 HMRC Charter

Following a consultation exercise in 2008, Finance Act 2009 introduces into statute a Charter for HMRC covering taxpayers and tax credit claimants.

Section 92 requires the Commissioners to prepare a Charter, which must include standards of behaviour and values to which HMRC will aspire when dealing with people in the exercise of their functions.

The law also requires the Commissioners to regularly review the Charter, and publish revisions or revised versions when they consider it appropriate to do so.

Finally, the Commissioners must, once every year make a report reviewing the extent to which HMRC has demonstrated the standards of behaviour and values included in the Charter. The Charter must be prepared before the end of 2009.

5.2 Duties of senior accounting officers of qualifying companies

This provision was significantly watered down during its passage through Parliament, after pressure from a number of accountancy bodies. It will now only apply to a small number of the largest companies.

Section 93 introduces Schedule 46, in which the substantive legislation appears.

5.2.1 Main duty

The main duties of a senior accounting officer are to take reasonable steps to ensure that the company establishes and maintains appropriate tax accounting arrangements. In particular, he must take reasonable steps to monitor the accounting arrangements of the company and identify any respects in which those arrangements are not appropriate tax accounting arrangements.

5.2.2 Certificate

He will then have to provide a certificate in respect of each financial year of the company which will state whether the company had appropriate tax accounting arrangements throughout the financial year and if it did not, provide an explanation of where those arrangements fell short. The due date for the certificate is the due filing date for the company accounts. A single certificate can cover more than one company.

In order for the powers to be exercised, affected companies will have to ensure that HMRC are notified as to who (by name) is the senior accounting officer for the year in question, by the due filing date for the certificate.

5.2.3 Penalties

The penalty for failure to comply with the main duty at any time in the financial year is £5,000, but no more than one penalty can apply to each company for each financial year. The penalty for failure to provide a certificate, or providing a certificate that contains a careless or deliberate inaccuracy is £5,000. Inaccuracies which are not careless or deliberate become so if the officer discovers the inaccuracy at some later date and did not take reasonable steps to inform HMRC of the inaccuracy. Both penalties are subject to reasonable excuse appeals with the normal limitations :

(a) an insufficiency of funds is not a reasonable excuse unless attributable to events outside the person's control,
(b) where the person relies on any other person to do anything, that is not a reasonable excuse unless the first person took reasonable care to avoid the failure, and
(c) where the person had a reasonable excuse for the failure but the excuse has ceased, the person is to be treated as having continued to have the excuse if the failure is remedied without unreasonable delay after the excuse ceased.

Where there is a change of senior accounting officer, only the last in post during the year can be liable for a penalty for failure in the main duty. When there is a penalty for failure to provide a certificate it cannot be levied on anyone who has been replaced as senior accounting officer before the time allowed for compliance has expired. If a certificate is purported to have been given by one officer, nobody else can be liable to a penalty in respect of that certificate.

A qualifying company is also liable to a penalty of £5,000 for failure to notify the name of the senior accounting officer.

5.2.4 Appropriate tax accounting arrangements

For the avoidance of doubt, some guidance is provided by Schedule 46 para 14 as to what appropriate tax accounting arrangements are. They are accounting arrangements that enable the company's relevant liabilities to be calculated accurately in all material respects, which includes arrangements for keeping accounting records.

Relevant liabilities means those in respect of :

(a) corporation tax (including any amount assessable or chargeable as if it were corporation tax),
(b) value added tax,
(c) amounts for which the company is accountable under PAYE regulations,
(d) insurance premium tax,
(e) stamp duty land tax,
(f) stamp duty reserve tax,
(g) petroleum revenue tax,
(h) customs duties, and
(i) excise duties.

5.2.5 Qualifying company

The test is based on the preceding financial year. So a company is a qualifying company in respect of a financial year, if in the previous financial year it satisfied either or both of :

- Relevant turnover of more than £200 million, or
- Relevant balance sheet total of more than £2 billion.

For a company that is not a member of a group the two measures relate to the company alone (balance sheet value being the amount of assets on the balance sheet). If a company is a member of a group then the aggregate turnover and aggregate balance sheet value is tested for all members of the group at the end of the last financial year, using the 51% test. It follows that all of the companies in a group will be included in the requirements if the group as a whole meets the test.

5.3 Publishing the name of deliberate tax defaulters

Taxpayers (individuals and companies) who are penalised for deliberately understating their tax due (or inflating claims) where the potential lost revenue exceeds £25,000 will have their names and addresses and the details of the tax, interest and penalties involved published.

Section 94 sets out the basis for this power, and makes clear that the publication of details will only arise following an investigation into the person or company, and therefore will not apply if the taxpayer voluntarily came forward with a disclosure.

The penalties which trigger this publication power are :

- Para 1 Sch 24 FA 2007 – submission of a return or other document containing an inaccuracy – deliberate inaccuracies only
- Para 1A Sch 24 FA 2007 (introduced by FA 2008) – inaccuracy in document attributable to the deliberate supply of false information or deliberate withholding of information by a person
- Para 1 Sch 41 FA 2008 – failure to notify – deliberate failure only
- Paras 2 to 4 of Sch 41 FA 2008 – issue of unauthorised VAT invoices, putting a product to a use attracting a higher duty and handling goods subject to unpaid excise duty – in relation to deliberate action only.

Each penalty is taken separately for the accumulation of the £25,000.

No publication can be made if the penalty is reduced for disclosure and the full discount for disclosure applies.

