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Personal Tax

Office rent

Two individuals operate as a small tax consultancy from their respective houses and claim rent-a-room relief on the rental income paid to them by the company for the use of offices. The director has disclosed this in the white space on his self assessmnet returns; the secretary does not file returns.

Are they correct?

The relief

Rent-a-room relief applies to furnished residential accommodation in the taxpayer's only or main home. It applies to ordinary letting of living accommodation.

Genuine lodgers who study at home or do some of their business work at home in the evenings or at weekends do not disqualify the exemption due to the lessor.

The subject is dealt with in HMRC's *Property Income Manual* at PIM4001 to PIM4060. The issue of letting a room as office accommodation is dealt with specifically in PIM4002, and HMRC officers have been advised to refuse claims for rent-a-room relief in such circumstances.

Tax Bulletin 12, referred to the tenants under the rent a room legislation as 'lodgers' which leans toward HMRC's interpretation of disallowing relief.

HMRC's stance in the *Property Income Manual* at PIM 4002 has remained consistent over the last 15 years. To be successful, they must be prepared to take a detailed and sustainable case before a tribunal and, in the event of a successful outcome, to continue the fight through the courts to its bitter end. HMRC will not give ground in this area and have served notice that they will take it all the way if challenged.

SA105 Notes and *Help Sheet 223* make it clear that HMRC will resist a claim that rent-a-room relief applies in cases where a room is used for business purposes, anything less than a consistently comprehensive disclosure of the amount and circumstances of the claim may lead HMRC to question whether the director correctly self assessed.

The director

The fact that the director has had the sense to include notes in the 'white space' as to what he has entered regarding rent-a-room income is in his favour.

It appears that once the usual enquiry time limit has passed – that was 31 January following the previous 31 January filing date – HMRC have their hands tied and will not be able to amend the entries for the 2005, 2006 and 2007 tax returns, and possibly the 2008 return.

Please note that the deadline for 2008 returns onwards is as per FA 2007, s 96, which amended TMA 1970, s 9A(2); that is, 12 months after the date that the tax return was filed.

Secretary

Given the guidance in the self assessment notes, help sheet and manual, HMRC is likely to adopt the view that the secretary had an obligation to submit self assessment tax returns for all years in question and to declare the rental income received. In this event there will have been a failure to give notice under TMA 1970, s 7.

Taxation Forum, 16 September 2009

Lecture P556 (8.27 Minutes)

Advancing income into 2009/10

Finance Act 2009 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 (representing a 45% increase over the current 25%).

The higher rate of tax on the dividend is computed as follows:

	£
Net dividend	900
Tax credit	100
Gross dividend	1,000
Higher rate tax at 42.5%	425
Tax credit	-100
	325
£325 / £900 =	36.11%

Advancing income to 2009/10?

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 (ensuring dividends are "paid" in 2009/10);
- 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.

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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.

It should also be noted that an incorporation will trigger the cessation provisions for income tax purposes and will invariably crystallise higher taxable income figures in the final year – assuming overlap brought forward is small in comparison to current profit levels. Incorporating in 2009/10 will only trigger a maximum of 40% tax whereas in later years it could well be 50%.

Income splitting

Following HMRC's defeat in *Jones v Garnett* 2007 STC 1536 (often referred to as the *Arctic Systems* case), a large number of owner-managed companies continue to take advantage of providing tax efficient dividend payments to the owner-manager's spouse.

HMRC's attempts to introduce anti-avoidance legislation were quickly derailed in the face of a massive 'thumbs-down' by the professional bodies and industry groups. The draft legislation was shown to be completely unworkable and it was difficult to see how it would be policed by HMRC and how they would collect the anticipated tax revenues.

Mr Darling seems to have shifted 'income splitting' onto the back-burner – at least for the time being – following statements issued in both the pre-Budget report 2008 and the Budget 2009. Income splitting (provided it is implemented correctly) is therefore very much alive and kicking.

Hitherto, the splitting of dividends between married couples has largely been designed to make full use of the spouse's 10% basic rate band for dividends. After 6 April 2010, it may be given a further twist as owner-managers seek to mitigate the effect of the 36.11% effective rate for dividends.

Loans to shareholders

Under the post-6 April 2010 regime, some might consider making use of loans rather than dividends. Based on current understanding, there are no plans to increase the rate of the TA 1988, s 419 tax – which is 25% of the amount of the loan/overdrawn current account.

Even when the income tax (and NIC) under the beneficial loan rules (ITEPA 2003, s 175) is added on, loans to owner-managers may still prove to be a more attractive option than an outright dividend payment suffering the relevant super tax rate of 36.11%.

It is important to ensure that the loan is properly documented. Although it may seem tempting to draw regular loans/advances, these payments may look like 'PAYE-able' earnings to a vigilant tax inspector.

Lecture P557 (20.44 Minutes)

Definition of income and interaction of losses in tax credit claims

The Statutory Instrument is the Tax Credits (Definition and Calculation of Income) Regulations 2002, as amended subsequently. This legislation was amended in late 2003 to reflect some of the problems in dealing with the self employed claimant, and in particular to deal with losses brought forwards and carried forwards. The income of the claimant, or joint claimant is calculated for the tax year in the following manner.

Step 1

Add together :

- Pension Income
- Investment income
- Property Income
- Foreign Income
- Notional Income

If the result is £300 or less, treat as nil. If the result is more than £300 only the excess is included. For a couple the £300 applies to their joint income from these sources. Note that where a claim has terminated for a single claimant becoming a couple or vice versa, the £300 deduction **is not applied** on the annual declaration, as it is taken into account in respect of all of the claims for the year. This deduction is made by the Revenue when processing the claims.

Losses – Rental income

Where a rental activity incurs a loss it is normally carried forward and set against profits of subsequent years for tax credit purposes, as for tax purposes. Where the loss arises through capital allowances, its treatment for tax credit purposes is the same as the treatment of trading losses (see below).

Step 2

Add together

- Employment Income
- Social Security Income
- Student Income (i.e. certain student dependant grants)
- Miscellaneous Income

Where a claimant has been in receipt of maternity pay or paternity pay the amounts received are reduced by the sum of £100 per week.

Step 3

Add together steps 1 & 2.

Step 4

Add trading income to Step 3 or deduct a trading loss of the year from Step 3. From the above is deducted

- Gift Aid Payments – gross amount
- Pension Payments into an occupational scheme
- RAP/PP – gross amount

Employment income

The definition was amended after the initial regulations were released and now includes emoluments and benefits in kind which are taxable on the employee, less any amounts which are exempt from tax or can be claimed against the employment income under Part 5 of ITEPA 2003.

Trading Income

This is the profit or loss for the year under Schedule D Case I or V disregarding averaging. Where a loss is produced this is deducted from other income of the couple (including the spouse's income). Where this leaves a deficit, this is carried forward for deduction from trading profits (only) in the subsequent year. With regard to losses brought forward, losses incurred in 2001/02 and not relieved against the spouse's income for tax credit purposes may be brought forward into 2003/04. Losses incurred in the tax year 2002/03 are not included in tax credit claims at all.

Student Income

This means any grant under the Education (Student Support) Regulations 2002 other than

- A grant for a dependant child,
- A grant for books, travel or equipment

Foreign Income

This means income arising outside the UK which is **not**

- Employment Income
- Trading Income
- Investment Income

Foreign income is computed on an income arising basis whether or not remitted.

Notional Income

Notional Income means income, which a claimant is treated as having, but which he does not in fact receive. This includes amounts treated as income under the Taxes Act including

- s34 Premium on Rent
- s249 Stock Dividends
- s421 Release of a loan to a participator by a close company
- s660A Income rising under a settlement where the settlor retains an interest,
- s660B payments to unmarried minor children of the settlor
- s677 sums paid to settlor otherwise then as income

If a claimant has deprived himself of income for the purpose of securing entitlement to, or increasing the amount of a tax credit he is treated as having that income. If income would become available to a claimant upon making an application for that income he is treated as having that income.

If a claimant provides a service to another person, who could afford to pay, for less than full value then trading income or employment income is deemed to include such an amount. This does not apply where the claimant is a volunteer providing services to a charitable or voluntary organisation.

Article by Rebecca Benneyworth

Lecture P558 (9.22 Minutes)

Tax credits – the problems with renewals

Once the confirmation of actual income of the year of award has been received, the final entitlement will be determined. This will be followed by the issue of the final notice of entitlement. The tax credits awarded and paid in the year will be amended by the income taper effect as follows :

- A reduction in income producing additional entitlement through less taper will produce an additional award payable immediately. The original recipient (that is, either the working partner or the main carer) will receive the top up payment.
- An increase in income of no more than £25,000 will not affect the award made. The next year's award, however will of course take into account the increased income.
- An increase in income of in excess of £25,000 will produce additional taper using the increase in excess of £25,000.

Recovery of overpaid tax credits

Where a claim remains in payment, overpaid tax credits are recovered against the future entitlement as follows:

- Where the full award is available – that is the current income is below the first income threshold of £6,420 (more for those entitled to child tax credit only) – the rate of recovery is 10% of the current award.
- Where taper has applied, but the claimant(s) remain entitled to some fast taper credits the recovery rate is 25%.
- Where the family element only is currently awarded the current award is forfeit.
- Where no entitlement to tax credits remains the claimant will be rendered a demand for payment, which is subject to joint and several liability between a claimant couple.

Note that these rules apply only to repayments in respect of overpaid tax credits for preceding year and not to current year overpayments.

Renewal procedure

In April of each year, renewal packs are sent out. The procedure is as follows :

- Those in receipt of the family element only or nil awards will be automatically renewed. The award will continue in payment, but the claimants will need to review their renewal carefully. They will need to confirm that the statement of circumstances is correct for the whole of the year just ended. They will then need to confirm that the income they have received in the year just ended is within the range shown on the renewal form. A further confirmation of the likely income for the following year is also necessary – once again a range of income is provided on the renewal form. This being the case, no further action is necessary and the award will continue in payment.
- Those in receipt of more than the family element will receive a full renewal, on which their entitlement is stated, and on which they will declare their income for the year. This will then amend the award to finalise it and enable the next year's award to be provisionally calculated. Once again, the claimants will check that their circumstances are correctly stated throughout the tax year and then declare their actual income for the year just ended.
- Awards will remain in payment at the previous year rates until the renewal notice is filed or 31 July.
- Renewal notices can be filed with provisional amounts, and it is possible to extend the renewal date to 31 January where self employed individuals do not have their income ready for renewals by 31 July. In this case provisional figures should be submitted to avoid withdrawal of the tax credits in payment.

Clearly, when the renewal is likely to produce large fluctuations in entitlement the claimant's interests are best served by prompt filing of the renewal form.

Renewal procedures – practicalities

There are essentially two separate renewals processes, depending on the award made to the claimants in the year just ended. These will be dealt with separately.

Family element and Nil awards

Those in receipt of the family element only or nil awards will be automatically renewed. The award will continue in payment, but the claimants will need to review their renewal carefully.

Claimants need to confirm that the statement of circumstances is correct for the entire year or period of award, and for the subsequent tax year.

They will then need to calculate their income for tax credit purposes, and check that is it within the range shown on the renewal form. Provided the income falls within the stated range, there is no need for the claimants to notify HMRC Tax Credit office, and the award will continue in payment as before.

The reason for the renewal being done in this way for these claimants is to reduce the work involved in renewals. The likelihood of a change in income producing a change in the award is slight, and so a "No reply" structure has been adopted, with claimants only contacting HMRC if the income falls **outside** the range quoted.

Example

In 2008/09 Tina and Tim had two qualifying children.

Tim works full time, and they have no childcare costs eligible for tax credits.

Their joint income for the year 2007/08 was £29,000, on which a tax credit award of £545 was made.

In 2008/09 their joint income rose to £30,000.

Gross tax credits

Basic	1,800
Couple	1,770
30 hours	735
Child x 2	4,170
	8,475

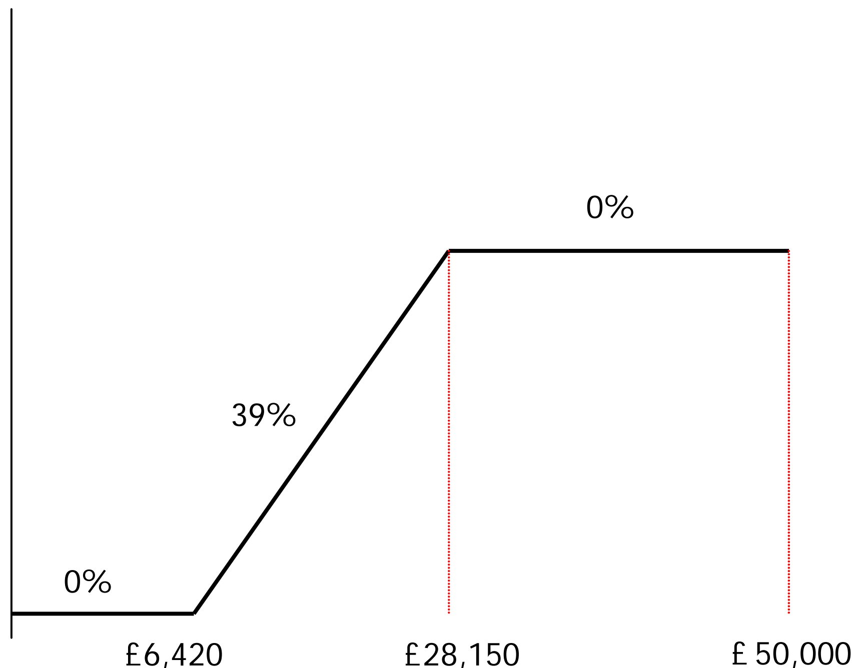
The taper of 39% of income over £6,420 gives a taper amount of £8,806, and thus the award made is of the family element only.

The amount of income which would provide the transition from family element to fast taper tax credits is

£8,475 / 39% + £6,420 = £28,150

Thus, unless Tim and Tina's income falls below £28,150 or rises above £50,000 there will be no change in their tax credit award.

Graph of rates and amounts of taper against income



A similar range is quoted for the subsequent year to ensure that payment at the current rate is appropriate, and then no further action need be taken.

However, where the final income figures are not known for a claimant in this position, in the absence of any notification to HMRC, they will regard that year as final, and the award cannot subsequently be revised. This is easy to miss for those clients, and should be looked at carefully within the practice. Ideally the client, or the adviser should write to HMRC and advise that the income is not yet final, and therefore the tax credit claim for the preceding year should remain open until 31 January. In the absence of such notification the previous year will be closed and should the income of the claimants fall substantially, no further payment of tax credits would be available to them.

Full awards – review and declaration

Those in receipt of more than the family element will have to submit a full renewal, on which their entitlement is stated, and on which they will declare their income for the year. This will then amend the award to finalise it and enable the next year's award to be provisionally calculated.

Once again, the claimants will check that their circumstances are correctly stated throughout the tax year and then declare their actual income for the year. The calculation of income is prepared according to the tax credit rules, and you should note that there are some significant differences from normal tax rules. The joint income of a couple is declared on the renewal pack.

