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Personal Tax

Liechtenstein and the New Disclosure Opportunity

The registration period for the New Disclosure Opportunity (NDO) closed on 30 November, with a separate facility for those with accounts or other assets held in Liechtenstein opening the next day. Anyone who has clients with offshore tax irregularities to disclose, whether registered for the NDO or not, must now seriously consider the best way to do this. No-one should discount the Liechtenstein facility as, perhaps surprisingly, it is theoretically available to anyone, even those who currently have no connection whatsoever with Liechtenstein.

The Liechtenstein Disclosure facility, or LDF, operates in a fundamentally different way to the NDO and could save clients a massive amount of tax and interest in the right circumstances.

Key principles of the LDF
The principles of the scheme are outlined in a Memorandum of Understanding between the Liechtenstein authorities and HMRC. The key points are:

- Liechtenstein banks and other financial intermediaries must identify "relevant persons" – effectively anyone who may have a tax liability in the UK, for example, if a UK address is somehow linked to the account in question.
- Those financial institutions will be audited to verify their compliance with the above requirement.
- Those persons must then register with HMRC to make a disclosure under the LDF and forward the registration certificate to the Liechtenstein bank, unless detailed evidence that there is no additional liability in the UK can be provided.
- If the certificate is not provided, the Liechtenstein bank is required to cease acting for the relevant person.
- Once registered for the LDF, the person has up to 10 months to make a full disclosure to HMRC of all UK tax due in respect of the Liechtenstein assets.

There is no need to already have a link with Liechtenstein. Anyone who now moves funds into Liechtenstein, or obtains an interest in an appropriate Liechtenstein asset, can use the LDF, although there are various complexities to consider before ascertaining if the full beneficial terms of the LDF will be available, such as how the original bank accounts were opened. Practitioners must therefore give the facility serious consideration before making a disclosure of tax irregularities (say, under the NDO) if they are to properly and fully advise clients of all the possibilities available.

Differences to the NDO
The terms of the LDF lead to some interesting and significant differences between it and the NDO. Some key differences are:

1. An LDF disclosure needs to cover only 10 years from 6 April 1999 at the most, rather than almost double that, to 6 April 1990, under the NDO. Clearly, this could cut the tax bill drastically depending on the history of the irregularities. Interest could have an even more marked effect. Remember that interest rates in the early 1990s were huge compared to today, staying at well over 10% for several years. So an LDF disclosure could save not only a significant amount of tax but also a hugely disproportionate amount of late payment interest on those early amounts of undeclared income.
2. If IHT is relevant, for example the funds in the offshore bank account derive from an earlier death and were not declared for IHT purposes, there is no limit on how far back the disclosure must go. The tax must still be declared under the NDO even if more than 18 years has passed. There is no such extension under the LDF.

3. LDF disclosures can benefit from a special "Composite Rate" of 40% per annum to cover all taxes. At first glance, this may not seem attractive but it may well be extremely beneficial if, for example, company profits have been diverted to a director (potential CT, VAT and s419 and beneficial loan charges) or PAYE and NIC are involved, which could easily total more than 40% tax.
4. There is an absolute guarantee of immunity from prosecution for any underlying tax offences under the LDF. There is no such a guarantee under the NDO, although it is unlikely that HMRC will seek criminal sanctions if a full disclosure is made.
5. Under the LDF, taxpayers and their advisers can open dialogue with HMRC on a no-names basis, a practice which HMRC stopped several years ago and is not available under the NDO.
6. The fixed 10% or 20% penalty guaranteed under the NDO is not necessarily guaranteed under the LDF and may be significantly higher.
7. The disclosure under the NDO is effected by a relatively simple set of forms. A much more detailed disclosure will be required under the LDF, more akin to a report under HMRC's Code of Practice 9.

Which scheme should you use?
The differences between the two schemes mean that it is not a simple choice as to which to use, if both are theoretically available. It may be, for example, that the NDO is preferable thereby exposing almost 20 years of tax for all accounts (including those in Liechtenstein) but with the certainty of a 10% penalty rather than the potential for a much higher penalty in certain circumstances if the LDF is used.

Generally speaking, the "winners" in all this will be those individuals who have underpaid taxes for many years, whether deliberately or otherwise, and whose circumstances mean that Liechtenstein can be used. The restriction on any disclosure to 10 years has a major impact on the tax due and potentially a huge saving of interest.