Publication can be in any manner chosen, but the person affected must be notified first and given the opportunity to make representations. Publication cannot take place before the penalty becomes final (on the expiry of all appeals or through a contract settlement), but may then be published within one year and the publication may be maintained for one year from the date of publication. The information that may be published is :

(a) the person's name (including any trading name, previous name or pseudonym),
(b) the person's address (or registered office),
(c) the nature of any business carried on by the person,
(d) the amount of the penalty or penalties and the potential lost revenue in relation to the penalty (or the aggregate of the potential lost revenue in relation to each of the penalties),
(e) the periods or times to which the inaccuracy, failure or action giving rise to the penalty (or any of the penalties) relates, and
(f) any such other information as the Commissioners consider it appropriate to publish in order to make clear the person's identity.

5.4 Amendments to and extension of Information and Inspection powers in Sch 36 FA 2008

Schedules 47 and 48 (which are introduced respectively by sections 95 and 96) make amendments to Sch 36 FA 2008. The most notable of these are :

- The extension, by section 96, of Schedule 36 to the following taxes and duties :
  - Insurance premium tax
  - Inheritance tax
  - Stamp duty land tax
  - Stamp duty reserve tax
  - Petroleum revenue tax
  - Aggregates levy
  - Climate change levy
  - Landfill tax, and
  - Relevant foreign tax.
- The differentiation in the inspection powers between "business assets" and "documents", so that business assets do not include documents unless they are stock or plant. The power to inspect does, however, cover business documents on the premises, but as a separate category to business assets.

- The introduction of a penalty (new para 40A) for supplying information or documents in response to a request for such which contains an inaccuracy which is either careless or deliberate, or if not the inaccuracy was later discovered by the person and the inaccuracy was not notified to HMRC. The penalty is £3,000. This prompts a number of consequential changes to the penalty regime.
- Modifications to the rules on notices in relation to groups of companies and partnerships.
- Introduction of a parallel power to enter the premises of an involved third party (new para 10A) and inspect the premises, business assets on the premises and relevant documents on the premises, if the inspection is reasonably required by the officer for the purpose of checking the position of any person or class of persons as regards a relevant tax. The definition of involved third party is in new para 61A, and relates mainly to financial services, including Lloyds managing agents, but also including those approved by HMRC to operate payroll giving schemes.
- Introduction of a new power to enter premises for the purpose of valuing them (new para 12A) if the valuation is reasonably required for checking any person's position as regards income or corporation tax. This is extended to inspecting the premises and any other property on the premises for the purpose of checking any person's position as regards :
    - Capital gains tax
    - Corporation tax in respect of chargeable gains
    - Inheritance tax, or
    - SDLT / SDRT.

  Written notice must be given to the occupier, and their agreement sought to an appropriate time unless the Tribunal approves and 7 days written notice is given. There are rights of appeal against this power.

5.5 Powers to obtain contact details for debtors

Section 97 introduces Schedule 49 which sets out a new power for HMRC to obtain contact details for tax debtors from third parties. The information will be obtained by the issue of a notice to the third party naming the debtor and requiring the information sought, which must be complied with in the time stated.

Third parties affected by this legislation are :

- Companies
- Local authorities
- Local authority association, or
- Anyone who the officer has reasonable grounds to believe has obtained the contact details in the course of carrying on a business.

Business here includes a profession or a property business.

The power cannot apply to a charity which obtained the details in the course of providing services free of charge, or to another party who obtained the details in providing services free of charge on behalf of a charity.

The third party may appeal on the grounds that it is unduly onerous to comply with the notice. The penalty for failure is otherwise £300.

5.6 Recovery of overpaid tax

Section 100 introduces Schedule 52 which covers the new statutory right to recover overpaid tax, replacing error or mistake relief for claims made on or after 1 April 2010.

Schedule 52 deals in Part 1 with income tax and capital gains tax and in Part 2 with corporation tax.

A person who has paid an amount of the relevant tax who believes it is not due may make a claim for repayment or discharge of the amount, whether paid by the person under self assessment or assessed as a liability. Schedule 52 is now the sole way in which relief is granted for overpayments of tax.

5.6.1 No relief due

Para 2 sets out the circumstances in which no effect is given to a claim. These are (in relation to income and capital gains tax) :

- Case A is where the amount paid, or liable to be paid, is excessive by reason of :
  (a) a mistake in a claim, election or notice,
  (b) a mistake consisting of making or giving, or failing to make or give, a claim, election or notice,
  (c) a mistake in allocating expenditure to a pool for the purposes of the Capital Allowances Act or a mistake consisting of making, or failing to make, such an allocation, or
  (d) a mistake in bringing a disposal value into account for the purposes of that Act or a mistake consisting of bringing, or failing to bring, such a value into account.
- Case B is where the claimant is or will be able to seek relief by taking other steps under the Income Tax Acts or an enactment relating to the taxation of capital gains.
- Case C is where the claimant :
  (a) could have sought relief by taking such steps within a period that has now expired, and
  (b) knew, or ought reasonably to have known, before the end of that period that such relief was available.
- Case D is where the claim is made on grounds that :
  (a) have been put to a court or tribunal in the course of an appeal by the claimant relating to the amount paid or liable to be paid, or
  (b) have been put to HMRC in the course of an appeal by the claimant relating to that amount that is treated as having been determined by a tribunal.
- Case E is where the claimant knew, or ought reasonably to have known, of the grounds for the claim before the latest of the following :
  (a) the date on which an appeal by the claimant relating to the amount paid, or liable to be paid, in the course of which the ground could have been put forward was determined by a court or tribunal (or is treated as having been so determined),
  (b) the date on which the claimant withdrew a relevant appeal to a court or tribunal, and
  (c) the end of the period in which the claimant was entitled to make a relevant appeal to a court or tribunal.
- Case F is where the amount in question was paid or is liable to be paid
  (a) in consequence of proceedings enforcing the payment of that amount brought against the claimant by HMRC, or
  (b) in accordance with an agreement between the claimant and HMRC settling such proceedings.
- Case G is where :
  (a) the amount paid, or liable to be paid, is excessive by reason of a mistake in calculating the claimant's liability to income tax or capital gains tax (other than a mistake in a PAYE assessment or PAYE calculation), and
  (b) liability was calculated in accordance with the practice generally prevailing at the time.
- Case H is where :
  (a) the amount paid, or liable to be paid, is excessive by reason of a mistake in a PAYE assessment or PAYE calculation, and
  (b) the assessment or calculation was made in accordance with the practice generally prevailing at the end of the period of 12 months following the tax year for which the assessment or calculation was made.