Article by Rebecca Benneyworth

Lecture P559 (12.04 Minutes)

Emoluments or gain?

The appellant was employed by Sensormatic in 1998 and was later given options to purchase shares in the company. It was agreed that if there were a change in control of the company, the appellant would be allowed to sell any shares he held in Sensormatic at the price paid on the change in control.

In 2001 Tyco offered to buy Sensormatic via an exchange of shares. Just before the transaction took place, the appellant exercised his options and so held shares in Sensormatic.

After Tyco had acquired the company, he exchanged his Sensormatic shares for shares in Tyco, which were valued at $47.245 each.

Then in 2002, when the shares were worth $17.269 he called on Tyco to buy back the shares at the price paid on the change in control. The appellant's gain was in the region of £1.5 million.

HMRC said the gain should be treated as emoluments of the appellant's employment. It should be taxed under Schedule E because he had disposed of his Tyco shares to his employer for a consideration which exceeded market value and had acquired them originally as a result of his employment within the meaning of TA 1988, s 162.

If that failed, HMRC said that the difference between the price which Tyco paid the appellant for his shares and their market value on that date was a benefit under s 154.

Conclusion

The tribunal judge concluded that the appellant had not acquired his Tyco shares by reason of his employment. His right to acquire the shares in Tyco was because of a general offer and because he held Sensormatic shares. It was not because he was employed by Tyco.

The exchange of shares was a fair bargain at a fair valuation, and in the exchange he gave up Sensormatic shares worth the same as Tyco shares.

Thus HMRC's s162 argument failed.

Turning to the s 154 argument, the judge applied the principle in *Mairs v Haughey* [1993] STC 569. She said that Tyco had agreed to honour the terms and benefits of Sensormatic's employee plans when it took over the company.

The provisions in the change in control agreement referred to 'the provision of benefits and protection' indicating a clear intention of giving a gratuitous benefit to each employee.

Section 154 would have applied had the payment been made by Sensormatic. It remained a benefit under s 154(2) when paid by Tyco.

She further concluded that the benefit was provided to the appellant by reason of his employment and that a cash payment could constitute a benefit.

The taxpayer's appeal was dismissed.

John Patrick Smith (TC 163)

Capital Gains Tax

Ernest Burton and related appeals

An appeal concerned a flip flop scheme, specifically the liability of offshore settlements to capital gains tax in respect of trustees' gains in the year of assessment.

The taxpayer set up a trust in 1994 with the initial sum of £10 and himself as life tenant. The trustee company was resident in the Isle of Man. Next the taxpayer settled 31,250 shares from Streamline Holdings Ltd in the trust, and the trustee transferred them to Broomhurst, a Manx company.

In 1998 Broomhurst accepted an offer from Jarvis plc for the shares and received loan notes in exchange.

In March 1999, the taxpayer established another trust, this time with UK resident trustees.

Two days later, the trustee of the 1994 trust borrowed £1.433 million from Coutts, and three days after that, the trustee appointed £1.386 million to the trustees of the 1999 trust.

The taxpayer and his family were subsequently excluded from the class of beneficiaries of the 1994 trust.

Broomhurst redeemed the Jarvis loan notes in 1999/2000. It was then liquidated and the proceeds of the redemption were paid to the trustee of the 1994 trust which repaid the Coutts loan.

The issue was whether the taxpayer was liable to capital gains tax under either TCGA 1992, s 86 or s 87, on the gain realised by the 1994 trust on the liquidation of Broomhurst following the redemption of the Jarvis loan notes.

Looking first at the s 86 point, the tribunal judges, Theodore Wallace and Adrian Shipwright, said that the crucial point here was whether the fact that the source of the £1.386 million appointed was the loan secured on an asset remaining in the 1994 trust, resulted in the taxpayer having a continuing interest in the 1994 trust in 1999/2000.

They both agreed that during that year the taxpayer had had no interest in the 1994 trust as a matter of trust law or within the meaning of 'an interest in a settlement' in Sch 5, para 2(1)(c).

The s 87 point divided the judges. Wallace J said that when the money was transferred from the first to the second settlement, the taxpayer should be treated as receiving a capital payment within s 87(4).

However, this was subject to s 97(4) because the payment was not an 'outright payment of money'. The value of this payment however was effectively nil.

Shipwright J did not consider that the taxpayer had received a capital payment from the 1994 trust and therefore no charge could arise under s 87.

The taxpayers' appeals were allowed.

CGT on unapproved employee share options and EMIs

This Revenue and Customs Brief addresses questions HMRC have received concerning the practical implications of Revenue & Customs Brief 30/2009 on the application of CGT to share options on unapproved employee and Enterprise Management Incentives share options.

Losses accrued in tax years prior to 1996–97

Q1 Where a pre–1996–97 loss has been calculated but remains unused, it may have been shown in a pre–Self Assessment return or included in the summary record of the totals of unused losses in a Self Assessment return. Is the quantum of the loss final or does it fall to be recomputed in accordance with the new guidance should gains now accrue from which it must be deducted?

A1 The quantum of the loss is not "final". For years before the introduction of Self Assessment there is no statutory mechanism for agreeing or litigating the amount of a capital loss accruing on a disposal of an asset in the absence of gains for it to be set against. A taxpayer cannot have the quantum of a loss brought before the First–tier Tribunal until such time as a gain arises against which the loss can be set. This statutory position was endorsed in the tax case Tod v South Essex Motors (Basildon) Ltd 60TC598.

Q2 If not final, on what basis has HM Revenue & Customs (HMRC) reached this conclusion?

A2 Where a loss accrues on a disposal in years before 1996–97, HMRC cannot open an enquiry into that loss until it is deducted from chargeable gains. So if a loss arose on a disposal in 1995–96 and is deducted from chargeable gains accruing in 2009–10, HMRC may enquire into that loss as part of an enquiry into the 2009–10 return. There is no statutory mechanism for agreeing or litigating the quantum of the loss arising on the disposal made in 1995–96 in advance of the 2009–10 enquiry. Any such loss deducted in 2009–10 has to be computed in accordance with our current understanding of the law.

Q3 Should such unused losses have to be recomputed, taxpayers would seem to be in an uncertain position as regards pre–1996–97 losses because, if there is a changed understanding of the law, the quantum might change. What is HMRC's view of a change in legislation to give taxpayers more certainty?

A3 A claims mechanism for allowable capital losses was introduced by Finance Act 1995 with effect for 1996–97 and subsequent years to coincide with the adoption of Self Assessment. Parliament decided at that time not to change the system for pre–Self Assessment years.

Losses accrued in tax years 1996–97 onwards: enquiry window now closed

Q4 In 2001–02 Susie sold shares she had acquired earlier that tax year through the exercise of an unapproved share option. Based on the Revenue note of 8 January 2003 Susie claimed an allowable loss of £18,000 in her 2001–02 return. There was no enquiry into her return. No losses or gains accrued to her otherwise than on this disposal until in 2008–09 Susie realised chargeable gains of £100,000. What losses are deducted from the 2008–09 gains?

A4 Where there has been a claim for an allowable loss accruing in 1996–97 or a later year, the deduction of that loss from chargeable gains does not extend the time limit for opening an enquiry into the original claim. Losses £18,000 are deducted from the 2008–09 chargeable gains.

Losses from earlier years only partially used

Q5 In 1993–94 Ravid sold shares he had acquired on the exercise of an unapproved employee share option. In accordance with the Revenue's then guidance he returned chargeable gains of £10,000 on that disposal and was assessed to capital gains tax. Subsequently based on the Revenue's then understanding of the law as published on 8 January 2003 he calculated that there was a loss of £40,000 on the disposal of the shares. He could not claim error or mistake relief and deduct the loss from his 1993–94 chargeable gains as he had made his return for that year in accordance with the practice generally prevailing at the time it was made.

No chargeable gains or losses then accrued until 2004–05. Ravid returned for that year chargeable gains of £25,000 and deducted £16,800 of the 1993–94 losses so as to reduce the gains to the level of the annual exempt amount leaving £23,200 (£40,000 less £16,800) of the losses unused. No enquiry was made into Ravid's 2004–05 return. No further chargeable gains or

losses accrued to Ravid until 2009–10 when he realised chargeable gains of £20,000. On the basis of the HMRC's understanding of the law as announced on 12 May 2009 there would have been a gain of £10,000 on the disposal in 1993–94 rather than any loss. What are the implications for Ravid?

A5 It is too late now for Ravid to amend, or for an enquiry to be opened into, his 2004–05 return. Ravid made his 2004–05 return in accordance with the practice generally prevailing at the time it was made and so no assessment can be raised to withdraw the losses that were deducted (see A11 below). But as HMRC do not now agree that any allowable loss accrued on the disposal in 1993–94 we would not accept that in calculating Ravid's 2009–10 liabilities there was any balance of losses accruing in an earlier year that have not been allowed as a deduction from chargeable gains accruing in a previous year.

Q6 In 1998–99 Rowena sold shares she had acquired some years earlier on the exercise of an unapproved employee share option. In accordance with the Revenue's then guidance she returned chargeable gains of £10,000 on that disposal. Subsequently based on the Revenue's then understanding of the law as published on 8 January 2003 she calculated that there was a loss of £40,000 on the disposal of the shares. In March 2003 Rowena made a 1998 99 claim for allowable losses of £40,000 – no enquiry was made into that claim. Rowena could not claim error or mistake relief for 1998–99 as she had made her return in accordance with the practice generally prevailing at the time it was made but following the Revenue's guidance published in March 2003 she set £10,000 of the loss against her 1998–99 chargeable gains and received a repayment of tax. Thus £30,000 of Rowena's 1998–99 losses had not been allowed as a deduction from chargeable gains.

No chargeable gains or losses then accrued to Rowena until 2004–05. Rowena returned for that year chargeable gains of £25,000 and deducted £16,800 of the losses so as to reduce the gains to the level of the annual exempt amount leaving £13,200 (£30,000 less £16,800) of the losses unused. No further disposals were made by Rowena until 2009–10 when she realised chargeable gains of £20,000. On the basis of the HMRC's understanding of the law as announced on 12 May 2009 there would have been a gain of £10,000 on the disposal in 1998–99 rather than any loss. What are the implications for Rowena?

A6 As in A5 above, Rowena's 1998–99 and 2004–05 self–assessments are not now capable of variation. But unlike A5, the 1998–99 losses that were claimed which have not been allowed as a deduction from chargeable gains accruing in a previous year remain available for Rowena to deduct from her 2009–10 chargeable gains (see A4 above). Losses of £9,900 are deducted from the 2009–10 chargeable gains to reduce them to the level of the annual exempt amount leaving £3,300 (£13,200 less £9,900) of the losses unused and available to deduct from chargeable gains accruing in future years.

Gains or losses accruing in tax years 1996–97 onwards: enquiry open

Q7 Does HMRC consider that chargeable gains returned or losses claimed before 12 May 2009 in accordance with HMRC's previous understanding of the law should be revised where the return is under enquiry?

A7 Subject to A15 below, yes. If there is an enquiry the closure notice issued at the completion of the enquiry and any amendment it makes should be in accordance with the law. Revenue & Customs Brief 30/09 sets out HMRC's current understanding of the law.

Q8 Where there is an enquiry into a return on an unrelated matter and it is now past the time for opening an enquiry into that return will HMRC amend the chargeable gains returned or losses claimed to reflect HMRC's current understanding of the law if the chargeable gains or losses were computed in accordance with practice at the time the return was made? Would the position be the same for a "full" enquiry?

A8 Subject to A15 below, yes. An enquiry is opened to check that a return is correct and may extend to anything contained within the return. The closure notice issued on completion of the enquiry and any amendment it makes must be in accordance with the law. The position is the same for all enquiries whether "full" or not.

Q9 Where an enquiry is closed and losses are reduced, how do you deal with later years in which the losses that had been claimed were deducted from chargeable gains accruing? For example, Roderick claimed losses of £40,000 in his 2005–06 return, which was the subject of an enquiry.

When the enquiry for that year was concluded the losses were only £12,000. Roderick had set £25,000 of the losses he originally claimed in 2005–06 against the chargeable gains he returned for 2006–07 and the balance of £15,000 against the chargeable gains he returned for 2007–08.

A9 When the allowable losses from an earlier year that have been allowed as a deduction from chargeable gains accruing in a later year are reduced, it may be necessary to amend the return for the later year. If that return cannot be amended, whether on the closure of an enquiry or otherwise, an assessment may be required. In the example Roderick can only set losses of £12,000 against his 2006–07 gains. If Roderick can amend his 2006–07 and 2007–08 returns, or when any enquiry into those returns is closed, the losses deducted should be corrected. If there is no enquiry into either of the returns and they have not been amended, assessments may be needed to correct the losses that are deducted.

Tax years for which HMRC may still open an enquiry – the position of the taxpayer

Q10 Does HMRC consider that any action is required where returns or claims that were made in accordance with HMRC's previous guidance are not under enquiry but are within the time limit for amendment, and if so why?

A10 We anticipate that taxpayers will ensure that their returns or claims are in accordance with the law and make any necessary amendments if they are in time to do so.

Q11 Is there any question of a taxpayer being at fault if he or she had made a return before 12 May 2009 on the basis of HMRC's previous guidance? Can HMRC confirm that this was then the "prevailing practice"?

A11 We regard our previous guidance as describing the practice generally prevailing from the time of its publication on 8 January 2003 until 12 May 2009 when Revenue and Customs Brief 30/09 was published. HMRC would not regard the fact that a return was made during this period in accordance with the practice then generally prevailing to of itself mean that the return had been made negligently.

Basis for HMRC's current understanding of the law

Q12 Will HMRC provide details of the legal advice they have received which forms the basis for their current understanding of the law?

A12 HMRC does not supply legal advice that it has received, which is covered by Legal Professional Privilege and in most cases may also be the subject of taxpayer confidentiality.

Q13 What is the detailed explanation of HMRC's new understanding of the legal position?

A13 HMRC's current understanding of the interaction of section 38(1)(a) and sections 119A and 120 TCGA 1992 when section 17 TCGA 1992 operates to substitute the market value of the shares acquired at the time an option is exercised is as follows:

So far as the cost in money of shares acquired on the exercise of an employee share option is concerned, subsection (1) of section 38 lays down what may be deducted in computing the chargeable gain on the disposal of the shares as follows:

"(1) Except as otherwise expressly provided, the sums allowable as a deduction from the consideration in the computation of the gain accruing to a person on the disposal of [the shares] shall be restricted to–

(a) the amount ... of the consideration in money ... given by him ... for the acquisition ..."

Subsection (2) of section 119A (and subsection (2) of section 120) then provides that

"(2) Section 38(1)(a) applies as if the [amount counting as income] had formed part of the consideration given by the person making the disposal for his acquisition of the [shares]."

We now consider that the effect of this legislation is that the "consideration in money" as referred to in section 38(1)(a) that was given for the shares is treated as enhanced by the amount counting as income. And the aggregate amount is the sum that would therefore fall to be deducted in the computation of the gain as the cost of acquisition.