Potential users of either facility need to think very carefully and perhaps prepare some "what if" calculations covering all the available options before choosing how best to properly square matters with HMRC.

Article by John Cassidy, PKF (UK) LLP

Lecture P570 (11.49 Minutes)

STOP PRESS
The deadline for taxpayers with offshore investments to notify their intention to disclose under the New Disclosure Opportunity has been moved from 30 November 2009 to 4 January 2010. It is recognised that some bank customers will not have been contacted by their banks in good time for the original deadline.

Grace v CRC before the Court of Appeal

The only contemporary case in which an unrepresented taxpayer successfully established that he was not resident in the UK for tax purposes has reached the Court of Appeal.

Mr Grace is an airline pilot employed by British Airways on long-haul flights arriving and departing from Heathrow and Gatwick airports.

He owns a house in Horley which he uses effectively as a hotel in between flights. He has no other social or family ties in the UK, apart from an ex-wife and two children whom he has not seen for over 30 years.

Mr Grace set up home in Cape Town, South Africa in 1997 and now commutes to the UK for work. He owns a house, a car and a private plane in Cape Town as well as having family and a well-structured social network there.

HMRC argued that he was resident and ordinarily resident in the UK and taxed him accordingly. An appeal was successful in front of Special Commissioner, Dr Brice.

This was appealed to the High Court by HMRC. Mr Justice Lewison decided that not only had the commissioner made an error of law in reaching this conclusion, but that such error justified overturning her decision.

Issues for the Court of Appeal

Lord Justices Dyson, Waller and Lloyd heard arguments from Malcolm Gammie QC and Keith Gordon on behalf of Mr Grace and by Ingrid Simler QC and Akash Nawbatt on behalf of HMRC.

Mr Gammie led his submissions by categorising the issues to be considered as twofold. First, did the commissioner make such a perverse finding on the facts that no other commissioner in that position would have reached the same conclusion? In that case the decision ought to be overturned.

Second, did the commissioner make an error or misdirection of law? In that case the decision may stand (if the error does not affect the final conclusion) or may be remitted to the Commissioners for redetermination (if the error might have led to the final conclusion).

Dealing with the issues in turn, Mr Gammie relied on Dr Brice's 'impeccable' decision in the case of Shepherd (SpC 484) and on appeal by Mr Justice Lewison [2006] STC 1821 to argue that only the commissioner was in a position to reach a decision on the events of 1997 in Mr Grace's case.

This was because she heard the evidence tested in cross-examination and had the benefit of the arguments made by HMRC on the law. Day count, he added, was plainly a question of degree which was a matter for the commissioner to determine.

Mr Gammie considered each of the errors that the judge had alleged that the commissioner had made. To each, he explained why Dr Brice was in fact right or that the issues had ceased to be relevant in the case.

Miss Simler started by reminding the court that it was accepted that there was an error of law in the commissioner's approach to employment as a temporary purpose.

She explained to the court that the intention of staying in a place was irrelevant, that there could be no doubt that employment was considered a settled purpose and that a 'real home' test must not be conducted when considering the issue.

She argued that that error together with other identified issues amount to such an error of law which vitiates the decision and warrants overturning.

Miss Simler further challenged the commissioner's decision on residence as ignoring the principle of dual residence.

She argued that Dr Brice had erred in finding similarities with noted case law, in particular CIR v Zorab 11 TC 289 and CIR v Brown 11 TC 292 which, she argued, were cases where the subjects were never resident in the UK prior to the relevant period.

Lord Justice Waller did not seem persuaded by this line of argument as he noted that Dr Brice is a very experienced Special Commissioner and that such an error would make her seem 'ridiculous'.

Miss Simler asked if she could 'ride on two horses' and explained that while she saw the force of Lord Justice Waller's argument and did not suggest that the commissioner was 'ridiculous', she had dealt with dual residence and TA 1988, s 336 in the same paragraph of her decision, as such her conclusion was flawed.

In reply, Mr Gammie highlighted that most of the authorities that HMRC relied on concerned the question of 'ordinary' residence. If someone is said to be 'ordinarily resident' it does not necessarily follow that he is 'resident'.

He concluded by referring the court to Lysaght where the Court of Appeal had sought to treat someone's employment differently from the other factors that should be considered when determining residence.