In corporation tax, references are to corporation tax and CTA rather than ITA, and Case H does not exist.

A claim must be made not more than 4 years after the end of the relevant tax year, but must not be included in any tax return. However, making a claim will enable HMRC to make a discovery assessment if facts come to light that make this appropriate.

5.7 Interest harmonisation

A harmonised interest regime on both underpaid and overpaid tax has been introduced in respect of all taxes and duties administered by HMRC with the exception of Corporation Tax and petroleum revenue tax, which are expected to be harmonised in Finance Bill 2010. Sections 101 to 105 and Schedules 53 and 54 set out the changes.

5.7.1 Late payment interest

Section 101 deals with late payment interest, and excludes corporation tax and petroleum revenue tax, but applies to all other taxes and duties. The basics of late payment interest are set out in section 101, with the detail in Sch 53. The start date for late payment interest is the date that the amount becomes due and payable; it is paid without deduction of tax and is not compounded. Where a liability is paid by set off, the date of payment is the date that the set off takes effect.

Schedule 53 deals with some of the special scenarios such as interest on payments on account where there has been an application to reduce the payments, or when an overpayment arises. Interest is only due on the payments on account to the extent that they exceed 50% of any overpayment, and is charged when a balancing payment is due, but only on an amount up to the original payment on account when a reduction has been made.

Interest is charged on assessed amounts and following an amendment to a return from the original due date. If a taxpayer dies and the executor is unable to pay the liability before the necessary formalities (probate, letters of administration etc) the start date for interest is the later of the normal due date for the liability and 30 days after the probate or letters of administration have been granted (or equivalent in Scotland). Interest is charged on IHT due by instalments by reference to the due date for each instalment.

5.7.2 Repayment interest

Section 102 similarly sets out the basic rules for repayment interest, with the detail in Schedule 54. Once again, corporation tax and petroleum revenue tax are excluded from the new rules. Repayment interest will apply to amounts paid to HMRC that are subsequently repaid, and to any amount that becomes payable to a person by HMRC under an enactment, but not to amounts payable under a court order or judgement under which interest can be added by the court. Repayment interest is not compounded, and runs until the date on which the payment or repayment is made by HMRC.

Schedule 54 sets the start date for repayment interest. The general rule is supplemented by more specific rules applying to some situations

Start date – general rule

The repayment of an amount paid to HMRC generates interest from the later of dates A and B:

A. the date on which the amount was paid to HMRC
B. in connection with an amount that has been paid in connection with a liability to make a payment to HMRC, and is to be repaid by them, the date on which the payment became due and payable to HMRC.

The payment of an amount which has not been paid to HMRC but is payable by virtue of a return having been filed or a claim having been made, the start date is the later of :

- the date (if any) by which the return was due to be filed or the claim was required to be made, and
- the date that the return was actually filed, or the claim made.

Start date – special rules

Where the repayment arises due to a carry back of a loss or averaging claim, the start date is 31 January after the end of the later fiscal year in relation to the claim.

Where income tax has been deducted at source and is then to be repaid the start date is 31 January following the fiscal year.

Repayments of tax for a year have a statutory allocation against the tax paid, given by para 13 of Sch 54. the order of attribution is :

- first against a balancing payment if tax for the year, or the payment of tax if no payments on account have been made;
- second, in two equal parts against the payments on account, and
- third, to income tax deducted at source for the year.

5.7.3 Rates of interest

Section 103 sets out a statutory process for determining interest rates which is left to secondary legislation. Regulations have already been laid which set the mechanism and require interest rates to be calculated by reference to the Bank of England base rate.

Interest rates will be adjusted automatically every time the base rate changes, and the first change in interest rates under these Regulations will be made in late September 2009. Changes will normally take effect 13 days after the monetary policy committee meets to decide on the base rate.

5.8 Penalty for failure to make a return

As promised, the Act also introduces new penalties for failure to make a return, which will replace all of the late filing penalties currently applying. The commencement date is left to secondary legislation and there is currently no indication of when that will be.