However, where section 17 TCGA 1992 applies to replace the consideration given on exercise (and any consideration given for the option that would otherwise be treated by section 144(3)(a)

TCGA 1992 as if it were also part of the cost of acquiring the shares) it provides, in subsection (1), that

"(1) ... a person's acquisition ... of an asset shall for the purposes of this Act be deemed to be for a consideration equal to the market value of the asset ..."

So where section 17 applies we now regard both the consideration actually given for the shares and the amount counting as income that is treated by section 119A or section 120 as forming part of the consideration given for the acquisition of the shares as having been replaced by the market value of the shares on exercise.

Disclosure

Q14 If a taxpayer disagrees with HMRC's guidance and returns chargeable gains or claims losses on a different basis should he or she disclose in the "white space" within the return that the return has not been made in accordance with HMRC's published understanding of the law, and if this is done would it provide protection against a discovery assessment?

A14 Statement of Practice SP1/06 contains detailed guidance. The Statement includes the following:

Taxpayers who adopt a different view of the law from that published as the Revenue's view can protect against a discovery assessment after the enquiry period. The Return would have to indicate that a different view had been adopted by entering in the Additional Information space comments to the effect that they have not followed Revenue guidance on the issue or that no adjustment has been made to take account of it. The background note states:

"18. It is open to a taxpayer properly informed or advised to adopt a different view of the law from that published as HMRC's view. To protect against a discovery assessment after the enquiry period, the return or accompanying documents would have to indicate that a different view had been adopted. This might be done by comments to the effect that the taxpayer has not followed HMRC guidance on the issue or that no adjustment has been made to take account of it. This would offer an opportunity to HMRC to take up the return for enquiry. It is not necessary to provide all the documentation that HMRC might need to quantify that insufficiency if an enquiry into the Return is made.

19. Provided the point at issue is clearly identified and the stance adopted is not wholly unreasonable, the existence of an under–assessment or insufficiency is demonstrated by the statement that a different view of the law has been followed. In these circumstances the taxpayer achieves finality if no enquiry is opened within the statutory time limit."

Taxpayers who used HMRC's previous guidance

Q15 Do taxpayers who before 12 May 2009 computed their chargeable gains or losses in line with the Revenue's guidance that was published on 8 January 2003 have a "legitimate expectation" that their tax treatment should be more favourable than it would be under HMRC's current understanding of the law?

A15 HMRC does not accept that its published guidance alone can necessarily create a "legitimate expectation" for a taxpayer. Whether a taxpayer has a legitimate expectation will depend upon the specific facts and circumstances of the case. Chargeable gains and allowable losses included in returns or claims should be calculated on the correct statutory basis, which HMRC now understand to be as described in Revenue & Customs Brief 30/09. HMRC's primary responsibility is to apply the law correctly and collect underpaid or under–declared tax. However, in some limited circumstances, to apply the statute may be so unfair as to amount to an abuse of power by HMRC and in these circumstances HMRC may be bound by its previous guidance. We will normally be bound by previous guidance where the taxpayer can demonstrate that he or she:

– reasonably acted in reliance on the previous guidance, and

– would suffer detriment from the correct application of the statute.

To have acted in reliance on the advice the taxpayer must have done or refrained from doing something as a direct consequence of the advice. HMRC understand that in this context "detriment" means real loss, it is not sufficient to have merely suffered disappointment or upset.

These questions and answers address practical implications that may have been raised by Revenue & Customs Brief 30/09. The examples in this Brief are, of course, simplified and are intended to illustrate the general principles. The exact position in any actual case will depend on the precise facts and circumstances of the case.

Revenue & Customs Brief 30/2009

Dividing property as part of a divorce settlement

This article highlights the main areas to be considered from a tax point of view when negotiating and agreeing a settlement involving property assets. (References to a married couple in this article should also be taken as references to civil partners).

CGT on separation

Where assets are transferred at any time up to the end of the tax year of separation, it will be treated as having been made on a 'no gain/no loss' basis, allowing the transferee to acquire the asset at the transferor's original acquisition cost and avoiding an immediate charge to capital gains tax.

However, disposals after 5 April in the year of separation, but before decree absolute, will be taxed as if the transfer had occurred at open market value, as the separated couple are now treated as connected persons for tax purposes.

The family home

Only or main residence relief is usually available under TCGA 1992, s 222 to exempt any gain on the disposal of the family home, or an interest in it and is available for a period of three years following departure of either spouse.

Where a settlement has not been reached within this time frame, further relief is potentially available under TCGA 1992, s 225B for disposals after 6 April 2009 (disposals before that date relied on extra-statutory concession D6). This former concession, now on the statute books, provides for the situation where a couple separate or divorce and one partner ceases to occupy the matrimonial home, and subsequently as part of a financial settlement disposes of the home, or an interest in it, to the other partner.

The home is regarded for the purposes of s 222 as continuing to be the residence of the transferring partner from the date their occupation ceased until the date of transfer.

The application of s 225B (and previously ESC D6) is conditional on the transferring spouse not having elected for another property to be their main residence under s 222.

Where the non-resident spouse is likely to purchase a property which will become their main private residence, and the sale of the family home is deferred, transferring the property into trust can provide a capital gains tax shelter. Such a trust arrangement can be achieved by agreement between the parties or by a court order known as a Mesher order.

Mesher orders

In some circumstances, the court will order the postponement of the sale of the family home until certain conditions are met, such as the children reaching a certain age or the spouse either dying or remarrying.

Such an order is known as a Mesher order, the effect of which is to allow one spouse to remain in occupation.

HMRC's *Capital Gains Manual* (at CG65365) states that a Mesher order creates a settlement for capital gains tax purposes.

Therefore TCGA 1992, s 70 comes into play, treating the transfer to the trust as a disposal of the whole asset (deemed to be at market value) to the trustees even though one of the transferors will retain an interest in it as a beneficiary under the settlement.

Provided the property meets the conditions for a main residence, the gain on the creation of the settlement should be exempt by virtue of s 222 relief.

At some point in the future the relevant conditions will be met and the trust arrangement will cease at that point.

The property is treated as having been disposed of by the trustees and provided that the property has been occupied as the only or main residence of the spouse entitled to occupy it under the terms of the order or agreement, main residence relief under s 222 will again be available by virtue of the provisions of TCGA 1992, s 225 to the trustee for the trust period.

The non-occupying spouse is then deemed to have reacquired a share in the property at its current market value.

Any subsequent gain on the disposal would potentially be taxable based on the increase in value between the date of the deemed disposal out of the trust and the eventual sale.

Alternative arrangements

In some cases, the court order may not actually result in a disposal. This might occur where the court simply recognises an existing equitable share, or provides for an amount to be paid to the non-occupying spouse from the eventual sale proceeds.

In these circumstances there is no disposal and therefore a potential exposure to capital gains tax for the non-occupying spouse when the property is eventually sold.

For these reasons, in appropriate cases where a sale is likely to be deferred for an extended period, consideration should be given to holding the property in trust.

Whether a Mesher order is given by the court, or private arrangement made, this may be the most effective means by which main residence relief can be made available over the maximum period.

Second homes

There has in the past, and there will continue to be until April 2010, an opportunity to avoid an immediate charge to capital gains tax on the transfer of 'furnished holiday lettings'. Provided the property meets the relevant qualifying conditions, it can be treated as a business asset for the purposes of holdover relief under TCGA 1992, s 165.

Such a transfer, as part of a financial settlement, would not normally be regarded as a gift, but holdover relief under s 165 on qualifying assets is available for disposals that take place prior to the decree absolute, and after divorce, where the court makes an order transferring assets on an ancillary relief application or formally ratifies an agreement between the parties.

A holdover claim might appear attractive at the time of the agreement, particularly as there are no actual disposal proceeds, but the transferee spouse should be aware that they are taking on the inherent capital gain from the transferor.

On eventual disposal of the asset they will be taxed on the total gain arising on the full joint-ownership period.

The April 2009 Budget proposals to the rules for furnished holiday lettings, which are effective from 6 April 2010, mean that they will no longer qualify for holdover relief. Where existing divorce proceedings are likely to result in such a transfer and claim for relief, the deal will need to be done before the new rules apply.

From an article by Paul Benney writing in Taxation, September 2009

Inheritance Tax and Trusts

Avoiding 50% tax: Cheap loans and EBTs

With a 50% 'super tax' fast approaching, the idea of taking cheap company loans instead of cash remuneration is looking increasingly attractive for many higher paid directors and employees. However, you cannot take a long term loan from your company without the company incurring a tax charge under section 419 of the 1988 Income Tax Act (ICTA 1988).

One way to get around this problem is to set up an Employee Benefit Trust (EBT). This allows you to transfer funds into your trust, which then advances them to you and your family and employees. So far, so good - cheap loans all round. However, HMRC seems to have finally had enough with EBTs. It has just published a briefing to illustrate its 'new' view that if your company is a close company, and you are one of its participators, any loan back to you from your EBT will incur an inheritance tax charge. It is an interesting approach and HMRC has to jump through several hurdles to get there.

EBTs in a nutshell

An EBT is a special sort of trust which is set up to benefit 'all or most of the persons employed by or holding office with the body concerned'.

They were a tax planner's dream for a while. Up until 2002 a company could make a contribution into an EBT and receive corresponding corporation tax deduction for the payment. The trustees of the EBT would then use these funds to confer benefits to the company's employees, and some companies used them to make large loans (sometimes millions of pounds) to employees, but normally it went to the directors and their families, who benefited from the tax free cash, often using a web of sub-trusts. Incidentally, if you happened to die in service, this sort of loan can be written off tax-free too.

Following the case of MacDonald (HMIT) v Dextra Accessories, the government changed the rules. From 27 November 2002 a company is no longer entitled to tax deduction on its contribution to the EBT unless the EBT applies the funds within nine months of the company's year end as some form of remuneration which is subject to PAYE and NICs.

The result has made EBTs less attractive, but they remain a useful tool when it comes to tax planning as they can still be used to make cheap loans to employees, distribute profits and fund share ownership trusts. They are also handy when income tax is so high in comparison to corporation tax.

The close company trap

A close company is basically a UK registered company with five or less participants/directors - see section 102(1) of the 1994 Inheritance Tax Act (IHTA 1984) though for a full description.

When a company is close there are special rules to ensure that it cannot use its funds (which are, after all, its participator's funds), to avoid inheritance tax. Therefore, when a close company transfers its funds into a trust which is set up for the benefit of the company's participators, this can become a taxable event under IHT transfer of value provisions, according to HMRC. These rules create a tax charge on the funds transferred proportionately according to each participator's interests, subject to their available annual IHT exemption.

Not every transfer of funds, or 'disposition' as it is known in IHTA speak, is only treated as transfers of value (i.e. taxable). There are exemptions which are found in sections 10 to 13 of IHTA 1984. These cover dispositions that are:

- Section 10: Not intended to confer gratuitous benefit.
- Section 11: For the maintenance of family (not relevant here).
- Section 12: Allowable for income tax or corporation tax, or if it provides retirement benefits to employees and their dependants under an approved pension arrangement.
- Section 13: Into a trust not designed to benefit a close company's participators.

EBTs and transfers of value

When a close company makes a contribution into an EBT, the EBT's trust deed is drafted so that the trustees have to use the funds to reward employees for their past services. This means that there is not normally any intention to confer any gratuitous benefit and therefore the section 10 exemption applies. HMRC disagrees with this and argues that there must be a gratuitous benefit, particularly when the scheme is set up to provide unlimited loans to the controlling director.

If the EBT does not use the company's contribution within nine months of the company's year end to make payment which is subject to tax, the contribution is effectively held in 'corporation tax limbo'. It is an asset for tax (and on the company's balance sheet) and it is only when the EBT converts the payment into taxable earnings in a later period that the contribution becomes allowable for corporation tax for the company. As the payment is not allowed for corporation tax, this means that it must be a transfer of value of this point, so this rules out the exemption in section 12 too.

There is no relief under section 13 as the loan is made to participators.

HMRC is going to be homing in on close company EBTs and if it is correct in its analysis, IHT is payable by the company. It is due six months after the end of the month in which the contribution is made, or at the end of April in the year following a contribution made between 6 April and 30 September inclusive. Interest is charged on any unpaid tax from the due date. If the company does not pay, HMRC will collect it from its participators (see paragraph 30124 of its inheritance tax manual, 'Liability in Special Cases: Transfers by a Close Company').

Is HMRC right?

The application of the transfer of value rules is just HMRC's view of how things stand. It looks reasonable, especially if the loans are being made to one person of their family on a semi-permanent basis. Then again, can the creation of an asset in the company's balance sheet really be defined as a transfer of value, particularly when any employee loan is capable of it or will be repaid, and tax will be paid on the funds at a later date?

I put these questions to David Heaton, who is Baker Tilley's top man when it comes to employment taxes. He says that the guidance is 'contentious', and notes that whoever wrote HMRC's guidance has not noticed that we have a new Corporation Tax Act. (It's quite cheery to see that tax is evidently so taxing that even HMRC can't keep up with it!).

David thinks that a properly drafted EBT will probably scupper this interpretation, and believes that the gratuitous benefit part is going to be difficult for HMRC to argue. "Only time will tell whether the tribunals agree", he says.

As with all these things, the devil is in the detail. If you have an EBT set up, you may want to have your paperwork reviewed in the light of HMRC's new approach.

HMRC says: "Pending the resolution of any legal challenge to this view, existing cases will be pursued by HMRC on this basis".

Article by Nicola Ross Martin writing in AccountingWeb on 17 August 2009

LexisNexis® Tolley

Administration

Extra Statutory Concessions - is it all over?

Following the case of R v HM Commissioners of Inland Revenue ex parte Wilkinson [2005] UKHL 30, HM Revenue and Customs (HMRC) has taken a hard line on the concessions it operates. It will not make any new Extra Statutory Concessions (ESCs) and it is slowly but surely working its way through every one to determine if it should be abolished or legislated. It is also turning its mind to unwritten concessions.

The case

Wilkinson was a case concerned with the widow's bereavement allowance but it cast doubt on the extent to which HMRC can offer concessions. It held that HMRC is unable to make ESCs that seek to contradict the legislation. Therefore whilst HMRC can create an ESC to resolve the law where it is unclear, it cannot create an ESC to oppose the law. This therefore raises the question as to how much reliance can be placed on an ESC.

The remaining concessions

HMRC has just published the latest booklet of ESCs as at 10 August 2009. This list covers concessions previously operated by the Inland Revenue which are still in use. ESCs previously operated by HM Customs & Excise can be found in Notice 48. This is the first updated list for around four years.

Action stations

In the past twelve months HMRC has published two formal technical consultations on what to do about 30 concessions and in addition there was an informal consultation at the beginning of the year on three further concessions. In the March 2009 Budget a number of concessions were listed which HMRC indicated would cease to apply from April 2010. Controversially one of these ‘concessions’ is equitable liability. This has elicited a vigorous campaign for its retention.