This attempt had been rejected by the House of Lords who held that residence was a matter for the commissioner to consider in light of a person's attachment with a place.

Judgment was reserved.

Lecture P566 (13.12 Minutes)

Strategies for avoiding the 50% rate

During the course of the summer, private equity firms and other businesses with large numbers of highly paid staff have been holding meetings with their accountants to think up ways of mitigating the impact of the new 50% tax rate which comes into force next year for those earning over £150,000.

Strategies to circumvent this tax charge include:

- bringing forward payment dates for bonuses and dividends to before 6 April 2010;
- paying, say, three years' worth of salary and bonus this year to top employees who then loan the money back to their employers in return for a pre-arranged rate of interest over the three-year period; and
- paying salaries in the form of interest-free loans which may then be written off if the top rate of tax returns to 40%.

In the case of a profitable unincorporated business with a year end date in the first half of 2009/10, consider the possibility of having a short accounting period to, say, 31 March 2010 in order to maximise the amount of profit which falls into 2009/10 rather than 2010/11.

Article by Robert Jamieson

Lecture P567 (10.02 Minutes)

CRC v Rogers, Chancery Division

In 2001, the taxpayer's employer promised him 9% of the shares in the holding company of the group.

Before he could fulfil this, the owner died, but his father made good the promise and, in 2002, the shares were put into an offshore trust for the benefit of the taxpayer's children.

The taxpayer declared income from the trust in three tax returns. HMRC opened an enquiry and assessed him to tax of £2.7 million on the basis that the shares were equivalent to employment income equal to the market value of the shares.

The taxpayer appealed, but this appeal had not been heard by the time of the instant proceedings.

In November 2008, HMRC went to the High Court to enforce the debt. The taxpayer paid £100,000 on account. In March 2009, he applied, under TMA 1970, s 55, to have the debt postponed until his appeal against the assessment was heard by the tax tribunal.

He said that in light of new advice, the shares should be considered a gift rather than an emolument of employment.

The General Commissioners refused the application, saying they did not believe there had been a change in circumstances of the case.

The taxpayer appealed to the High Court seeking a stay of the enforcement action pending the hearing of the appeal against the General Commissioners' decision. HMRC applied for a summary judgment against the taxpayer.

The judge in the High Court noted that the taxpayer had limited resources and that if the action continued, he might be made bankrupt.

This would leave him without funds to pursue further action, which would be an unjust state of affairs. There was, however, no risk to HMRC if the taxpayer's application were granted.

In addition, it was impossible to say that an appeal under s 55 did not have the prospect of a successful outcome because it did and there had been a change in circumstances.

With regard to HMRC's summary judgment claim, there was no real likelihood of defending the claim. The department had discretion to enforce a statutory debt but should not abuse its power in so doing.

In the instant case, it did not know about the corporate structure of the group of companies in which the relevant shares were held.

While the original share valuation could not be considered unreasonable, a fresh one might be required in light of the new information.

The taxpayer's application for a stay of action was allowed. HMRC's application for summary judgment was dismissed.

Transactions in securities

Introduction

Consultation on the new transactions in securities legislation closed at the end of October. The proposed new rules will be contained within s682 – 686 ITA 2007 but what is proposed?

The new rules will only apply to close companies where a person takes part in one or more transactions in securities, consideration is received and the main, or one of their main purposes, is to obtain an income tax advantage. Capital gains tax is not considered.

In addition, the person must actually obtain an income tax advantage and overall, there is no fundamental change in ownership.

What are 'Transactions in securities'?

The meaning contained within s683(2) focuses on the sale of shares but can also include issuing securities or amending their rights.

Receipt of consideration

While much of the old legislation in this area is carried into the new rules, there are a number of areas that need further clarification:

- For earn outs, is it only present distributable reserves that need to be taken into account?
- What is the impact of any transfer to IFRS for SMEs on quantifying distributable reserves?
- All shareholders could be caught by the rules; would a de minimis limit not be appropriate?
- How should we treat the sale of close to non-close companies to ensure consistency?

No commercial test

Under the new rules the old commercial test is no longer relevant but is this right given the substantial case law that exists?