Section 106 sets out the power to make Regulations, and Schedule 55 provides the detail of the new penalty regime. The new regime applies to the following taxes (and returns) :

- Income tax and capital gains tax (SA returns)
- Income tax or corporation tax (partnership returns)
- Income tax (annual PAYE returns)
- Income tax (pension scheme returns)
- CIS tax (CIS monthly returns)
- Corporation tax (CTSA return)
- IHT (IHT account)
- SDLT (land transaction return)
- SDLT (returns under paras 3,4 or 8 Sch 17A FA 2003)
- SDRT (notice of charge to tax)
- PRT (a return and statement)

These, apart from the CIS return are annual or occasional obligations (prompted by a specific occurrence or event). Other taxes will follow later.

5.8.1 Annual and occasional returns

The initial penalty for failure to submit the return by the due date is £100. The second stage applies where the return is more than 3 months late, and HMRC has decided, and given notice that daily penalties apply (and a start date for daily penalties, which can be earlier than the date of the notice). The daily penalty is then £10 per day for up to 90 days.

Once the return is 6 months late the penalty becomes a further 5% of the tax shown as due by the return or £300 if greater.

When the return is 12 months late, a further 5% or £300 will apply, unless the taxpayer is held to be deliberately withholding information that would enable HMRC to assess the tax due. In these cases the penalty would be :

- Deliberate and concealed withholding – 100% of the tax which would be shown as due by the return, or
- Deliberate but not concealed – 70% of the tax, and
- In both cases £300 if greater.

In the case of partnership returns, the penalties are payable by each partner, in addition to any penalties for late filing of his personal return.

5.8.2 CIS returns

The initial penalty is £100. This is followed by a penalty of £200 when the return is two months late.

When the return is six months late a tax geared penalty of 5% becomes due, subject to a minimum of £300. When the return is 12 months late a further tax geared penalty will apply, again based on the behaviour, and whether information is deliberately withheld. In these cases :

- Deliberate and concealed withholding – 100% of the tax which would be shown as due by the return, or £3,000 if greater
- Deliberate but not concealed – 70% of the tax, or £1,500 if greater, or
- No deliberate withholding – 5% of the tax or £300 if greater.

Where the returns are over 12 months late and concern only gross paid recipients the penalties for withholding information are £3,000 or £1,500 in the cases set out first and second above.

Welcome relief for those who fail to register for CIS is brought by para 13. When the first return is filed under the scheme, the total penalty for all defaults is a maximum of £3,000 and the tax geared penalties cannot apply.

5.8.3 Tax geared 12 month penalties and disclosure

The provisions about disclosure when information has been withheld are identical to the provisions in other modern penalty legislation. The terminology is the same, and the structure identical. So the following table summarises the minimum penalties following a disclosure :

	Original penalty	**Minimum penalty following disclosure**	
		Unprompted	**Prompted**
Deliberate and concealed	100%	30%	50%
Deliberate not concealed	70%	20%	35%

There is also a provision for a special reduction under special circumstances, but which do not include ability to pay or the loss of revenue by one taxpayer is compensated by an overpayment by another.

There is no penalty where the taxpayer satisfies HMRC or the tribunal on appeal that he has reasonable excuse for the failure. The normal provisions apply, that is that insufficiency of funds or relying on another to do something is not a reasonable excuse and following the end of the reasonable excuse circumstances the failure is remedied without unreasonable delay.

5.9 Late payment penalty

Section 107 and Schedule 56 make provision for a new late payment penalty regime which will apply in addition to interest. The measures will commence by Order, and no start date has yet been announced. VAT is not included in these measures, so default surcharge continues to apply to late VAT returns and late payment of VAT until further changes come forward in FB 2010.

The provision cover the following taxes, from the following dates :

- Income tax (and capital gains tax) balancing payments – 30 days late
- PAYE – normal due date
- Tax due by pension schemes - 30 days late
- CIS tax – normal due date
- Corporation tax – filing date for the return
- IHT – due filing date for the return
- IHT due by instalments (ss 227 & 229 IHTA) – first instalment – due filing date, subsequent instalments – 30 days late
- SDLT – 30 days late
- SDRT – 30 days late
- PRT – 30 days late

There are also dates by reference to determinations in the absence of a return and in respect of other assessments.

5.9.1 Annual amounts and PAYE / CIS in excess of 6 months

The penalties for all amounts except corporation tax (but including amounts recoverable under MSC legislation) are :

- Initial penalty 5% of the tax
- Second penalty 5 months after first penalty date 5%
- Third penalty, 11 months after first penalty date 5%

For corporation tax they are :

- Initial penalty 5%
- Second penalty 3 months after penalty date 5%
- Third penalty 9 months after penalty date 5%.

5.9.2 PAYE and CIS of less than 6 months

The penalty is determined by the number of defaults in a tax year, that is late payments. The first default is ignored; after that :

- When there are 1, 2 or 3 defaults in a tax year the penalty is of 1% of the total of those defaults

- When there are 4, 5 or 6 defaults the penalty is 2% of the total of the defaults,
- When there are 7, 8 or 9 defaults the penalty is 3% of the total amount of the defaults, and
- For 10 or more defaults the penalty is 4% of the total defaults.

Any amounts that are unpaid more than 6 months after the penalty date are liable to 5%, and a further penalty of 5% applies after 12 months.

The rules on special reductions, reasonable excuse and appeals are the same as for other penalties. Section 108 permits the suspension of penalties during the currency of agreement for deferred payment – most of this relates to the old penalty regime. Regulations were issued in late July to the same effect for the new regime in relation to PAYE and CIS tax as no penalties for late payment existed under the old regime.