Some concessions will continue in existence but, post-*Wilkinson*, those which deviate in any material respect from the letter of the law are likely to be either withdrawn or enacted.

The Tax Faculty of the ICAEW has pointed out that concessions have been around for decades. The first concession was reported to the then Public Accounts Committee in 1897. It was the result of the successful attempt to exempt from death duty that part of the estate of Emperor Alexander III of Russia which was held by the Bank of England.

The number of concessions increased throughout the 20th century although they did not always find favour with the judiciary. Scott LJ said in a case in 1943:

> *No judicial countenance can or ought to be given in matters of taxation to any system of extra-statutory concession ... The fact that such extra-statutory concessions have to be made to avoid unjust hardship is conclusive that there is something wrong with the legislation.*

The latest, 2009, list contains just over 100 concessions still in existence.

The legislation process

ESCs to be legislated by order under s160, FA 2008 currently are:

A61	Clergymen's heating and lighting etc expenses
A68	Payments out of a discretionary trust which as taxable as employment income
B10	Income of contemplative communities or of their members
B47	Furnished letting of dwelling house - wear and tear of furniture
D26	Relief for exchanges of joint interests
D44	Rebasing/indexation: shares derived from larger holdings held at 31 Mar 1982
D50	Treatment of compensation
	Estimated Gift Aid donations by companies

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ESCs which are to be legislated using other powers (not s160, FA 2008) are:

A61 Clergymen's heating and lighting etc expenses; National insurance element
Zero rating of nurses' prescriptions by pharmacists
GP dispensing

Following the first round of consultation, ESC's previously enacted in legislation on 18 March 2009 (by SI 2009/730) using powers conferred by s160, FA 2008 are:

A33	Lump sum retirement benefits: Changes after 5 April 1980
D3	Private residence exemption: Periods of absence (A)
D4	Private residence exemption: Periods of absence (B)
D6	Private residence exemption: Separated couples
D15	Relief for the replacement of business assets: Unincorporated associations
D35	Employee Trusts: Transfers of assets to beneficaries
D37	Private Residence Exemption: Relocation arrangements
D51	Transfer of assets from a close company at undervalue
F7	Foreign owned works of art
F19	Decorations awarded for valour or gallant conduct exempt from IHT
I1	Gas and oil allowance
3.36	VAT: Imported works of art, antiques
	Exemption of spirits based flavourings and essences
	Travel and subsistence for the self employed
	Negilible value: cases involving earlier no gain/no loss
	National heritage sales by treaty to museums

ESC's enacted using previously existing powers are:

3.12	VAT: Buses with special features for carrying disabled persons
4.3	Insurance Premium Tax: Insurance relating to motor cars or motorcycles
	Relief for goods supplied

ESC's to be withdrawn with effect from 1 April 2010 are:

A56	Benefits in kind: The tax treatment of accommodation in Scotland provided for
C8	Close companies: Loan creditors
C13	Agricultural co-operative associations "second and third -tier" associations
D47	Temporary loss of charitable status due to reverter of school and other sites
3.8	VAT: use of margin scheme for vehicle sales when incomplete records have been
4.1	Insurance premium tax: Special accounting scheme introductory provisions
4.4	Insurance premium tax: Home contents insurance
6.1	Excise duties: hydrocarbon oil duty: duty paid deliveries for bonded
	Grants and subsidies: Highlands and islands Enterprise
	Equitable liability

The following ESC's have been deemed intra vires - and thus can stay as they are:

D16	Relief for the replacement of business assets: repurchase of the same asset
D21	Private Residence Exemption: Late claim in dual residence cases
D22	Relief for the replacement of business assets: Expenditure on improvements to
D24	Relief for the replacement of business assets: Assets not brought immediately into
D25	Relief for the replacement of business assets: Acquisition of an interest in an asset
D45	Rollover into depreciating assets
D49	Private residence relief: Short delay by owner-occupier in taking up residence

Francesca Lagerberg, Head of Tax at Grant Thornton UK LLP

Lecture P560 (9.19 Minutes)

Applications to serve notice

The First-tier Tribunal heard two cases where HMRC applied for consent to serve notices under FA 2008, Sch 36 para 5 on financial institutions to obtain documents about customers with UK addresses with non-UK bank accounts.

The first financial institution had associated companies in the Channel Islands and resisted the issue of the notice saying that according to the figures there was no serous prejudice to the collection of tax, there could be problems with confidentiality, the notice should stop at 5 April 2008 rather than 31 March 2009, and it was unduly onerous.

The second institution had a subsidiary in the Isle of Man which held information on some 3,600 relevant individuals. It appealed against the notice on the grounds that the extraction of the information would take 300 man days to obtain and that the documents would be unusable by HMRC.

The tribunal judge gave consent in each case, saying that the requirements for the notices were satisfied.

The applications were allowed in each case.

Re. application by CRC for approval to serve notice on financial institution (TC148); re. application by CRC for approval to serve notice on financial institution (TC149)

Are documents covered by legal professional privilege?

HM Revenue and Customs (HMRC) has published new regulations about whether information it has requested can be withheld due to legal professional privilege.

The regulations are in SI 2009/1916 The Information Notice—Resolution of Disputes as to Privileged Communications Regulations 2009, which became effective on 7 August 2009.

They apply where HMRC has given an information notice to a person and there is a dispute about whether the requested document can be withheld due to legal professional privilege. The aim is to provide a clear method to resolve these disputes.

HMRC will amend technical guidance and add new operational guidance to the Compliance Handbook in September 2009.

Meanwhile this Business Brief aims to give an overview of the new system.

Background

The new compliance checks legislation is one of the first pieces of cross cutting legislation designed to make the tax system simpler and more consistent.

From 1 April 2009, under Schedule 36 of the 2008 Finance Act, HMRC has one set of powers covering Capital Gains Tax, Corporation Tax, the Construction Industry Scheme, Income Tax, PAYE and VAT to:

- visit business premises to inspect the premises, assets and records
- ask taxpayers and third parties for information and documents

One restriction of these powers is that an HMRC officer cannot require a person

- to provide privileged information
- to produce the privileged part of a document

Information is privileged if a claim to legal professional privilege or, in Scotland confidentiality of communications, could be maintained in legal proceedings.

This is a complex area of the law but, broadly speaking, privilege attaches to:

- documents containing confidential communications between lawyer and client for the purpose of obtaining or giving legal advice
- documents produced for the purpose of contemplated or actual litigation

Information notice sent in correspondence

If an HMRC officer asks an unrepresented person for documents where legal professional privilege may be an issue, they should explain what documents may be protected by privilege.

The person or anyone acting on their behalf shall specify in a list each disputed document or type of document so they can be identified. They should send the list to HMRC by the deadline given in the information notice.

The officer should check the list and identify

- items they accept are privileged
- documents they do not need to see
- documents that they still need to see

The officer then needs to contact Central Policy or the HMRC Solicitor for advice about items they still need to see. If Central Policy or the HMRC Solicitor agrees some of these documents are not covered by privilege the officer must then contact the person and:

- explain why they think the document is not privileged
- tell the person they must send the document unless they disagree with HMRC's view
- tell them what they need to do if they want the Tribunal to decide whether the document is subject to legal professional privilege

The person must make an application to the Tribunal within 20 working days of the date of the HMRC letter.

Information notice given at a visit

It will be unusual for an officer to give an information notice at a visit. They should only do so if it is reasonable and proportionate, and to address an identified risk.

If the person has an adviser the officer should give them the opportunity to contact them. If the person is unrepresented, and privilege may be an issue, the officer should explain what documents may be protected by legal professional privilege.

If there are disputed documents the person should place them in a container that prevents the documents being seen. They will then seal, label and sign the container. The officer will countersign and take custody of the container.

The officer must ensure that container, with its seal intact, reaches the Tribunal so it can resolve the dispute. Although the deadline is 42 working days they should aim to do this within 20 working days.

If the documents are in electronic form the officer may be prepared to accept copies – see Ch43360–www.hmrc.gov.uk/manuals/chmanual/ch23360.htm.

Business Tax

Subsistence for employees and the self-employed

Employment Income Manual para EIM05200

If subsistence is paid at a scale rate, which is calculated to do no more than reimburse the expenditure incurred by the employee on allowable expenses, that is not in itself regarded as a round sum allowance. Accordingly, on application the employer can be authorised to make such payments gross.

That treatment can indeed apply to any expenditure where it is often difficult to obtain receipts and the item is widely incurred in broadly similar amounts.

Scale rate payments may be made to employees who necessarily travel in the performance of their duties or have to travel to a temporary place of work. The statutory rules are in Section 336 to 342 ITEPA2003. Where the employer agrees a scale rate in a dispensation, the scale rate may also be taken into account for NIC purposes.

Benchmark scale rates for employee day subsistence from 6 April 2009

HMRC has introduced an advisory system of benchmark scale rates which employers can use to make subsistence payments to employees who incur allowable business travel expenses free of tax and NICs.

The advisory system only covers benchmark scale rates for day subsistence payments. If an employer wishes to pay subsistence to employees who have to stay overnight they can either reimburse the actual cost incurred by the employee or agree a tailored scale rate to cover meals and other expenses in a dispensation with HMRC.

Under normal rules an employer is required to notify HMRC of all expenses paid to an employee, even where those expenses would be allowable, unless they have a dispensation. As part of the dispensation process, where business travel expenses are paid, the employer often agrees scale rates for travel and subsistence expenses with HMRC that broadly match the allowable expenditure incurred by its employees on business travel. HMRC normally expects employers to conduct a sampling exercise before it will agree to a particular rate being included within a dispensation. The aim of the exercise is to identify a reasonable level of allowable expenditure that reflects the most common level of spending. HMRC recognises that a sampling exercise can be burdensome and expensive for employers. It has therefore introduced an advisory system of benchmark scale rates for day subsistence payments that an employer can use without having to carry out a sampling exercise.

Applying the scale rates for employees

As part of this new approach, in response to concerns from some employers and professional advisers about consistency between what is agreed for different employers, HMRC also proposes to standardise the different scale rates that it will agree with employers.

Under the benchmark system, HMRC has set advisory scale rates for particular day subsistence expenses that it will accept for all employers. As long as the employee has incurred subsistence expenses while travelling on an allowable business journey, employers will be able to make tax and NICs free subsistence payments up to the advisory rates without agreeing them with HMRC. Employers wishing to use the benchmark scale rates for subsistence payments notify HMRC of their intention by ticking the appropriate statement/box on form P11DX before starting to use the system.

The rates that can be used are not particularly generous but nevertheless represent a relaxation of HMRC’s long-held view that consuming food and drink is to live, not to work. They can usefully be used by those running their own businesses via a limited company.

The rates are:

- **Breakfast rate** (irregular early starters only) - A rate of up to £5.00 may be paid where a worker leaves home earlier than usual and before 6.00 am and incurs a cost on breakfast taken away from his home. If the employee regularly leaves home before 6.00 am because, for example, he works an early shift he would not be entitled to use the breakfast benchmark scale rate.
- **One meal rate** (Five hour rate) - A rate of up to £5.00 may be paid where the worker has been away from his home/normal place of work for a period of at least five hours and has incurred a cost on a meal.
- **Two meal rate** (Ten hour rate) - A rate of up to £10.00 may be paid where the worker has been away from his home/normal place of work for a period of at least ten hours and has incurred a cost on a meal or meals.
- **Late evening meal rate** (irregular late finishers only) - A rate of up to £15.00 may be paid where the employee has to work later than usual, finishes work after 8.00 pm having worked his normal day and has to buy a meal which he would usually have at home.

If the employee is paid an allowance under the five or ten hour rule, the late meal allowance could still be paid if he finishes work after 8.00 pm and buys a meal that he would usually have at home. However, if the employee regularly finishes work late because, for example, he normally works the afternoon or evening shift, he would not be entitled to use the late evening meal rate.

The benchmark rates are the maximum tax and NICs free amounts that could be paid by employers who choose to use this system. An employer could of course choose to pay less than this rate. If a higher amount is paid without agreeing a tailored scale rate with HMRC, the excess should be subject to tax and NICs.

Benchmark scale rates must only be used where all the qualifying conditions are met as under:

- the travel must be in the performance of an employee's duties or to a temporary place of work
- the employee should be absent from his normal place of work or home for a continuous period in excess of five hours or ten hours
- the employee should have incurred a cost on a meal (food and drink) after starting the journey

There a number of other aspects as follows:

- The early starter and late finisher rates are for use in exceptional circumstances only and not intended for employees with regular early or late work patterns.
- Tax and NICs free scale rate payments must be limited to three meal rates in one day (or 24 hour period). A meal is defined as a combination of food and drink.
- Where employees are required to start early or finish late on a regular basis, the over five hours or over ten hours rates could be paid provided all the other qualifying rules are satisfied.
- Benchmark scale rates would not apply to employees covered by Working Rule Agreements, for which separate specific rates are already set for particular occupations.
- Some existing dispensations also include a tax free scale rate for staying with family and friends when employees are required to stay overnight on business. HMRC has reviewed this policy and concluded that there is no legal basis for giving tax relief because it is not linked to any specific underlying expense. Therefore, a scale rate for staying with family and friends will not be included within the advisory system or given in any new dispensations. All agreed tax and NICs free scale rates in existing dispensations covering such an allowance will be withdrawn when the dispensation comes up for review.
- Employers wanting to use the benchmark rates should apply to HMRC for a dispensation, by completing form P11DX, On the form you need to indicate with a tick against the appropriate statement under 'Travel and Subsistence' that you intend using HMRC's benchmark scale rates to reimburse your employees' subsistence payments. By ticking this box you would be merely notifying HMRC that you intend paying HMRC's benchmark scale rates for day subsistence and that you have adequate management processes in place to ensure that payments are only

made where all the qualifying conditions are met. appropriate boxes and supply the requested information on the form.

HMRC say they will review the rates annually and consider revising them when there has been a change in the scale rate of plus or minus 10 per cent based on the Consumer Price Index from when it was last revised.

The self-employed

A new Section 57A ITTOIA2005 provides from 6 April 2009 for a deduction for any reasonable expenses incurred on food or drink consumed by the trader at a place to which he travels in the course of carrying on the trade, or while travelling to a place in the course of carrying on the trade, if Conditions A and B are met:

- ♦ CONDITION A is met if a deduction is allowed for the expenses incurred by the trader in travelling to the place, or the expenses of travelling to the place are not incurred by him but if they were they would be tax-deductible.
- ♦ CONDITION B is met if at the time the expenditure on food or drink is incurred, the trade by its nature is itinerant; OR the trader only travels to the place occasionally in the course of the trade and either (i) the travel in connection with which the expenditure incurred on the food or drink is undertaken otherwise than as part of the trader's normal pattern of travel in the course of carrying on the trade, or (ii) the trader does not have such a normal pattern of travel.

Article by Gerry Hart

Lecture B556 (10.26 Minutes)

Should property developers appropriate whilst prices are low?