Fundamental change in ownership

Change in ownership is set at *75% of ordinary share capital* and this change must be satisfied for two years after the transaction and is based upon the parties having *never* been *connected.*

- Why 75%?
- Will HMRC look at cases where the sale is of less than 75 per cent on their own merit?
- Should the definition of connected include business partners?
- Proving that parties have never been connected could be difficult?

Income tax advantage

To work out the income tax advantage, income tax payable had the consideration had been a qualifying distribution would be compared with the capital gains tax payable on a person by person basis.

Each person’s position will be dependent on their own personal circumstances. A single transaction could have a number of different results for the individuals concerned, not always directly related to their purposes or influences in the transaction.

Capital Gains Tax

Employee Share Schemes in a Recession

Employee share schemes are set to become even more popular than in recent years. This is a direct consequence of a series of factors, all of which have come together in the last 12 months.

Mitigating 50% tax

There are some very basic measures that any company can consider to help mitigate the impact of 50% tax on employees' incomes and wherever possible, give rise to a future increase in value that is taxable as a capital gain. This will suffer a maximum tax rate of 18% with the possibility that entrepreneur's relief might apply reducing this to 10%. For the most part, these strategies do not require exotic planning and will not leave the taxman breathing down anyone's neck.

First, if an employee has existing unapproved share options that can be exercised, by doing this prior to 6 April 2010, he or she can be certain of paying a maximum income tax rate of 40%. By leaving the exercise until 2010/11, those with a marginal tax rate of 50% will face a tax liability that is 25% higher, or even 60%.

The likelihood is that the benefit of exercising options before 6 April 2010 will actually be significantly more than the 10% difference in tax rates, since with depressed share prices at the moment, a tax liability based on the difference between current market value and the option exercise price may not be all that substantial. It is to be hoped that in a couple of years time stock values will have recovered and, therefore, a much more significant gain realised but escape tax at the new additional tax rate.

Secondly, companies might consider offering immediate share acquisitions to key employees with similar tax saving consequences. It is to be emphasised that this will not be acceptable for quoted companies, where there is generally the requirement to see a three-year vesting period prior to the acquisition of shares.

The problem with either of these routes is that they might well give rise to a significant tax liability that must be paid for the tax year of the share acquisition (i.e. by 31 January 2011). This could be resolved by the payment of a bonus - or the relevant individuals using their private resources. Otherwise, it may be necessary to consider slightly more complex structures.

Underwater Options

This topic has been challenging both large and small companies since the advent of the recession last summer. In principle, if an employee director has an option to acquire shares that will cost far more than they are worth, it not only ceases to be an incentive but could prove to be a real disincentive to continue working for that employer.

Therefore, a solution is required and the most common are either to alter the option exercise price by moving it downwards or to cancel the existing options and grant new ones at a more realistic value.

While this seems like an obvious way forward, there are a number of different pitfalls that must be avoided. To start with, there is a general public, corporate and governmental view that if companies are doing badly, the people who have led them there are merely getting what they deserve if their share options are worthless. Therefore, there could be a backlash if options are re-granted.

In addition, ABI guidelines that must be observed by quoted companies do not permit actions of this type. Even so, there has been a stream of AIM listed companies that have taken exactly this approach in recent months, recognising that the falling share price has less to do with company performance than it has to do with market failure.

There is also a potential problem for those that have been using the HMRC approved Enterprise Management Incentives. These have an individual limit that cannot be breached either when taking into account subsisting options or any options granted within the previous three years, even if they have been cancelled. Therefore if, for example, an individual already has his or her maximum allocation of options and those were granted within the last three years, they will not be entitled to receive new grants until the expiry of three years from the last grant.

Article by Philip Fisher, PKF (UK) LLP

Lecture P568 (12.21 Minutes)

Enterprise Management Incentives (EMI)

EMI can be a fantastic way of incentivising employees and, in so doing, save tax, possibly at 50% or 60%. This HMRC approved share option scheme offers employees up to £120,000 of shares in a highly tax-efficient structure that remains flexible enough to meet most companies' needs.

In order to be able to benefit from this plan, companies must be carrying on a qualifying trade. Amongst others, this excludes property development and trading, professional services and leasing (which is interpreted widely). Care should be taken to ensure that any company that is interested actually meets the criteria. If they do not, the more restrictive Company Share Option Plan is a possible approved alternative.

In addition, at the date on which the options are granted, the relevant company/group must not have more than 249 employees or £30 million of gross assets.