5.10 Recovery of debt through PAYE

Section 110 and Schedule 58 set legislation to allow the recovery of tax debt through PAYE. There are minor amendments to the PAYE regulations to permit any tax (referred to as a relevant debt) to be recovered through PAYE coding adjustments, apart form "excluded debts" which are :

- Child or working tax credit that the payee is liable to repay, and
- PAYE deducted from employees, until after the end of the tax year (for a payee who is also an employer).

A relevant debt is an amount payable under or by virtue of an enactment, or payable under a contract settlement.

5.11 Managed payment plans

Any tax falling due after Royal Assent may now be the subject of a managed payment plan, which is an agreement between the taxpayer and HMRC to pay the tax by instalments. Section 111 sets out the structure of this new debt management approach, which is to permit taxpayers to make instalment payments so that half the tax is paid before the normal due date and half afterwards, without triggering interest or penalties. The idea is to allow taxpayers to spread annual liabilities over a longer period. The plans apply to income and capital gains tax and corporation tax (except where group payment arrangements are in place).

5.12 Tax administration measures not dealt with here

Some measures are beyond the scope of a general course, and accordingly have not been included in these notes. These are :

- Schedule 50 – amendment of records keeping requirements in FA 2008 to relate to other taxes and duties, including IPT, SDLT, aggregates levy, climate change levy and landfill tax.
- Schedule 51 – further changes to time limits affecting IPT, IHT, SDLT, PRT, Aggregates levy, climate change levy and landfill tax.

6 OTHER TOPICAL AREAS

6.1 Advancing income

With increases in tax on the horizon clients will need to consider whether they want to pay tax earlier at a lower rate or later at a higher rate.

Examples: advancing income
Harry earns £120,000 a year. If he advances £20,000 from 2010/11 into 2009/10, he will avoid the loss of his personal allowance in 2010/11. He will pay £8,000 more for 2009/10 but at least £10,590 less for 2010/11 (£8,000 plus 40% x £6,475). That is a good rate of return, not least because it is tax-free.

Harriet earns £200,000 a year. If she advances £50,000 from 2010/11 into 2009/10, she will avoid the 50% rate in 2010/11. She will pay £20,000 more for 2009/10 but £25,000 less for 2010/11. Again, that is a good rate of return.

There are many standard ways of advancing income to an earlier year, and they are probably all well-known:

- reducing retained reserves by paying dividends from a small company prior to 6 April 2010;
- advancing payments of salary;
- deferring expenditure which is allowed on a paid basis, e.g. staff bonuses;
- making sure that stocks and WIP are fully accounted for at the last year-end before the 2010/11 basis period;
- paying distributions from trusts;
- claiming for losses in a later year rather than an earlier year;
- closing a bank account early to trigger the receipt of accrued interest.

One particular area in which the timing of income should be considered is illustrated by the following example.

Example – accounting date
George is an architect who has been trading for many years with an accounting date of 30 April. His business has grown substantially in recent years; his overlap relief brought forward is only £16,000, but he estimates that his profits are likely to be:

Year to 30 April 2008	£120,000
Year to 30 April 2009	£150,000
Year to 30 April 2010	£180,000
Period to 31 March 2011	£150,000

He intends to retire on 31 March 2011.

George's problem is that the 30 April year-end means that the increases in his income are deferred into later years when the tax rates will be higher. If he does nothing, he will be taxed on the following profits:

2008/09	£120,000
2009/10	£150,000
2010/11 (£180,000 plus £150,000 less £16,000)	£314,000

£164,000 of profit will be taxed at 50%.

If we assume that profits accrue evenly in the accounting periods, consider the effect of changing the accounting date to 31 March 2009:

Year to 30 April 2008	£120,000
Year to 30 April 2009	£150,000
Period to 31 March 2010	£165,000
Year to 31 March 2011	£165,000

The tax charges change as follows:

2008/09	£120,000
2009/10 (£150,000 + £165,000 – £16,000)	£299,000
2010/11	£165,000

Only £15,000 of profit will be taxed at 50%. There is a significant advancing of tax liability, but the cash flow comparison is still likely to be favourable:

	If the change is made	
2009/10	**£149,000 more taxed at 41%**	**+ £61,090**
2010/11	**£149,000 less taxed at 51%**	**– £75,990**

That is a very good rate of return.

Of course, someone with a 30 April year end and overlap relief which is very small in comparison to the current level of profits was always going to suffer badly on cessation; but the problem is exacerbated considerably by the increase in tax rates.

Article by Mike Thexton

6.2 Tax disclosure programme for tax arrears on assets in Liechtenstein

Lecture P555 (7.27 Minutes)

New disclosure opportunity (NDO)

Following the Tax Chamber's decision to order over 300 banks to provide HMRC with details of customers holding offshore accounts, HMRC announced an NDO.

Main features are:

- notification of intention to disclose must be made between 1 September 2009 to 30 November 2009 if by paper; if electronically the period is 1 October to 30 November
- actual disclosures have to be made from 1 September 2009 to 31 January 2010 (paper) or from 1 October 2009 to 12 March 2010 (electronically)
- fixed penalty of 10% of tax if not contacted by HMRC under the Offshore Disclosure Facility in 2007
- otherwise, fixed penalty of 20%

Liechtenstein

Two ground breaking tax agreements between the Government of Liechtenstein and the UK were signed on 11 August 2009, resulting in off shore investments in Liechtenstein made by UK residents being properly taxed. It was also stated that they represent the commitment of Liechtenstein to increased tax transparency.