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

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

1. Taking the property out of the business themselves – possibly to let or even to occupy.

2. Letting the property out through the business rather than selling the property.

In either case HMRC may be looking for a deemed market value sale.

Case 1

HMRC have case law and now statute on their side. There will be a market value appropriation (Sharkey v Wernher) and this should be reflected in the year end accounts and computations.

With the property market at a low ebb, it might not be a bad time to transfer the property out of the business. There may be a small profit on extraction or even a small loss but the taxpayer then holds the property as a capital asset (i.e. one they plan to rent out in the long term). The benefit of holding the property as a capital asset is that the client will have the benefit of the lower CGT rates on eventual sale rather than the income tax rates. For higher rate tax payers this is a distinct advantage.

The extraction will be a zero rated supply for VAT purposes – assuming the property is properly transferred e.g. from development company to husband and wife via a conveyancing solicitor. This ensures there are no serious 1995/2518 Regulation 108 claw back provisions.

Case 2

The issue is not so clear cut. HMRC may argue that the property should be moved from current assets to fixed assets due to rental income being generated on the asset rather than a profit on sale. Whenever an asset is moved from current assets to fixed assets there will be a deemed market value sale for tax purposes.

It could however be argued that the property should remain in stock as long as the developers intention remains to sell the property. This would then avoid any direct tax issues when moving the

property from stock to fixed assets. This will also reduce the impact of the 1995/2518 Regulation 108 clawback provisions as the property is only temporarily let.

If the current asset treatment serves the client's situation best then practitioners are advised to keep contemporary evidence of the clients intention to sell when the market picks up, This could be in the form of comments in the directors report, company minutes, letter of representation or a letter from the client. Every year this intent should be re confirmed by the client.

The client may however be best served by transferring the assets to fixed assets whilst the property values are low. There may be a small profit or indeed a loss on the transfer but the client will then hold the property as a capital asset which will eventually be subject to the lower CGT rates.

This would work well where the client has limited VAT input tax on the build – maybe because they have a separate "building services company" which charges the "developer" the zero rate on all the building work.

With top rate income tax at 50% from next year, the attraction of an 18% CGT rate should not be underestimated. Where however land transactions are undertaken to secure the capital treatment we must consider the clients exposure to s.776 TA 1988.

S.776 TA 1988

Certain gains on disposals of land are treated as income chargeable to income tax where:

(a) the land (or any property deriving its value from the land) is acquired with the sole or main object of realising a gain from disposing of it; or

(b) the land is held as trading stock; or

(c) the land is developed with the sole or main object of realising a gain from disposing of it when developed.

The provisions apply if all or any part of the land in question is in the UK and a gain of a capital nature is obtained (for himself or for 'another person') from the disposal of all or part of the land by the person acquiring, holding or developing it or by any connected person, or a person party to, or concerned in, any arrangement or scheme to realise the gain indirectly or by a series of transactions.

For this purpose, a gain is of a capital nature if it does not (apart from these provisions) fall to be included in any computation of income for income tax purposes. Any number of transactions may be treated as a single arrangement or scheme if they have, or there is evidence of, a common purpose. 'Another person' may include a partnership or partners in a partnership, the trustees of settled property and personal representatives and for this purpose these are regarded as persons distinct from the individuals or persons who are for the time being partners, trustees or personal representatives.

'Property deriving its value from land' includes any shareholding in a company, partnership interest, or interest in settled property, deriving its value, directly or indirectly, from land, and any option, consent or embargo affecting the disposition of land. See, however, 'Exemptions' below.

Land is 'disposed of' for the above purpose if, by any one or more transactions or by any arrangement or scheme (whether concerning the land or any property deriving its value therefrom), the property in, or control over, the land is effectively disposed of.

The gain from the disposal is treated as income arising when the gain is realised and the charge for any tax year is on the full amount of any such income treated as arising in that year. (Before 2005/06, the charge was under Schedule D, Case VI but this label is now removed.) The person liable for the tax is the person whose income it is. Usually this will be the person realising the gain, but, if all or part of any gain is derived from value provided directly or indirectly by another person (as above) or from an opportunity of realising a gain provided directly or indirectly by another person, the income is that other person's.

An amount treated as arising under these provisions to a non-UK resident is treated as being from a source in the UK only to the extent that the land to which the disposal relates is in the UK.

Exemptions

(i) An individual's gain made from the sale etc., of his residence exempted from capital gains tax under TCGA 1992, ss 222–226 or which would be so exempt but for TCGA 1992, s 224(3) (acquired for purpose of making a gain).

ii) A gain on the sale of shares in a company holding land as trading stock (or a company owning, directly or indirectly, 90% of the ordinary share capital of such a company) provided that the company disposes of the land by normal trade and makes all possible profit from it, and the share sale is not part of an arrangement or scheme to realise a land gain indirectly. This does not apply if the person obtaining the gain is only a party to, or concerned in, an arrangement or scheme to realise the gain indirectly or by a series of transactions. See Chilcott v CIR Ch D 1981, 55 TC 446.

(iii) If the liability arises solely under (c) above. Any part of the gain fairly attributable to a period before the intention was made to develop the land. [ITA 2007, ss 765–767; ICTA 1988, s 776(7)(9)(10)); ITTOIA 2005, Sch 1 para 312(5)].

In my opinion it is unlikely that s.776 would apply where a developer crystallises a trading profit (or loss) in the current climate but we need to be aware of a potential attack from HMRC in this regard.

Article by Dean Wootten

Taking full advantage of the new car regime for capital allowances

Under the Finance Act 2009 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.

The new rules apply to cars purchased on or after 1 April 2009 for corporates and 6 April 2009 for unincorporated businesses. The new lease rules will only apply to leases taken out on or after the same effective dates (1 or 6 April 2009 depending on the trading structure).

Example – Piers

Piers trades to 31 March 2010 and incurs the following capital expenditure:

		£
Volvo C30 1.6 DRIVe 104 g/km		16,070
Fiat Panda 1.1 Active ECO 119 g/km		5,995
Lexus RX450h SE-L Hybrid 148 g/km		41,600
Thermal insulation		33,000
Lorry		27,000
Porsche Boxster 2.9 221 g/km		33,704
Peugeot 407 2.2 Coupe 219 g/km (40% private use)		21,995
20% pool b/f	55,590	
10% pool pool b/f	22,350	
Audi A6 3.0 V6 Diesel Saloon 179g/km	31,740	

The computation....

	AIA 100%	*FYA 40%*	*FYA 100%*	*Main 20%*	*Audi*	*Private use*	*SR 10%*	*Total*
WDV b/f				55,590	31,740		22,350	
Th Insul	33,000							
Lorry	17,000	10,000						
Volvo			16,070					
Fiat				5,995				
Lexus				41,600				
Peugeot						21,995		
Porsche							33,704	
AIA	(50,000)							50,000
FYA		(4,000)	(16,070)					20,070
WDA				(20,637)	(3,000)		(5,605)	29,242
WDA						(2,200)		1,320
WDV c/f		6,900		82,548	28,740	19,795	50,449	**100,632**

From the above example it can be seen that unincorporated businesses still retain the ability to receive a balancing allowance on cars with private use – the Peugeot. Cars without private use or for any car owned by a corporate will not be able to secure a balancing allowance when sold. Proceeds are simply deducted from the appropriate pool. For some clients the combination of the capital allowance regime and the benefit in kind regime may make the corporate an unattractive trading option – even where expected profits are high.

Why not have a partnership with a corporate partner?

Let us consider Mr Clark, who currently runs his business as a sole trader. It is successful, making £180,000 a year at present. He has considered incorporating it, but he drives a large and expensive car which he replaces every two years, suffering significant depreciation costs when he does.

Because he has high business mileage and low private mileage, he has always concluded that the extra tax he would pay on the car as a benefit in kind, or the deduction he would lose if he provided the car himself as an employee, make incorporation much less worthwhile than it would otherwise be.

The prospect of the 50% rate of tax is making incorporation look inevitable, but the change to capital allowances means he will lose even more. Is there another solution?

What about forming a limited company, Clark Ltd, and then going into business in partnership with it – the Clark Partnership, with Mr Clark and Clark Ltd as its partners?

The terms of the partnership could distribute the profit in the most tax efficient way possible – probably a personal allowance partnership salary to Mr Clark and then a very small share of the rest of the profits.

The rest of his income would come from company dividends, but it would be kept below the new £150,000 threshold. He could even bring his wife into the equation and the company could pay dividends to her as well.

The trade is still run by a partnership, and therefore the private use rules will apply, so Mr Clark can still get the same tax treatment on the cost of his motoring as he does now.

Although there will be both a set of partnership accounts and company accounts to prepare, the company accounts will be very straightforward, simply showing the share of partnership income.

It is an idea that deserves some attention in appropriate cases.

Lecture B557 (20.35 Minutes)

Construction industry bosses arrested in HMRC dawn raids

HMRC officers have arrested 21 people in connection with a multi–million pound construction industry fraud. This is believed to be a variant of missing trader fraud involving the Construction Industry Scheme.

The plot is believed to have been orchestrated by organised crime gangs in a bid to steal millions of pounds in a complicated conspiracy through a version of “missing trader” fraud. This sees the creation of a contrived chain of companies, which claim to subcontract labour for the construction industry, with the sole intention of disappearing before paying the taxes due to the public purse. They pocket the money and hijack legitimate companies along the way.

The conspiracy exploits individuals working in the construction industry and abuses the government scheme that regulates the industry's tax affairs. It is thought thousands of construction site workers may have been robbed of the tax and national insurance contributions they believe they have paid over the last six years.

The arrests were made on suspicion of conspiracy to cheat the public revenue and money laundering offences under the Proceeds of Crime Act 2002. The Act was specifically designed to take the profit out of crime, making it harder for money to be laundered and depriving criminals of their illicit wealth.

Businesses can apply for “Gross Payment Status”. This means a contractor can make payments, for labour provided, to a subcontractor without accounting for the tax due on the money. The subcontractor then becomes liable to HMRC to pay the tax and the VAT element of the money they have received.

However, it is alleged the subcontractor contracts out the work to a second subcontractor, who never actually carries out the work and goes “missing” with the tax that is owed. The first subcontractor then covers the transactions by false paperwork which is used to fabricate their tax records and their position for direct and indirect tax purposes.

HMRC Brief 60/2009 11 September 2009

Incorporated dentists and the NHS pension scheme

Those advising newly incorporated dental practices with NHS contracts may come across problems when deciding the owner’s split between salary, dividends and goodwill due to a lack of detailed pension information on offer.

A significant number of dentists who incorporated in recent years will also have NHS contracts with their Primary Care Trust. Recently they will have received an Annual Reconciliation Report to complete, to ensure that the correct amount of pensionable earnings is applied against their NHS pension.

On the surface this looks like a simple case of confirming the amounts already shown against each practitioner’s name (the NHS refer to ‘performers’), but when we were asked to verify the details for one of our dental clients, we found that it’s not quite so straightforward.

The difficulties arise because there are three separate and competing sides to the conundrum, and no single set of guidance notes to pull everything together.

The accountant's position

Taking the accountant's perspective first, incorporation will mean greater tax efficiency for their dentist clients, as they switch from a self-employed income to a combination of earned income, dividends, and possible goodwill payments from the sale of the practice to the incorporated body.

However, this drive to reduce the tax burden could unwittingly reduce NHS pension contributions and thus the eventual pension benefits that would otherwise be received.

The NHS point of view

Turning to the NHS pension scheme, the contract value that previously would have been paid to a self employed dental practitioner is instead paid to the limited company. The total value of the contract comprises of more than one element and not all of it can be considered as earnings for pension purposes.

The NHS guidance notes state that 43.9% of the contract value can be considered as net relevant earnings for pension purposes. The remainder of the contract value is seemingly set against costs. For example, an NHS contract with a value of £200,000 would correspond to a 'net pensionable earnings' figure of £87,800.

On the other hand, the accountant could suggest drawing a low salary with the remainder taken as dividends and/or goodwill payments. Fortunately, the NHS pension scheme recognises dividends and has stated that dividend payments are pensionable under the scheme. However, where there is the possibility to receive income in the form of goodwill payments the situation needs careful consideration. Goodwill payments do not count as net relevant earnings and nor do they count as dividends, so they will not be considered in relation to the NHS pension scheme.

So far we have considered the accountant's approach to tax efficient remuneration and how that needs to be structured in terms of income and dividends so that the member's NHS pension benefits are not compromised. If only it were that simple!

HMRC's perspective

The third part of the conundrum comes courtesy of HMRC. Having juggled salary, dividend and goodwill in order to reduce tax whilst creating sufficient pensionable income in terms of the NHS pension scheme, you now need to consider HMRC rules. While the NHS recognises dividends for the purposes of pension accrual, HMRC has advised that dividends do not constitute 'relevant UK earnings'. In order for pension contributions to be relievable against tax, they need to be made from earned income and not dividends or goodwill payments.

How does this all fit together? When considering an NHS contract with a value of £200,000, we know that the 'net pensionable earnings' element is £87,800, which can comprise salary and dividends. The accountant's position will be to minimise the salary component so that tax and national insurance contributions are kept as low as possible. The employee contribution to the pension scheme is currently 8.5% and HMRC will expect this to be offset against relevant UK earnings - in other words, salary.

Since 6 April 2006 (A-Day), pension contributions can equal 100% of relevant UK earnings - or the annual allowance, whichever is lower. In the current example, an employee contribution rate of 8.5% of £87,800 net pensionable earnings equates to a required salary level of £7,463.

Further notes

By understanding how the various rules slot together, the calculations become quite straightforward, but further complications can arise where 'added years' are being purchased in the pension scheme. A quirk of the scheme is that 'added years' are subject to an earnings cap, a notional salary cap left over from the pre A-Day pension rules. For the 2008/2009 tax year the earnings cap was £117,800.

As if that wasn't complicated enough, the forthcoming changes to pension tax relief for people earning over £150,000 will have many people scratching their heads. It doesn't help that there isn't a single guidance note from either the NHS Pension Scheme or HMRC covering this matter from the perspective of incorporated dental practices.

Dennis Hall writing in AccountingWeb

Effective use of business losses

The rules for relief of losses arising from a trade are included in ITA 2007 at Part 4. This broadly covers Ss 59 to 130.

Carry forward against future profits of the same trade

- Relief of last resort, in the absence of any other claim is for the losses to be carried forward and set against profits of the same trade, irrespective of amount. The losses are therefore set against the first available profits, provided the same trade is carried on, and cannot be "disclaimed" to preserve personal allowances. The sensible restriction of capital allowance claims may assist here. (Section 83 ITA).
- The time limit for determining the loss for this relief is 5 years and 10 months after the end of the fiscal year.