Provided that all of these qualifying criteria are met, employees may each be offered up to £120,000 worth of shares. In the current market, £120,000 will buy an awful lot more shares in the average company than it would have done last summer. With such low stock prices, there must also be a belief that, as long as the employer can weather the current economic storm, there will be real growth in the coming years making this a great nest egg for the future.

Companies can decide on how they wish to structure the option arrangement. The minimum period prior to exercise can be as little as one day, although arguably it should be longer to meet the spirit of the legislation, while options can subsist for up to 10 years and might only be exercisable on a company sale or float.

The option exercise price, i.e. the amount that the individual has to pay to buy the shares, is most commonly set at the market value of the shares on the date on which the options granted. However, it could as easily be zero, par value (although that may not be different from market value these days) or even above market value to act as an additional incentive.

If the exercise price is below market value when the option is granted, income tax will be payable on the difference, but not until the option is exercised.

At that time, income tax will be payable on exercise and, in addition, if the shares are then readily convertible into cash, the tax will be deducted through the PAYE scheme and National Insurance Contributions (NIC) will also be due from both employer and employee.

Therefore, if it is possible to exercise options during 2009/10 there will be a tax saving for anyone in the 50% or 60% bands and in addition, if the shares are not readily convertible into cash, no NIC will be due.

One significant advantage of EMI over unapproved options is that HMRC is willing to agree market values in advance of the granting of options. This means that both the employer and employee can fully understand their commitments prior to entering into the option agreement.

If companies are unquoted, at the moment the likelihood is that the market value that could be agreed for a small minority shareholding, typically less than 5%, will be very low. While in one way this is bad news in another it makes the incentive very much more attractive to key staff members that the employer is keen to keep in the longer term.

Provided that the option exercise price is no lower than market value, there will never be a charge to income tax or NIC on the exercise of the option or at a later date, other than in extremely limited circumstances.

Article by Philip Fisher, PKF (UK) LLP

Lecture B568 (8.21 Minutes)

CGT elections

The recent case of David Adams (TC48), which was heard by the new first-tier tribunal, could prove to be an interesting one. Mr Adams disposed of some shares which included deferred consideration. Clearance under the paper-for-paper provisions of S137 TCGA 1992 was granted by HMRC and Mr Adams should have made an election under S138A TCGA 1992 so that his right to deferred consideration could be treated as a non-QCB security of the acquiring company. Unfortunately, no such election was made, but Mr Adams submitted his tax return on the basis that it had been.

HMRC advanced two arguments in this context. The first was that, in the absence of a S138A TCGA 1992 election, the value of the right to deferred consideration should have been included in Mr Adams' CGT computation and tax paid accordingly. The second point was that the tax return was incorrect and that Mr Adams had been negligent.

One's first impression is that HMRC have a good case. However, the tribunal proved to be extremely sympathetic to Mr Adams. They said that an election under S138A TCGA 1992 did not have to be in any prescribed form and did not have to be made as part of the return. It could be in any form and the guidance given in the CGT Help Sheet, which suggests that the election should be made by putting a cross in the appropriate box on the capital gains pages, was irrelevant. The submission of a CGT computation alongside the return which excluded the deferred consideration could only be correct if S138A TCGA 1992 applied and so, in the tribunal's words, 'any officer with sufficient knowledge of the law who received the return with the computation could not have been under any misapprehension that the appellant wished S138A TCGA 1992 to apply'. How fascinating! As one reporter has said:

> *'Whilst I would not want to look a gift horse in the mouth, I cannot help feeling this is rather generous. Just think, if for some reason it had been to the taxpayer's disadvantage for such an election to be made, it would surely have been quite reasonable for him to say that he did not make an election and none could be implied so that maybe this gives the taxpayer the best of all worlds.'*

Almost as good were the references to negligence. Naturally, there could be no negligence having regard to the above decision, given that the return was not incorrect. But it is what the tribunal said about negligence which was of particular interest. Apparently, Mr Adams had relied on his professional advisers. He was entitled to do so and, once that had been made clear, any allegation of negligence against him personally should have been withdrawn by HMRC.