Main features:

- A new Tax Information Exchange Agreement (TIEA) will enable the UK and Liechtenstein to exchange information to ensure the right tax is paid in each country in future.
- A tax disclosure programme will clear up the tax arrears of UK residents with investments in Liechtenstein and put things right for the future. It will allow penalties on unpaid tax to be capped at 10% of tax evaded over the last ten years providing the taxpayer tells HMRC everything. Those who fail to make a full disclosure by the end of the programme will find their accounts in Liechtenstein closed down.
- The Liechtenstein Disclosure Facility (LDF) runs from 1 September 2009 to 31 March 2015.
- All Liechtenstein financial intermediaries will have to review all clients identifying those who need to confirm their tax position with HMRC and advise them to do so within a specific time frame.
- Where a UK investor confirms to the intermediary that they are cooperating with HMRC the financial intermediary can continue to provide financial services to that person.
- Where a UK investor cannot confirm that they are cooperating with HMRC the financial intermediary must withdraw financial services in Liechtenstein or apply various sanctions.
- The Liechtenstein Government will introduce new laws to ensure audit of the process.
- To take part in the programme, investments must either be held in Liechtenstein on 1 August 2009, in which case the person can participate from the start of the facility on 1 September, or, if the investments or assets are moved into Liechtenstein after that date the person can participate from 1 December 2009, at the end of the registration period for the New Disclosure Opportunity.
- The penalty on unpaid tax will be limited to 10% in most cases on the same basis as the NDO operated by HMRC.
- The recovery of earlier years' tax lost will be restricted to a maximum of 10 years up to 5 April 2009.
- The taxpayer can elect to apply a special Composite Rate of 40% to cover all taxes on an annual basis without the benefit of any relief or deduction.

Both HMRC and the Liechtenstein authorities expect that by the end of the facility all UK taxpayers holding assets and investments in Liechtenstein will be meeting all their UK tax liabilities.

The text will be laid as a Schedule to a draft Order in Council for consideration by the House of Commons. The TIEA will enter into force as soon as both governments have completed the necessary legislative procedures.

Telephone helpline: 0845 600 4680.

Client action

It must be good practice to contact all private clients to ask whether they have any offshore accounts where the income has not previously been declared, ensuring that you use a non-threatening tone and that you are not suggesting that you think they do have such accounts. Spell out the need to tell you everything now so as to take advantage of the NDO, whether relating to Liechtenstein or elsewhere.

Article by Gerry Hart

6.3 <u>"False" self employment in construction – HMRC consultation</u>

Lecture B555 (9.32 Minutes)

Decided tax cases have shown that there is no single matter to which reference can be had in distinguishing the self-employed from the employed. In fact often tax cases have proved to be unhelpful outside of their own particular facts. However, the following tend to be relevant:

- the provision of service for remuneration
- control
- integration
- provision of equipment
- hiring of helpers/use of substitutes
- degree of financial risk
- responsibility for investment and management
- contract terms
- duration of engagements
- number of engagements
- mutuality
- dependence on, or independence of, a particular paymaster

Recent cases

There are plenty of recent examples of HMRC struggling to re-classify an individual as an employee and/or whether IR35 applies where a limited company is used to provide services of an individual, but also evidence of a new approach of obtaining evidence of the realities of the arrangement from the end-user.

The future

It is within the construction industry that HMRC have faced particular problems. They humiliatingly lost the status cases of ***MAL Scaffolding*** (March 2006) and ***Parade Park Hotel*** (March 2007) where there were no written contracts. They received heavy criticism from the commissioners as under:

Mal Scaffolding: "*HMRC appear to have approached their investigations on the basis that there must be an employment relationship between MAL Scaffolding and the workers there if one looks hard enough. Officers then went looking on that basis and persuaded themselves that they had found that for which they were looking. They have failed totally to persuade me."*

Parade Park Hotel: *"the facts mean no mutuality of obligation, insufficient control to be an employee, and a number of terms of the relationship being inconsistent with it amounting to a contract of service."*

Presumably as a reaction to those and other defeats, HMRC are consulting on what they provocatively call **"false" self-employment in construction: taxation of workers.**

The consultation document

Comments are required by 12 October 2009. The main thrust of HMRC's argument that change is needed is that workers are treated as self-employed for tax and NIC "*despite the fact that the way in which the work is carried out on a day to day basis demonstrates that there is an employment relationship."* They seemingly have forgotten that whether or not self-employment exists is a question of fact, to be decided by the judiciary.

The reason HMRC say that they are concentrating on the construction industry (but who is to say that if the proposals are implemented, they will not extend them to other activities?) is that there is a much higher proportion of self-employed workers than in other sectors. A survey in 2007 showed that 34% are self-employed, compared to 11% in other sectors.

The proposed solution from HMRC is as follows:

1. Where a person whose main business involves construction operations (same definition as under CIS) uses the services of a worker to carry out such operations, then the payment received for those services will be deemed to be employment income.
2. PAYE and NIC will then apply.
3. There will be exemption if any one (or more) of the following criteria are met by the worker:
    - He provides the plant and equipment required for the job he has been engaged to carry out, but this excludes the tools of the trade which it is normal and traditional in the industry for individuals to provide themselves to do their job.
    - He provides all materials required to complete a job.
    - He provides other workers to carry out operations under the contract and is responsible for paying them.

These three alternative tests are surely far too harsh compared to the key tests applied in appeals against status decisions. No doubt they will be the main cause of complaint in responses to the consultation document.