Set off against other income of the year and the preceding year

- More immediate relief is available under Section 64. Under a claim, relief is available against other income of the year of the loss, or the preceding year.
- Where a claim is made for both current and previous year relief, the order of set off is as specified by the taxpayer, although HMRC advise that they will deal with claims in the order in which they are made.
- Priority is given to relief of a loss incurred in the year, so where two losses compete for relief in a year, the current year loss is relieved first, leaving the loss brought back to use the remaining income (if any).
- Normally losses are taken from the accounting period basis, rather than a strict fiscal year basis.
- In the early years of the trade, the losses are arrived at for the same periods as profits would be in order to identify the claims available under S64. However, if a loss would be taken into account twice, it is only brought in on the first such occasion. This will ensure that no duplicate loss relief is claimed. It is a general rule that no loss can ever be relieved twice.
- Where in the early years of trade a loss making period is brought into account twice in arriving at the basis periods, the amount of NIL profit is used for each period, and the overlap profits would also be nil. No overlap loss is calculated for the reasons outlined above.
- No claim under S64 is possible unless the trade is being carried on on a commercial basis with a view to profit.
- The time limit applying to Section 64 claims is one year after the 31 January following the fiscal year.

Extending Section 64 claims to capital gains

- A claim under Section 64 may be extended to include a claim to set the trading loss off against the capital gains of the year of the loss and the preceding year. This extension of relief was introduced by S72 Finance Act 1991.
- The claim against income of the year in which the capital gains are to be reduced must first be made.
- The loss available to carry back is then further reduced by any other loss relief claimed, such as S64 relief in the preceding year, or any relief under S72 (see below).
- The gain available for losses to be set against is the net gains of the year, after setting of brought forward capital losses and taper relief. This gives the amount of trading loss which may be claimed under the extension to Section 64. However, it is possible to now claim the amount of the capital gain before taper relief if the taxpayer chooses, which will provide additional relief.

- The loss is then set off against the capital gains **before** losses brought forward and taper relief, as the claim effectively turns the trading loss into a capital loss of the year. Great care is needed when considering this form of relief, as setting off against gains which will be tapered by 75% will produce minimal relief for the loss. (maximum 25% offset at the effective rate of CGT – this could be as low as zero if the CGT annual exemption is wasted. At best it will produce 10% loss relief). For gains after 6 April 2008, relief is of course only available at 18%.
- In some cases the claim will displace capital losses which have been brought forward, which will mean that capital losses are carried forward in preference to trading losses. In this case, again careful thought is needed before recommending this course of action.
- The time limit applying to claims against capital gains is one year after the 31 January following the fiscal year.

Losses in the early years of trade

- Section 72 provides the rules for relief of losses incurred in the first four (fiscal) years of trade.
- It is not possible to seek relief for a loss if the accounting period producing the loss has not ended. This is particularly relevant to opening year losses, whether claimed under S72 or S64. Close thought should be given to the selection of the accounting date in a business with early losses or low profits and significant capital allowances which together produce a tax loss).
- Relief is claimed in respect of each loss against the total income of the three preceding years, taking the earliest year first.
- Loss relief is not available if the trade is not carried on on a commercial basis with a view to profit, and for S72 it is also necessary to show that a profit could reasonably have been expected in the loss period or within a reasonable time after it.
- This relief is also excluded if the trade has been taken over from a spouse or civil partner who previously operated the trade (for obvious reasons).
- Where the losses from two periods compete for relief in a year, relief is given for the earlier loss first.
- The time limit for claims under S72 is twelve months after 31 January following the year in which the loss was sustained.

Terminal losses

- The loss sustained in the last 12 months of trade of a business is available for terminal loss relief under S89 ITA.
- Relief is given against the trading profits of the last three fiscal years of the business, taking later (most recent) years first.
- Any loss relief available under Section 64 reduces the loss available for relief under S89, although there is an HMRC practice that if the loss relief under S64 has not been finalised the taxpayer may choose to finalise the terminal loss relief claim first. In practice, the difference may well be academic.
- The terminal loss is calculated as follows:

Loss of the last fiscal year of trade from 6/4 to cessation	x
Trade charges of the same period	x
Loss of preceding period (from 5/4 to make up 12 months)	x
Trade charges of the same period	x

- If any of the amounts in the computation is a profit it is treated as a nil loss, and not used to **reduce** the terminal loss.
- Where overlap relief has been deducted and creates or enhances a trading loss this is treated as arising in the year of cessation, so it need not be apportioned, and falls into the first item on the computation above.
- The time limit for S89 claims is twelve months after the 31 January following the year of cessation.

Business transferred to a limited company

- Where a business is transferred to a company solely or mainly in exchange for shares, and trading losses in the business can be carried forward by the previous owner under Section 86 ICTA.
- The loss is available to set off against any income from the company, such as director's remuneration or dividends.
- The relief is available provided that the company continues to carry on the same business, and the shares are still held for the whole year for which the claim is made.
- Where relief is sought against dividends care will be needed to ensure that adequate relief is gained for the losses. The relief is also available against rent drawn from the company.

General points about trading loss reliefs

- It is not possible to restrict a loss claim so as to preserve personal allowances, or to leave dividend income into charge to avoid loss of non repayable tax credits.
- Where relief is taken for trading losses against sources other than trading income, a separate record of the loss for Class 4 NIC is necessary. Losses set off against other sources of income have not been relieved for Class 4 purposes, and remain available to carry forward to set off against future profits of the same trade.
- It is unlikely that HMRC will spot the omission of loss relief for Class 4 purposes, as it is not flagged up on the department's computer. The period allowed for back claim of Class 4 relief is 5 years and 10 months after the end of the tax year in which relief is sought.
- Where a taxpayer also claims tax credits, it is necessary to keep a further separate record of losses for tax credit purposes. No losses are ever carried back for tax credit purposes, but they are set against the other income of the claimant and his partner for the year concerned. Any losses unrelieved for tax credit purposes are then carried forward to the subsequent year, and set off against the total income of the two claimants in that year. The exemption of savings income under £300 still applies, so losses would only be offset against savings income in excess of £300 per couple.
- Where losses are carried back, although the amount of loss relief is calculated by reducing the income of the preceding year, no relief for the loss is given in that year. The relief is given in the year of the loss, as a tax credit – that is it is treated as if tax had been paid of the amount of relief so calculated. Care is therefore needed when considering reduced payment on account, as it is easy to make a mistake when losses are carried back. The same problem does not arise with losses brought forward, as they are treated as reducing the taxable income of the year.
- When a loss is set off under Sections 64 or 72 it can disturb relief for pension premiums already paid. For this purpose, the taxpayer can treat the loss as reducing the other (non trading and therefore non pensionable) income first, preserving profits in charge to "frank" the pension payment. This should be less of a problem in the future with the post A day rules as the allowance is 100% of the trading income, so unless the income is wiped out completely, relief may still be available.

Anti avoidance – 2008 restriction

- The Finance Act 2008 introduced restrictions on the available loss relief for sole traders who are inactive in their businesses.
- The restriction limits sideways relief for the loss (that is against any other source than the trading profits of the same trade) to £25,000 in any tax year.
- The limit applies to losses incurred on or after 12 March 2008. For periods spanning the date of change the loss pre and post must be calculated by separating out the capital allowances and time apportioning the loss, and re-computing the capital allowances.
- The definition of inactive is that the individual spends less than 10 hours per week actively engaged in the business, which is carried on on a commercial basis with a view to the realisation of profits form those activities.
- Where a loss arises on or after 12 March 2008 as a result of tax avoidance arrangements entered into on or after that date, the relevant limit is zero, and not £25,000.

Class 4 and losses

Where trading losses have been set against other income for tax purposes, these losses remain available for relief from Class 4 contributions. It is unlikely that this has been monitored automatically by tax software, and therefore should be checked regularly and repayments sought where appropriate. There is a six year time limit for reclaiming contributions overpaid, so this should be reviewed to ensure that no repayments are missed.

Article by Rebecca Benneyworth

Lecture B558 (15.57 Minutes)

Corporation Tax

Research and development - a new focus?

For a number of years the Government has been a strong supporter of research and development (R&D) relief. This allows a company to claim enhanced relief on qualifying costs against profits.

To qualify as R&D, an activity must be treated as such under generally accepted accounting practice and fall within any guidelines issued by the Treasury. Recent months have seen a slight change in the focus of Her Majesty's Revenue & Customs (HMRC) as to how these rules should be operated. And it's not been a change for the good. But first a reminder of the basic rules.

What reliefs are available?

Small and medium sized enterprises (SMEs) may claim:

- R&D tax relief - which increases the deduction to 175% of the qualifying expenditure (150% prior to 1 August 2008); or
- payable R&D tax credit - which allows companies who are not in profit to take the relief up front in the form of cash, in return for surrendering appropriate trading losses.

Large companies (ie companies that are not SMEs) may claim R&D tax relief for 130% of the qualifying expenditure (125% prior to 1 April 2008).

Broadly, a company is a SME if it (together with any company in which it holds 25% or more of the capital or voting rights) has:

- fewer than 500 employees (250 prior to 1 August 2008) and
- an annual turnover not exceeding €100 million (€50 million prior to 1 August 2008) and/or
- an annual balance sheet total not exceeding €86 million (€43 million prior to 1 August 2008).

If a company changes from a large company to a SME owing to this increase in the limits, any period that straddles this date will have to be split into two separate periods for the purposes of calculating the relief due. However, it is important to note that, generally, a large company (or group) will need to be an SME for two accounting periods before becoming entitled to the enhanced relief.

In addition, a company will not be a SME if 25% or more of its capital or voting rights are owned by enterprises that are not themselves SMEs (with limited exceptions).

On the other hand, a company will generally cease to be a SME in the second year that it exceeds those thresholds, providing an extra year to claim relief. These transitional provisions will not apply where a SME is purchased by a large company (or group) after 1 December 2008, rather than increasing in size due to organic growth. In this situation, the acquired company is treated as large for the entire accounting period in which the acquisition occurred. Prior to 1 December 2008, such companies were treated as SMEs until the start of the next accounting period.

Are there other qualifying conditions for SMEs?

The Finance Act 2008 introduced two new qualifying conditions for expenditure to qualify under the SME regime. As the SME regime falls within the European Commission's (EC's) rules on State aid, these changes were introduced to ensure that the SME regime continues to meet the requirements of the EC's State aid Framework.

The new qualifying conditions are that:

- the latest published accounts were prepared on a going concern basis, and nothing in those accounts indicates that they were only prepared on that basis because of an expectation that the company would receive R&D tax relief or R&D tax credits
- the R&D aid on the R&D project does not exceed €7.5 million.
- If the €7.5 million cap is exceeded, the excess expenditure can qualify for relief under the large company regime. Both conditions are effective from 1 August 2008.

Is there a minimum expenditure level?

To claim R&D tax relief, a company must spend more than £10,000 on qualifying R&D in the accounting period. This amount is pro-rated for periods other than 12 months.

What expenditure qualifies for relief?

R&D tax relief is given on revenue expenditure incurred during the relevant period on:

- qualifying staff costs - for example salaries and bonuses, Class 1 national insurance contributions (and other European Compulsory social security contributions) and pension payments relating to staff directly engaged in R&D including technical support, planning and organisation of the research. However, qualifying staff costs do not include benefits in kind
- computer software directly used in undertaking the R&D
- consumable or transformable materials used in the R&D process. This includes water, fuel and power
- externally provided workers - expenditure incurred by the company on workers who are not employees of the company carrying on the R&D, but instead are paid through an intermediary, such as an agency
- payments made to clinical trial volunteers - this category of expenditure has qualified from 1 April 2006 for large companies and from 1 August 2008 for SMEs.

Expenditure met by another person (eg through a contribution or a grant) does not qualify for relief under the SME scheme. In addition, if any part of the project costs is met by 'notified State aid' (which includes some government grants) then none of the expenditure on that project qualifies for relief under the SME scheme. However, if the expenditure would have been allowable had the SME been a large company, and the expenditure does not qualify under the SME scheme only because it was subsidised, relief can be claimed under the large company scheme instead.

How is R&D tax relief utilised?

Tax relief is available in the accounting period in which the expenditure is incurred rather than when it is written off to the profit and loss account.

R&D tax relief simply increases the deduction from taxable profits, thereby reducing the profit or creating an allowable trading loss. A loss incurred by a SME can be used to claim a R&D credit.

What are R&D tax credits?

Payable R&D tax credits assist SME companies who have not made a profit and would not benefit immediately from R&D tax relief. A claim can be made if the company has made a loss in the trade in which R&D is carried out, by surrendering the loss attributable to the R&D in exchange for a cash payment.

R&D losses may be surrendered for cash up to the lower of:

- the amount of R&D tax relief claimed during the accounting period; and
- the total loss of the trade for the period after R&D tax relief, reduced by all claims and reliefs that have been, or could be, made to use the loss.

The amount of the tax credit payment is the lower of 14% (16% prior to 1 August 2008) of the R&D loss surrendered, and the total gross PAYE and Class 1 NIC paid for all employees (not just R&D staff) in the accounting period. Class 1A and 1B NICs are excluded from this calculation as are other deductions. Although the amount of the payable credit reduced from 16% to 14% on 1 August 2008, the overall value has actually increased from 24% to 24.5% of the qualifying expenditure.

The company must claim the payable R&D tax credit and the R&D reliefs in its corporation tax self-assessment (CTSA) return for the accounting period for which the claim is being made. A claim can be made, amended, or withdrawn at any time before the first anniversary of the CTSA filing date for the accounting period.

A change in focus?

In recent months there has been a number of instances where HMRC thinking on R&D tax relief has changed. These seem to be symptomatic of a tightening of approach to R&D tax relief claims within HMRC's technical division. Significant areas include:

Production costs

HMRC is hardening its stance on claims for costs where the output of the R&D has or could be sold to the end user (eg sale of the prototype after successful testing). The implication of this is that any costs incurred in respect of production of the prototype (or other product) should be excluded from claims to R&D relief. Only costs that do not contribute towards the product sold on to the customer can be claimed. Costs of testing and non-production development are unaffected.

On a narrow interpretation, this could mean that where a prototype is sold, production costs cannot be claimed, but where it is scrapped they are claimable. However, a wider reading is also possible that would exclude any production costs where there is the prospect of producing goods or services for supply to customers, which would appear to undermine the whole basis of commercial R&D activity.

Clearly there are significant implications for clients involved in engineering and similar sectors where the level of R&D-related production costs can be substantial.

100% staff time claims

Section 1124 of the Corporation Tax Act 2009 (CTA 2009) limits staff costs claims to employees and directors who are actively and directly involved in the R&D. Where their direct involvement is less than 100% of their time, then their costs are pro-rated accordingly.

Historically it was common ground that if an employee's sole duties were eligible R&D, then the claim would be for 100% of their costs. However, a more aggressive approach from HMRC is being seen on challenging claims for 100% of staff time on R&D activities. The basis of its challenge is that no member of staff can spend all their time on R&D activities as there will always be an element of non-R&D time in an individuals' day to day activities and employment relationship (eg staff development time).

IP ownership (relevant to SME claimants only)

SME claimants are required to own any intellectual property (IP) resulting from the R&D process (s1052(4), CTA 2009) makes it clear that ownership can be alone or with others. Historically, this has been interpreted as meaning that the claimant can own less than 100% of the IP. HMRC now appears to be interpreting this as meaning that the claimant must have rights to exploit the IP without reference to the other party. This is potentially an issue for groups where the holding company requires joint ownership of the IP.