Article by Robert Jamieson

Lecture P569 (6.23 Minutes)

Inheritance Tax and Trusts

Downsizing within existing grounds and gift with reservation

A mother and father own and occupy a large house with substantial grounds. They intend to build within the exisiting grounds and then move into a smaller property with garden.They will then gift the large house and the rest of the grounds to their adult son.

However, the planning permission for the new property contains the restriction that '…the [new] building... shall not be occupied ... other than for purposes ancillary to the residential use of the dwelling known as [the existing large house]'.

Does this cause a gift with resrvation of title issue?

The effect of the planning permission restriction must significantly reduce the open market value of their new house. Could this, when the time comes, lead to a re-examination of the GROB status of the original gift? Indeed, would the valuation be affected in any case by IHTA 1984, s 163 ('restriction on freedom to dispose')?

The issues

There are two issues that need to be addressed separately in this case:

1. Does the gift of the main house constitutes a GROB by virtue of the parent's occupation of the ancilliary dwelling?
2. Is the valuation of that new propertyan issue given the substantial restriction on its ownership?

Gift of the house

In principle, FA 1986, s 102, which imposes the reservation of benefit charge, applies to a gift of property in or over which the donor retains some sort of benefit or enjoyment.

Of greater consequence in this situation is s 102A which deals specifically with interests in land. In simple terms, the parents in this case must not have a right to occupy the land/property gifted.

If the parents were to occupy a property within the grounds of the original house, there would clearly be a substantial right over part of the land gifted that had been retained.

However, providing the two properties are separately demarcated (e.g. at the Land Registry), and only that pertaining to the main house is gifted, there should be no grounds for a challenge on the basis of a GROB in the property gifted. HMRC's *Inheritance Tax Manual* refers to this specific situation at IHTM14334:

> 'Albert divides his landed estate into two parts and gives one part to his son Bernard, but retains the right to cross Bernard's part in order to gain access to the public highway.
>
> 'When the donor retains rights of way (or water and drainage) over the gifted land essential to his own continued enjoyment of land remaining in his ownership and those rights flow naturally from the division of the estate in the same way as if the gifted property were being sold at arm's length, the retention of those rights by the donor will not, of itself, be treated as giving rise to a reservation.'

Valuation of second property

IHTA 1984, s 163 refers specifically to valuation where there is a restriction on freedom to dispose, and s 163(1)(a) states that: 'the exclusion or restriction shall be taken into account only to the extent (if any) that consideration in money or money's worth was given for it'.

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This view is confirmed in HMRC's manual at IHTM09772:

> "The general rule is that a restriction or fetter is to be ignored when you value a property on the first 'relevant event' unless either:
>
> - the contract was entered into before 27 March 1974 and the first relevant event was not a transfer on death, IHTA 1984, s 163 (2); or
> - consideration was given IHTA 1984, s 163 (1)(a).'

As a result, the parents' estate will include an undiscounted value for the property assuming that property were able to be sold on the open market on death.

TAXATION FORUM, 18 November 2009

Administration

HMRC: Your Charter

Our role

We make sure that the money is available to fund the UK's public services by collecting taxes and duties as laid down by Parliament. We help families and individuals with targeted financial support.

We want to give you a service that is even-handed, accurate and based on mutual trust and respect. We also want to make it as easy as we can for you to get things right.

To find out more about our Vision go to www.hmrc.gov.uk/governance/vision.htm.

This Charter explains what you can expect from us and what we expect from you.

What you can expect from us:

1 Respect you

2 Help and support you to get things right

3 Treat you as honest

4 Treat you even-handedly

5 Be professional and act with integrity

6 Tackle people who deliberately break the rules and challenge those who bend the rules

7 Protect your information and respect your privacy

8 Accept that someone else can represent you

9 Do all we can to keep the cost of dealing with us as low as possible.

What we expect from you:

1 Be honest

2 Respect our staff

3 Take care to get things right.

More information

For more information about what we do, your rights, and where you can get help and support, please follow the links below.

To find out:

- what you can do if you are unhappy with our service or the way we have treated you (www.hmrc.gov.uk/dealingwith/complain.htm)
- how we handle information we hold about you (www.hmrc.gov.uk/leaflets/data-protection.htm)
- what you can do if you disagree with one of our decisions (www.hmrc.gov.uk/factsheets/hmrc1.pdf)
- what our ongoing service standards are (www.hmrc.gov.uk/servicestandards/)

We work closely with the Department for Work and Pensions to support you. You can find more information about this at www.direct.gov.uk.