In terms of working with these possible new arrangements, the consultation document states that the person making the payment to the worker has the obligation to apply the above criteria. Where the worker uses a **personal service company** which they control, the new proposals take precedence over IR35. If the payer is a **managed service company**, the MSC legislation takes precedence. Finally, where the payer is an **employment agency**, the new proposals take precedence over the Agencies legislation.

Controversially, HMRC say that the proposals will not confer employment rights on the worker. They add that the Government *"hopes that the tax changes would also engender a more appropriate treatment of workers throughout the industry, leading to a culture of responsible employers applying employment rights and providing training opportunities."*

Questions asked

No doubt HMRC will receive plenty of adverse comments to the document. All they actually ask is eight questions on the deeming criteria, as *"the Government is keen to ensure that the proposed legislation operates as intended and, in particular, that the deeming criteria are simple and easy to operate":*

1. Do these three criteria represent fair indicators of a person who is running his own business and is therefore genuinely self-employed?
2. Are there other indicators which ought to be considered for inclusion?
3. Are there instances where none of the criteria are met, but a worker would, by reference to the usual case law tests in respect of the true terms of an engagement, otherwise be treated as self-employed? If so, provide examples.
4. VAT registration can signal that the worker is in business on his own account, buying materials and investing in plant which takes the turnover if the business over the threshold for registration. Would it be helpful to include the additional requirement of VAT registration? This would mean that the worker would need to meet one of the three specified criteria and would also have to be registered for VAT.
5. Is the payer the correct person to have the responsibility for applying the criteria and operating PAYE and NICs?
6. Are there instances where the introduction of the deeming provision could bring about a significant additional administrative burden? If so, please give examples.
7. Are there occasions when the deeming provision could impact on the adaptability and flexibility of the labour market? If so, please provide examples.
8. What avoidance routes might be available and how should these be countered?

Article by Gerry Hart

6.4 <u>Cornell v Revenue and Customs Comrs TC108</u>

On 17 January 2005 the appellant commenced employment as a professional development manager with the company. Under the terms of her employment contract, the appellant's employment was subject to a three month probationary period to which one week's notice period applied. Clause 8 of that contract provided that upon “satisfactory completion of your probation period your employment will be subject to three months' notice”. However, during the probationary period the appellant was informed that her post was at risk of redundancy. On 13 April 2005 she was asked to leave the office and to remain away from the workplace. On 17 April 2005 the probationary period ended but the company did not assess the appellant's suitability or confirm her post. On 27 April 2005 the appellant's contract was terminated. The company produced a draft compromise agreement under which it agreed to pay the appellant £17,971.26. The agreement, which stated that her contractual notice period was three months, made it clear that the payment included payment in lieu of notice. The appellant did not agree that the contractual notice period was three months and she refused to sign the agreement. Notwithstanding that the agreement was not signed, the company made the payment to her, from which it deducted tax. In her self-assessment for the tax year 2005-06, the appellant claimed that the payment was exempt from tax. HMRC issued an amendment treating the payment as employment income chargeable to tax under ITEPA 2003 Pt 2, Ch 2 as it was a payment in lieu of notice made in pursuance of a contractual provision. The appellant appealed contending that—(1) the payment was for breach of contract as the company was under an obligation to provide her with work and was not entitled to suspend her from the performance of her duties or require her to remain away from the office; the consultation period was flawed; and the draft compromise agreement was evidence that the company itself was concerned that a claim might be made for breach of contract and wrongful dismissal and so it was a compensation payment; and (2) as she had not been assessed or confirmed in post at the conclusion of her probationary period, the three-month notice period that was applicable on satisfactory completion of the probationary period did not apply. Payment in lieu of notice was therefore limited to one week's salary and the balance of the payment was in respect of any claim she might have had in respect of the termination of her employment.

The judge found on the evidence that there was no breach of the appellant's contract of employment in the period 13 April 2005 to 27 April 2005. The company was not obliged under the employment contract with the appellant to provide work for her, whether before or after notice of termination. The consultation process was not relevant, in that although a failure to consult fairly could result in a dismissal being unfair, that was not itself a breach of contract, as a claim for unfair dismissal could arise even if the dismissal was in accordance with the contract, and thus not a wrongful dismissal. Furthermore, the evident purpose of the compromise agreement was to protect the company from future claims; it was not in any sense an admission of any such claims.

The judge found that the appellant was entitled to three months' notice at the time of the termination of her contract on 27 April 2005. The failure of the company to confirm her in post did not operate to prevent the contract from entitling her to three months' notice on its termination on 27 April 2009. It was evident from the contractual terms that the employment did not automatically come to an end at the conclusion of the probationary period; for the contract to be ended there would have needed to be a termination of the employment. Once the probationary period had ended the one week notice period did not apply. The period of notice prescribed in cl 8 – three months – applied with effect from the date of expiry of the probationary period. The phrase “satisfactory completion of your probationary period” in cl 8 meant completion of the probationary period without it being extended or the employment being terminated at that time. Accordingly, the payment was a payment in lieu of notice for that three month period in pursuance of a provision to that effect in the appellant's contract of employment. It followed that the appeal would be dismissed.

Appeal dismissed.

6.5 QCBs and M R Klincke

The taxpayer, Michael Klincke, sold his shares in his company and received shares in the acquiring company and also loan notes. The notes were considered to be non-qualifying corporate bonds for tax purposes.

The transactions constituted a reorganisation for the purposes of TCGA 1992, s 126 and therefore the gain on the taxpayer’s share disposal was rolled over into the new shares and loan notes.