Also if a company sells its IP without first applying for the necessary patent/copyrights, etc (if appropriate) HMRC appears to now be looking very closely at whether this does qualify for R&D tax relief and seems to be arguing it does not.

Claims

HMRC is increasingly reluctant to consider claims that have been submitted without the following:

- a detailed project narrative, describing the work undertaken in the claim period, that highlights the scientific or technological advances sought and the uncertainties that needed to be resolved
- a detailed staff analysis, showing the percentage of staff time spent on qualifying R&D, with job titles or other descriptions

If these are missing, HMRC will make an informal request for them. Significantly (for R&D tax credit claimants) they will not treat the claim as received until they have all this information, meaning that payment could be delayed.

Article by Francesca Lagerberg

Lecture B559 (9.56 Minutes)

Date of payment for relief on employers' pension scheme contributions?

The contribution is relievable on the date the contribution is paid.

Would a contribution paid by an employer obtain tax relief in the company's accounting period ending 30 June 2009 in the following circumstances:

- Company cheque passed to the pension provider on 29 June 2009.
- Company cheque not cleared until 2 July 2009.

Finance Act 2004, s 196(2)(b)

This refers to employer contributions being deductible in computing the amount of the employer's profits for the period of account in which they are paid.

However, there is no definition as to what is deemed to be the 'date paid' in any given set of circumstances or with any given payment method.

Member contributions

Registered Pension Schemes Manual para 5300080 gives specific details about the deemed 'date of payment' based on a number of different payment methods, but only in respect of member contributions.

Employer contributions

In view of this we asked HMRC what the position would be in respect of employer contributions.

They confirmed that employer contributions would be treated in the same way as member contributions for the purpose of determining the date paid.

This means that the date of payment of the contribution depends on what method is used to pay it:

- Cheque: The date the cheque is given to the scheme administrator or, if posted, the date the scheme administrator receives it.
- Debit/credit card: The date on which details are received by the scheme administrator.
- Direct debit: The date the scheme administrator is authorised to draw the sum from the member's bank account, i.e. the date set out in the direct debit mandate. This is subject to the proviso that the scheme administrator receives the correctly completed direct debit mandate, and actually receives the funds requested under the direct debit mandate.
- In specie transfer: The date the asset becomes the property of the scheme.

Conclusion

Returning to the original example, this means that the employer contribution should be relievable in the employer's accounting period ending 30 June 2009, as the employer's cheque was received by the pension provider on 29 June 2009.

The contribution will also need to meet the 'wholly and exclusively for the purposes of the trade' requirement for relief to be granted.

From an article by John Woolley writing in Taxation

Resident in the UK?

Laerstate BV was incorporated in the Netherlands. Its controlling director for the period 1993 to August 1996 was a German national, Mr Bock, who was resident in the UK. He resigned in 1996, leaving Mr Trapman as sole remaining director.

HMRC assessed the company to corporation tax for the years 1993 to 1996. They claimed that the company was resident in the UK during this time.

The company appealed claiming that it was not UK resident.

The tribunal judges said that the legal test for corporate residence was as decided by the Lord-Chancellor in *De Beers Consolidated Mines Ltd v Howe* 5 TC 198: 'the real business is carried on where the central management and control actually abides'.

This does not necessarily have to be where the directors meet, but is a question of fact.

Applying the law to the facts of the instant case, the judges said that while Mr Bock was director, central management and control of the company was exercised in the UK, where he lived.

His activities in the UK as a director were concerned with strategic, policy and management matters, and included decision-making in relation to company business.

The judges concluded that Mr Bock was resident in the UK during this time, therefore central control and management took place in the UK.

For the period from August to December 1996, the company's remaining director, Mr Trapman, was found by the judges to be acting on Mr Bock's instructions and they ruled therefore that the company was resident in the UK for those months.

Given that, according to their reading of the facts, Mr Bock's activities constituted top-level management and Mr Trapman was effectively limited to signing documents when told to do so, the judges ruled that the place of management of the company was the UK.

The appellant's appeals were dismissed.

Laerstate BV (TC 162)

Value Added Tax

VAT on property developments

This article examines a number of recent developments in the area of VAT and land transactions:

- The First Tier Tribunal case *Lower Mill Estate Ltd* (TC0016), in which an arrangement to reduce the VAT cost of holiday accommodation was held to be an abuse of rights.
- The First Tier Tribunal case *Civilscent Ltd* (TC0070), in which a separate disposal of parking spaces with flats was held to be standard rated.
- The First Tier Tribunal case *Trustees of the Lyndon David Hollinshead and Others* (TC0060), in which a group of insurance brokers fell foul of the disapplication of the option to tax.
- The ECJ decision *RLRE Tellmer Property s.r.o. v Finanční ředitelství v Ústí nad Labem* (Case C-572/07), in which the court considered whether cleaning and rent were separate supplies or a single supply.
- The HMRC announcement in *R&C Brief 36/09* of their policy on deposits received in advance of houses being built.
- The First Tier Tribunal case *Grimsby College Enterprises Ltd* (TC00129), in which a scheme to recover VAT on a college's building project failed.

Composite and artificial

A company, L, owned a plot of land with planning permission to build 575 homes with the condition that they were not to be occupied as a principal place of residence. It entered into arrangements with customers and a related company, C, under which:

- L granted a long lease over a plot of land to the customer, standard rated because of note 11 group 1 Sch.9 VATA 1994 (land with a right to build holiday accommodation on it);
- C sold construction services to the customer, purported to be zero-rated as construction of a dwelling.

HMRC ruled that there was a pre-planned series of transactions which together comprised the sale of a holiday home, which ought to be standard rated. The true interpretation of the arrangements was either that L sold the completed holiday home (effectively subcontracting the cost of construction to C), or L and C together sold the completed holiday home and were liable for output tax on their proportion of the consideration paid. As an alternative argument, the arrangement was abusive within the *Halifax* principle (being similar also to the case of *Part Service* C-425/06).

In respect of the main argument, the Tribunal held that it was not possible for supplies by two different companies to be treated as a single composite supply, nor as a joint supply of a holiday home by the two companies together. The decision of the Court of Appeal in *Telewest* was followed.

The company argued that *Halifax* should not apply because there were various commercial advantages to the arrangement from the companies' point of view – the effect was not only favourable for VAT. By selling the land first and the construction services afterwards, L generated cash income much earlier than it would have been received under what HMRC said was the "normal" transaction. Also, people who bought the land were not bound to use C for the construction services, and they were not bound to a particular timetable. The two transactions were spread over a long period in most cases, and could be spread over even longer. They should not be looked at as a single pre-planned arrangement.

Nevertheless, the Tribunal found for HMRC. Looking at the transactions and the relationship between the parties and the supplies in detail, it appeared that the conditions for *Halifax* to apply were satisfied. The transactions were artificial in that they had (in the Tribunal's view) been arranged specially to create a VAT effect; they were contrary to the purpose of the VAT law because they would benefit from exemption and zero-rating when in reality what was being supplied was something that ought to be standard rated. That had the potential to distort competition, which was

contrary to the purpose of the law. The trader's appeal was dismissed. It seems likely that there will be a further appeal.

First Tier Tribunal (TC0016): *Lower Mill Estate Ltd*

Not composite and not zero-rated

A company built apartments and granted 125-year leases to tenants. There were insufficient parking spaces for each apartment to have one, so the available spaces were sold separately. The parking space leases were for the same length of time as the apartment leases, and were subject to a condition that they should not be assigned to anyone who did not also own an apartment. HMRC ruled that the price paid for parking spaces was standard rated, and the company appealed.

The Tribunal agreed with HMRC that it was not possible to regard the grant of the lease and the lease of a parking space as a single economic transaction. There was too little legal or economic connection between them: someone who took a lease of an apartment was not guaranteed a parking space, and was given a separate choice of applying for and paying for one. The company's appeal against HMRC's ruling was dismissed.

First Tier Tribunal (TC0070): *Civilscent Ltd*

Composite and exempt

Three individuals involved in insurance set up a self-invested pension plan (SIPP) which bought a commercial property. As trustees, they signed a lease for 20 years over the property in favour of four companies which they ran, and opted to tax in order to recover the input tax on the purchase of the property. HMRC disapplied the option on the basis that they had financed the purchase of the property and would occupy it for exempt business purposes. They argued that they supplied the facilities of using the building, rather than something that would be exempt, pointing to HMRC guidance which suggests that joint occupation rules out the existence of a licence to occupy.

The Tribunal pointed out that this argument was flawed. There was a lease, not a licence. There was no question that the SIPP had supplied an interest in the land which was within Sch.9 Group 1, and it was exempt subject to the option to tax. Other arguments which sought to show that the supply comprised facilities rather than land were also dismissed.

First Tier Tribunal (TC0060): *Trustees of the Lyndon David Hollinshead and Others*

Cleaning and rent

A Czech residential landlord invoiced tenants separately for rent and the cleaning of the common areas of the building. The landlord believed that the whole supply was indivisible and should all be exempt. The authorities ruled that the two supplies were separate and the cleaning services were VATable.

The Advocate-General gave an opinion supporting the authorities:

1. Articles 6 and 13 of the Sixth Directive must be interpreted as meaning that residential tenancy (or, possibly, tenancy of spaces which are used for purposes other than those for dwelling), on one hand, and the cleaning of common areas which is associated, on the other hand, is to be regarded as autonomous and separable activities.

It is a matter of national courts to determine whether the provisions of the tenancy agreement, the rules of procedure of the building and the legal practice in effect in the state concerned exceptionally allow a different interpretation.

2. In situations where the national court held that the tenancy and the associated cleaning of common areas can not exceptionally be regarded as autonomous and separate operations, the cleaning of common areas must be regarded as a part of "letting of immovable property" under art. 13B(b) of the Sixth Directive and the amount paid in relation to that activity is exempt from VAT.

The ECJ has confirmed this, ruling that "*the letting of immovable property and the cleaning service of the common parts of the latter must, in circumstances such as those at issue in the main proceedings, be regarded as independent, mutually divisible operations, so that the said service does not fall within that provision*".

ECJ (Case C-572/07): *RLRE Tellmer Property s.r.o. v Finanční ředitelství v Ústí nad Labem*

Deposits for land on which houses will be built

HMRC have commented on the situation in which a customer pays a deposit for a supply of land on which houses will be built. The principle is of general application, although the Brief refers in particular to sales by developers to Registered Social Landlords.

Where construction has not reached what is called "the golden brick" (above ground level, qualifying as a "house in the course of construction" and therefore zero-rated rather than exempt), the question arises whether the payment of a deposit triggers an exempt supply by the developer which might restrict input tax.

HMRC believe that no tax point arises, and therefore no issue arises, if the deposit is held by a stakeholder and not made available to the vendor until completion. Where the vendor receives the money, there is a tax point; however, HMRC believe that the liability of the supply depends on what happens at completion. If it is clear from the contracts that the intention is for a completion of transfer when the "golden brick" stage is passed, the deposit will represent part payment for an intended zero-rated supply.

If the intention changes later, it may be necessary to revisit the computations and revise recovery on the basis that the supply would have become exempt.

R&C Brief 36/09

Attempted scheme fails

A college of further education appears to have attempted to recover input tax on building costs by means of a scheme involving a taxable subsidiary, but the Tribunal did not consider the scheme effective.

The input tax was claimed by a commercial company, Grimsby College Enterprises Ltd (GCEL). This company had been established by the Corporation of Grimsby Institute of Further and Higher Education (CGI) in 1993 to carry on commercial teaching operations. This was not driven by tax considerations, but out of concern that the charitable status of the parent might be compromised by carrying on commercial activities. GCEL had no staff or resources of its own: it bought in resources from CGI in order to sell them on to its customers. CGI was an "eligible body" for the purposes of Sch.9 Group 6 VATA 1994; GCEL was not.

HMRC enquired into GCEL's returns and initially appear to have accepted that it was entitled to the credit. However, on further investigation HMRC formed the view that the supplies of building services were in reality made to its parent. They raised an assessment to recover the input tax reclaimed by GCEL. The company appealed.

On appeal, HMRC offered two alternative lines: either the supplies were made directly to CGI for use in an exempt business of education or exempt supplies of land to GCEL, or else GCEL used the supplies to make exempt supplies of land to CGI. HMRC also argued that the arrangements were abusive, but were persuaded that they were not when CGI disclosed that the building would in any case be demolished within 10 years (so there would be no absolute advantage through use that exceeded the capital goods scheme adjustment period).

The Tribunal examined the background to the contract for construction. It had originally been entered into by CGI, but after taking tax advice the governors decided that it would be better if GCEL incurred the costs. It was argued by the taxpayer that a novation of the building contract followed; the Tribunal did not agree. The builders addressed their invoices to the company, which paid for them with funds loaned by CGI, but there was insufficient evidence to show that the contract had been legally transferred to GCEL. The supply of building services was accordingly received by CGI.

On the other hand, the supply of equipment within the buildings was input tax of the company. It had entered into the contracts for the fitting out of the building after the tax advice, so the same issue of novation did not arise. Even so, it was irrecoverable. The Tribunal concluded that the supply made by the company was an exempt licence to occupy granted to CGI. It was not a grant of "facilities" that would be taxable. GCEL had no resources or staff to "occupy" the building in a meaningful sense; it was CGI which used the buildings to make supplies of education, and it did so under a licence from its subsidiary. The Tribunal distinguished the facts from those in *Newnham College*, because in that case the subsidiary carried out the administration of the library.

The chairman concluded with the remarks, "*I have some sympathy with the Company and the Institute which, if they had organised (and documented) their affairs rather better, might have been able to achieve a tax saving. As it is, however, I am bound to conclude that they have failed in that objective, and that the appeal must be dismissed.*".

First Tier Tribunal (TC00129): *Grimsby College Enterprises Ltd*

Article by Mike Thexton

Lecture B560 (16.22 Minutes)

VAT on cars

Farmers in three recent cases have tried to reclaim VAT on cars, which they argued were for business purposes only.

In *Alex Paton & Son*, HMRC disallowed the taxpayer's claim to VAT on a Land Rover Discovery.

The taxpayer appealed to the tribunal on the grounds that the vehicle was used solely for a business purpose, and had been especially adapted to allow for the taxpayer's disability.

The main issue to be addressed, however, was not one of purpose but of availability. The relevant legislation, VAT (Input Tax) Order SI 1992/3222, articles 7(2E)(a) and 7(2G)(b), demand that the vehicle is not only for the purpose of business use only, but is also incapable of private use.

Crucially, article 7(2G)(b) says:

> 'A taxable person shall not be taken to intend to use a motor car exclusively for the purposes of a business ... if he intends to ... make it available otherwise than by letting it on hire to any person.'

Hence, most cases fail on the grounds that the vehicle is available, even if not intended, for private use.

The tribunal decided that the taxpayer had not taken sufficient steps to ensure that the vehicle was incapable of private use.