What you can expect from us:

1 Respect you

We recognise that you might be concerned about how we will deal with you.

We will:

- treat you with courtesy and consideration
- listen to your concerns
- answer your questions in a way you can understand
- try to understand your circumstances
- make you aware of your rights, including your right to appeal our decisions
- tell you how to exercise your right to appeal against our decisions.

2 Help and support you to get things right

We want to give you as much certainty as we can that you are paying or claiming the right amount.

We will:

- provide information that helps you understand what you have to do and when you have to do it
- provide information that clearly explains the taxes, duties, exemptions, allowances, reliefs and tax credits that we are responsible for
- process the information you give us as quickly and accurately as we can
- put mistakes right as soon as we can.

3 Treat you as honest

We know that the great majority of people want to get things right.

Unless we have a good reason not to, we will:

- presume you are telling us the truth
- accept that you will pay what you owe and only claim what you are entitled to
- explain why we need to ask you questions and why we have decided to check your records
- only question what you tell us if we have good reason to.

4 Treat you even-handedly

We will be even-handed in the way we deal with you. We will take into account your circumstances and provide a consistent service. If you need help we will also give you the appropriate support so you can meet your obligations.

We will:

- act within the law and our published guidance
- help you understand your legal rights
- explain what you can do if you disagree with our decisions or want to make a complaint
- provide you with information in a way that meets your particular needs
- consider any financial difficulties you may be having.

5 Be professional and act with integrity

Whenever you deal with us we will take responsibility for our actions and behave in a professional way.

We will:

- act with integrity
- make sure that you are dealt with by people who have the right level of expertise
- make decisions in accordance with the law and published guidance and explain them clearly to you
- respond to your enquiries and resolve any problems as soon as we can
- let you know how appeals, investigations or complaints are progressing.

6 Tackle people who deliberately break the rules and challenge those who bend the rules

The great majority of people are honest and get things right. We want to protect them from the effects of people deliberately breaking the rules. We will also challenge those who engage in avoidance, deliberately bending the rules. We will treat genuine mistakes, acting without reasonable care and deliberately misleading actions differently from each other.

We will:

- identify people who are not paying what they owe or claiming more than they should
- recover the money they owe and charge interest and penalties where appropriate
- distinguish between legitimately trying to pay the lowest amount and bending the rules through tax avoidance
- use our powers reasonably.

7 Protect your information and respect your privacy

We recognise we have privileged access to your information. We will only ask you for information we need to do our jobs. We will protect that information.

We will:

- protect information we obtain, receive or hold about you
- explain why we need information, if you ask us to
- only allow our staff to see information when they need it to do their job
- give you the information we hold about you when you ask for it, as long as the law lets us
- only share or release information about you when the law lets us and we need to
- respect your legal rights when we visit premises.

8 Accept that someone else can represent you

You may want someone else to deal with us on your behalf. To protect your privacy, we will only deal with them if they have been authorised to represent you.

We will:

- respect your representative's right to act for you and deal with them appropriately

You should always check that your representative has the right experience and knowledge to help you.

9 Do all we can to keep the cost of dealing with us as low as possible

We aim to take up as little of your time and money as we can.

We will:

- try to make our services straightforward and easy to access
- make it as cheap as we can for you to contact us
- explain clearly what we need from you
- do our best to give you complete,
- accurate and consistent advice
- do our best to get things right first time.

Your obligations

What we expect from you:

1 Be honest

We need you to be honest with us.

If someone else acts for you, we expect them to be honest too.

We expect you to:

- be truthful, open and act within the law
- give us accurate information
- give us all the relevant facts
- tell us as soon as you can if you think you have made a mistake.

2 Respect our staff

Our staff will respect you and we ask you to show them respect too. If someone else acts for you, we expect the same respect from them.

We expect you to:

- be polite
- accept that we will not tolerate rude or abusive behaviour.

3 Take care to get things right

We need you to take responsibility for getting things right, even if you have authorised someone to act on your behalf.

We expect you to:

- take reasonable care when you complete tax returns and fill out forms
- send us tax returns and forms on time
- make payments on time
- respond in good time if we ask you to do something
- talk to us if there is anything that you are not sure about or if you are having difficulty meeting your obligations
- tell us if you have any particular needs so we can take them into account
- tell us about any changes in your circumstances that will affect your payments or claims
- keep adequate records that support what you tell us and hold them for as long as the law says you need to.