The loan notes originally had an issuer option for redemption in US dollars. This was removed two years later, pursuant to an extraordinary resolution of the noteholders and a deed of variation.

According to the taxpayer, this made the notes qualifying corporate bonds (QCBs) and took them out of the scope of capital gains tax.

Mr Klincke then redeemed the notes and submitted his relevant tax return on the basis that the disposal of the notes was exempt from capital gains tax.

HMRC argued that the conversion of the notes into QCBs was purely to avoid capital gains tax.

The First-tier Tribunal judges found that the notes had been converted, as the rights and obligations of the issuer and holder were changed by the deed of variation.

However, at the time of conversion the latent gain rolled into the notes would crystallise when the notes were redeemed as QCBs. Thus the gain was not exempt from capital gains tax.

The taxpayer’s appeal was dismissed.

6.6 RLRE Tellmer Property sro v Finanční ředitelství v Ústí nad Labem

The claimant, which owned and rented out apartment blocks in the Czech Republic, also offered tenants a cleaning service for the common parts, for which the tenants were invoiced separately, but tenants had the option of making independent arrangements with a third party for the cleaning of the common parts. The claimant was assessed to VAT in respect of the cleaning services, but objected that those services and the lettings were indivisible transactions which were exempt under Czech legislation transposing article 13(B)(b) of Sixth Council Directive 77/388/EEC. The assessment having been confirmed by the defendant, the Tax Directorate of Ústí nad Labem, the claimant brought an action before the Krajsky soud v Ustí nad Labem (Usti nad Labem Regional Court), which referred to the European Court for a preliminary ruling the question, inter alia, whether the letting of an apartment and related cleaning of the common parts could be regarded as independent, mutually divisible taxable transactions.

Article 13(B) of the Sixth Directive provides:

"… Member States shall exempt … (b) the leasing or letting of immovable property …"

Although every transaction was normally to be regarded as distinct and independent, in view of the wording of article 2 of the Sixth Directive, formally distinct services could be regarded as a single transaction where one or more elements were to be regarded as constituting the principal service and others as constituting ancillary services (sharing the tax treatment of the principal service) in that they constituted for customers not an aim in themselves but a means of better enjoying the principal service, or where it would be artificial to split the supply: *Ministero dell'Economia e delle Finanze v Part Service Srl* (Case C–425/06) [2008] STC 3132, [2008] ECR I–897, paras 50–53. The letting of immovable property consisted in the conferment by a landlord on a tenant, for an agreed period and in return for payment, of the right to occupy property as if that person were the owner and to exclude any other person from enjoyment of such a right: see eg *Belgian State v Temco Europe SA* (Case C–284/03) [2005] STC 1451, [2004] ECR I–11237, para 19. Thus, even if the cleaning services of the common parts of an apartment block accompanied the use of the property let, they did not necessarily fall within the concept of letting. Moreover, such cleaning services could be supplied in various ways, such as a third party invoicing the cost direct to the tenants, or the landlord employing his own staff or using a cleaning company. In the present case, the claimant invoiced the cleaning services to the tenants separately from the rent. In such circumstances, the letting and the cleaning could be separated from each other, and so could not be regarded as constituting a single transaction.

On those grounds the court ruled: for the purposes of applying article 13(B)(b) of the Sixth Directive, the letting of immovable property and the cleaning service of the common parts of the latter had, in circumstances such as those at issue, to be regarded as independent, mutually divisible operations, so that that service did not fall within article 13(B)(b). *(Case C–572/07)*

6.7 Ms S March v Revenue and Customs Commissioners (2009)

A woman (M) operated a riding school. She registered for VAT from October 2005, and applied to account for VAT under the flat-rate scheme. In 2006 she arranged for the construction of a new riding arena at the riding school. She reclaimed VAT on the construction costs. The Commissioners rejected most of the claim on the grounds that it related to supplies of services, and issued an assessment to recover the tax which she had reclaimed. She appealed against the assessment, and also applied to be allowed to withdraw from the flat-rate scheme with retrospective effect. The Commissioners rejected this application, and she appealed. The tribunal allowed her appeal, holding that the Commissioners had acted unreasonably. On the evidence, most of the supplies relating to the construction of the riding arena had been supplies of services, although the specific supply of the track surface had been a supply of goods on which the tax could be reclaimed, and the supply of delivery of the track should have been accepted as an incidental part of the principal supply, applying the principles laid down in *AJ & K Price* (VTD 20700). However, the tribunal noted that the February 2004 edition of Notice 733 (Flat Rate Scheme for Small Businesses) 'offered no guidance on the meaning of a capital asset'. Such guidance was subsequently included in the March 2007 edition, and the tribunal noted that if such guidance had been available when M applied to join the scheme, her accountants may have realised that the scheme was not suitable for her. Furthermore, the VAT officer who had visited M in February 2007 had recognised that the scheme was not suitable, and had recommended that M 'may wish to consider leaving the flat rate scheme retrospectively from 1 July 2006, in order to claim the input tax on services relating to the new indoor riding school and any capital assets less than £2,000 in value'. The Commissioners' subsequent decision not to allow M to withdraw retrospectively meant that she 'was liable for £11,175 more in VAT than under normal accounting'. The Commissioners had 'denied a proper exercise of discretion by the officer reviewing the individual circumstances of the case'. Applying the guidelines laid down by the CA in C & E Commrs v John Dee Ltd (1995 STC 941), the Commissioners' refusal to allow a retrospective withdrawal from the scheme was unreasonable. (Costs were awarded to the appellant.)