While the taxpayer had attempted to obtain business use only insurance, the insurance company in question declined to provide it.

The tribunal decided that although it was unlikely the vehicle would be used for private use, it was not incapable of it, as there were no physical or legal restrictions.

In a similar case, *John Andrew Thomas Faith*, the taxpayer claimed that the vehicle, although purchased as a motor car, had been adapted to give it the appearance and functionality of a van.

On top of this, the taxpayer claimed that the lack of cleanliness and the smell of the vehicle, given its use on a farm, made it unavailable for private use.

The tribunal questioned both of these claims, saying that despite the alterations, the vehicle was still classified as a motor car for VAT purposes, and that the 'smell' of the vehicle was insufficient to put the vehicle beyond being 'available'.

Finally, in *Robert & Lillian Waddell* the taxpayer not only tried to reclaim VAT on his new vehicle, but also tried to reclaim what he termed 'depreciation' on an older vehicle.

Once again, the tribunal refused the appeal on the grounds that the vehicle was available for private use, the key point being that input tax is blocked simply if the vehicle is 'available for private use' rather than 'used for private purposes'.

However, they excused the mis-declaration of the depreciation claim as an honest mistake.

In all of the above cases, the taxpayers' appeals were dismissed.

To summarise the position of the tribunals that recurs regularly in these cases, one could recall the words of the Court of Appeal in the case of *CCE v Upton (trading as Fagomatic)* [2002] STC 640:

> 'The concept of a taxpayer taking any positive action to make his own property available for his own private use is unreal'.

In other words, if the vehicle is your own private property, the chances are you will find it impossible to prove that it will not be used privately, and therefore you cannot reclaim VAT on it.

Partial exemption after decision in Community Housing Association

This Revenue and Customs Brief confirms HM Revenue & Customs (HMRC) policy on the VAT partial exemption "payback" rules following the High Court decision in the case of Community Housing Association (CHA) [2009] STC 1324. It uses a number of specialist terms which are explained more fully in Notice 706 Partial exemption.

Payback policy

VAT Regulation 109 in SI 1995/2518, "payback" allows a business to recoup input tax on costs that are incurred to make exempt supplies, but are instead used wholly or partly to make taxable supplies. Payback also applies to costs incurred for both taxable and exempt purposes, but actually used to make wholly taxable supplies. A payback claim cannot be made unless:

- the costs in question were not used as originally intended
- the change of use arises after the end of the partial exemption longer period (if there is one)
- the change of use results in taxable supplies or both taxable and exempt supplies if the original intention had been to make a wholly exempt supply

Background to the CHA case

CHA is a housing association providing mainly rental housing, which is exempt for VAT purposes. CHA incurred input tax related to the construction of new dwellings for use in its business. CHA subsequently changed its operation by inserting a new subsidiary between itself and its suppliers. Then, having raised invoices to the subsidiary for the value of work undertaken on uncompleted projects prior to this change, CHA lodged a "payback" claim. They argued that input tax on costs for part completed projects incurred prior to the change were not used as originally intended and were now attributable to a taxable supply from CHA to the new subsidiary. HMRC rejected the claim on the grounds that there were no supplies of services between CHA and its subsidiary and, even if there were, the old costs did not become cost components of the supplies. The Tribunal agreed with HMRC.

High Court decision

The High Court overturned the Tribunal decision and allowed the payback claim. The High Court found as fact that CHA made supplies to its subsidiary and that the supplies transferred useful material and rights arising from the old supplies received by CHA. Based on these findings the High Court's decision was inevitable. HMRC have not appealed.

HMRC conclusion

Supply covers a wide range of circumstances but there are some basic requirements that must apply before a supply can exist. The recipient of the supply must receive some benefit, he must provide some consideration and the consideration must be paid in return for the benefit.

Any business making a supply will incur costs in doing so. These are the cost components of the supply. Conclusions on what the cost components of any supply are will flow from an analysis of the nature of that supply. The mere raising of invoices and passing of funds between companies does not automatically create supplies. Careful analysis may be called for, especially if the companies are close associates.

HMRC Brief 57/2009 7 September 2009

Car dealers excess output VAT

The first decision of the Upper Tribunal (Tax and Chancery Chamber) concerned five unrelated appellants, all motor dealers. They were brought together at the First-tier Tribunal, and several appeals by other traders have been stood over awaiting the decision in this case.

All the appellants had paid excess output tax on bonus payments made to them by motor manufacturers and on the sales of demonstrator vehicles.

HMRC accepted that the VAT treatment had been incorrect and that the appellants had overpaid tax from as early as 1973. They repaid the tax to the appellants along with simple interest on the capital sums.

The appellants argued that HMRC should have paid compound interest on the repayments, relying in particular on the European Court of Justice's ruling in Test Claimants in the *FII Group Litigation v CIR* (Case C-446/04) [2007] STC 326, the House of Lords in *Sempra Metals Ltd v CRC* [2007] STC 1559 and the High Court in *F J Chalke Ltd* and the *VIC Group Litigation*.

Having first decided that the appeals were out of time, the judges considered whether or not they could apply a discretionary extension of time. They said this was a 'difficult issue'.

The appellants had not acted 'with a sense of urgency'. They said it was 'one thing to say that an appeal was not made within 30 days of the decision because it was not appreciated that the claim for compound interest could be made, but once it was, or should have been, appreciated that such a claim could be made, the appellants ought to have taken steps to act promptly to appeal the earlier decision to pay simple interest'. The judges therefore decided not to extend the time limit.

Turning to the main issue, the judges referred to the appellants' claim that they were entitled to compound interest as a matter of EU law; the word 'interest' in VATA 1994 s 78 should be read as 'compound interest'. They said it was a matter of statutory construction.

On that basis, they had no doubt that s 78, construed 'solely in accordance with the ordinary principles of domestic law provided only for simple interest'.

The statutory scheme was one of simplicity and was straightforward to administer. It would go against the grain of the legislation to say that it provided for compound interest.

The taxpayers' appeals were dismissed.

John Wilkins (Motor Engineers) Ltd, John Pudney Ltd trading as Horsham Car Care, Squire Furneaux Group, Robmar Ltd trading as Worthing Kia, Lookers plc, Upper Tribunal Tax and Chancery Chamber

Under declared takings

HMRC made simultaneous, unannounced visits to two takeaway food premises operated by the appellants. Cash in the tills was less than takings apparently evidenced by till readings. Subsequent invigilations suggested that takings had been underdeclared for VAT purposes and HMRC made assessments.

The appellants put forward a number of suggestions as to why the invigilations were unreliable but the Tribunal rejected them all as sufficient reason to reduce the amounts assessed. The Tribunal's approach is best summarised by the following extract from its decision:

> "It is in our view difficult if not impossible to understand why, if they are honestly declaring their takings, traders who, like the appellants, have invested in sophisticated tills do not take care to ensure that they are used properly and correctly, that the information they produce in the form of Z-readings is accurate, and that the information is preserved. Instead, we are asked to accept that errors (which, according to the appellants, always had the effect of increasing the recorded takings and never the reverse) were commonplace and that the few Z-readings which were available when [HMRC made its] unannounced visit ... are unreliable. If traders fail to keep, or choose to conceal, reliable evidence of their turnover they can in our view scarcely complain that they are unable in consequence to mount an effective challenge to an assessment."

In the Tribunal's view the appellants' criticisms of the assessments relied on mere assertion, not evidence. The Tribunal was not prepared to reduce the amounts assessed merely to make an allowance for the possibility that true takings were less than HMRC had estimated. It was up to the appellants, who were in possession of the true facts, to produce evidence to support their assertions that the assessments were too high. They had failed to do this.

Indeed, the Tribunal concluded from the evidence that the appellants had evaded VAT dishonestly—there was no other explanation for their failure to produce evidence of the true takings (by, for example, retaining till readings).

The appellants argued also that HMRC had not been sufficiently generous in mitigating the dishonest evasion penalties. The Tribunal considered that if anything HMRC had been too generous in mitigating by 35%. However, the extent of mitigation was not disturbed.

The appeal was dismissed.

M Karimi Hajishoreh t/a Pizza 1; M Karimi Hajishoreh and K Saghafi t/a Chichini's TC58

Supplies of insurance introductory services

This Brief explains the HMRC position following the High Court judgment in Insurancewide.com Services Ltd and Trader Media Group Ltd [2009] EWHC 999 (Ch), [2009] SWTI 1724, [2009] All ER (D) 148 (May).

The High Court found against HMRC that supplies of insurance introductory services provided via the internet are exempt from VAT. HMRC has been granted leave to appeal this decision to the Court of Appeal.

Background

The appeals of Insurancewide (IW) and Trader Media Group (TMG) concern the VAT liability of internet 'click thru' services and whether introductory services such as this, that involve no intermediation of the contracts themselves, qualify as exempt insurance intermediary services.

The facts in each case are slightly different; IW is a comparison web-site providing 'click thru' services to insurer or broker web-sites whereas TM provides 'click thru' services from its Auto Trader car auction site to a third party co-branded broker web-site. Both are paid commission on successful take-up.

At tribunal, IW lost its appeal as they were found not to be acting as insurance agents at any time and appealed to the High Court. On the other hand, TM won its appeal as the tribunal found that their

services constituted insurance intermediary services and HMRC appealed the decision to the High Court. Given the similarities in the two cases, the High Court agreed to hear the appeals jointly.

The High Court hearing took place in March 2009 and the judgment was released on 15 May. The Court found that IW and TMG were insurance intermediaries for the purposes of the VAT exemption and an act of introduction with no further involvement in the intermediation of the contract of insurance qualified for exemption as an insurance related service.

Claims

Subject to the normal rules on capping and unjust enrichment, HMRC will pay claims for overpaid tax charged on insurance introductory services that follow the findings of the Court in IW/TMG. HMRC will raise protective recovery assessments under section 73(2) which will be enforced if HMRC are ultimately successful in the ongoing litigation.

Please note that HMRC see the judgment as applying to insurance introductory services only and do not see it as applying to introductory services relating to other financial contracts even if in other respects they are on 'all fours' with IW/TMG. This is because, for services that fall within items 1 to 4 of the UK finance exemption, intermediaries are required to be both bringing together the parties and carrying work preparatory to the conclusion of the contract. A key aspect of the decision in IW/TMG was the fact that UK VAT insurance law allows exemption for businesses that are either bringing together the parties or carrying out work preparatory. Claims will not therefore be paid in respect of finance introductory services following this judgment.

Further information

Details of where to send your claim can be obtained from VAT Notice 700/45 How to correct VAT errors and make adjustments or claims from the HM Revenue & Customs Helpline on Tel 0845 010 9000.

HMRC may reject all or part of a claim if repayment would unjustly enrich the claimant. More details on 'unjust enrichment' can be found at part 14 of VAT Notice 700/45 How to correct VAT errors and make adjustments or claims.

Protective recovery assessments are covered in V1-35

There may be direct tax implications where amounts of over-declared output tax are repaid to businesses and your attention is drawn to R&C Brief 14/2009 issued previously.

Where you are in any doubt about the correct treatment please contact the Helpline on Tel 0845 010 9000.

R&C Brief 59/2009 High Court Judgment in Insurancewide/Trader Media Group

Cost of advertising by Estate Agents

The issue before the tribunal was whether the VAT incurred by Skipton Building Society's estate agent subsidiaries on the cost of advertising in the local press was wholly attributable to the sales of the properties advertised. The VAT would in that case be fully recoverable.

However, HMRC argued that the cost was partly attributable to exempt services, such as mortgage provision, so should be treated as residual input tax for the purposes of the special method.

The taxpayer accepted that there was a link between the advertisements and the mortgage services, but that it was not a direct or immediate one, such as had been said to be essential in *BLP Group plc v CCE* (Case C4/94) [1995] STC 424. A general commercial link was insufficient.

HMRC argued that while the main purpose of the advertisements was to sell properties, some of them referred also to mortgage services. This was a sufficient link, as referred to in *Dial-a-Phone Ltd v CCE* [2004] STC 987.

The tribunal judges agreed that the primary purpose of the advertisements was to sell houses, but agreed those which also indicated other services, the input tax should be regarded as a cost component of both taxable and exempt supplies, and was therefore residual.

However, where mortgage services were not overtly mentioned, there was no direct and immediate link between the advertisement and the supply of the other service. In these instances there was only an indirect link which was not enough.

The appeal was allowed, except in respect of advertisements which mentioned the availability of mortgage services.

Skipton Building Society (TC 146)

Supply of staff to associated companies

Hilltop Assistance Limited (the Appellant) appeals against part of an assessment dated 8 March 2005 for the periods 06/02 to09/03 inclusive and 03/04 in the sum of £75,085.27 plus interest in respect of supplies of staff allegedly made by Wingate Management Limited (Wingate) to associated companies which were not members of the VAT group. The Respondents say that the contracts of employment were with Wingate and VAT should therefore be charged on the supply. The Appellant says that Wingate acted as agents and VAT was not therefore due.

Richard Chapman, of counsel, appeared for the Respondents and brought Mr Gary H Kennedy an officer of HMRC as a witness and produced a bundle of documents for the tribunal. Mrs Penny Hamilton appeared for the Appellant's and produced an agreed bundle of documents.

The Appellant had original defended the assessment on the basis that there was a joint agreement between Wingate and David J Miller Insurance Brokers Limited (Brokers). The Appellant abandoned that defence at the hearing and alleged that Wingate entered into each written contract with the employees of the Appellant as agents for Brokers. In 2000 a long established insurance and financial services business, which had been carried on by a partnership known as D.J.Miller Insurance Brokers (the Partnership) was restructured and part of the business was transferred into a number of companies. David Miller Holdings Limited is the non-trading group parent company, with three subsidiaries, Brokers, the Appellant and Wingate. Brokers carried on the insurance business, the Appellant provided assistance and claims management services to the insurance industry, and Wingate acted as paymaster for the staff working for, and under the direction of Brokers and the Appellant. The Partnership continued to carry on the financial services business. At all material times the companies and the Partnership operated from the same shop premises in Oswaldtwistle, Lancashire.

Mr Chapman asked that the case be adjourned as the Respondents had had insufficient time to consider the amend defence Mrs Hamilton objected. The Judge refused the application on the basis that there had been sufficient time since the beginning of the week for the Respondents to consider the matter. Further the tribunal had been fixed for two days and not only the parties but two representatives from solicitors acting for the solicitors and accountants, who had advised the Appellant and the group on the occasion of the restructuring, were in attendance. It was unlikely that the matter could be re-listed for a hearing in the immediate future and the assessment had been raised in 2005.

The tribunal adjourned for lunch and on its return the Judge was advised that the parties had agreed that Wingate was acting as an agent and Mr Chapman confirmed that the appeal should be allowed.

We therefore find that the Appellant was acting as an agent for Brokers in the supply of the staff and that the assessment of £75,087.25 plus interest is not due and the appeal is allowed.

As we were not asked to award costs to the Appellant none are awarded.

TC00153: Hilltop Assistance Limited