Informal enquiries within self assessment

Practitioners familiar with the tax issues surrounding big companies and HMRC's *Review of Links with Large Business* will have come across the term 'collaborative engagement'. With 'large and complex' taxpayers in mind, HMRC make it clear that 'collaborative engagements' are not part of 'an intervention regime'.

They recognise that 'this is a programme outside the statutory framework' and that there may be circumstances where 'a more formal intervention may be necessary'.

HMRC say they will seek to 'build stronger, more productive relationships with all our customers' and 'improve tax compliance through proportionate risk management'.

Is there a statutory basis?

As far as the writers are aware, no external discussion on any informal enquiry approach for small business has taken place. Hence practitioners may find the introduction of the 'new response framework' to such work as something of a surprise.

Most tax agents are familiar with the term 'tax investigation'; they also understand 'tax enquiry' and they will undoubtedly get to know 'compliance check'. But 'informal enquiry', what is that?

You can always ask

HMRC have potentially always been able to ask taxpayers for information without opening a formal enquiry. However, apart from the poorly received pilot on interventions, the department has chosen not to do so.

Under the new FA 2008, Sch 36 regime, HMRC have a broad range of formal powers to request information from the taxpayer and from third parties to check the taxpayer's 'tax position'.

Informal enquiries have possible advantages to the taxpayer include:

- resolution may well be quicker and HMRC may be more inclined to focus on a single, real, issue rather than asking a number of broad questions;
- costs of compliance may be less because informal requests for information can be discussed enabling peripheral information to be set aside;
- there could be added flexibility in closing a case down: if HMRC officers can avoid the statutory enquiry opening and closing formalities, they might be more amenable in borderline cases to accepting a swift resolution;
- by responding to an informal request, the tax agent is likely to enhance his relationship with HMRC and any goodwill so gained might well assist when dealing with other clients.

Informal enquiries typically might involve queries raised in a letter, or possibly an HMRC officer will telephone either the accountant or, if unrepresented, the taxpayer, and ask for information to help them to consider a self assessment tax return.

The caller will have a list of questions and where the officer is not satisfied with the initial response he will go on to request answers and documents in writing.

Co-operation within the law

It goes without saying that practitioners are required to act within the law in the best interests of the client. If HMRC decide to open an enquiry on informal lines, the client needs to be advised of the choices available:

- to provide the information informally (noting the advantages);
- to ignore and await a formal notice; or
- to go back and insist upon a formal enquiry notice (noting the safeguards).

Good result

Here is a real example of a large and complex case worked informally as a 'collaborative engagement'. This highlights both some good and some less than good issues.

The case involved a company where a corporation tax self assessment return had been filed with no enquiry started. The enquiry window was still open; however an unexpected telephone call was made to the authorised tax agent seeking the telephone number of the client – the HMRC officer said she wanted to contact the company directly.

This request was politely declined and the officer was asked to put any queries in writing to the tax agent. A letter with a few basic queries was sent immediately, the tax agent responded within two weeks and the informal enquiry was finalised three weeks later without adjustment.

While this was a good and speedy outcome no doubt appreciated by all, the writers do have serious concern over HMRC's apparent attempt to bypass the tax agent by seeking to open up dialogue with the client directly.

This cannot be right and it is suggested that HMRC may like to clarify procedures.

HMRC quite rightly see the way forward for compliance check work as the department being open with taxpayers, so far as possible, in the expectation that mutual co-operation results in a quicker and more cost-effective process for all.

However, it is very important that the legal position is not overlooked.

From an article by Mike Down and Gary Cryer

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Business Tax

Abolition of Furnished Holiday Lets

The Government has decided it should repeal the FHL rules from 2010-11. Until the FHL rules are repealed, HMRC will regard the FHL rules as applying to furnished holiday accommodation elsewhere in the EEA.

The letting of property is not a trade. However, the Furnished Holiday Lettings rules allow landlords of furnished holiday properties, which satisfy certain conditions, some of the tax treatments available to traders.

Under the FHL rules, landlords are treated as though their qualifying FHL business is a trade for the following purposes:

- loss relief;
- capital allowances;
- Landlords Energy Saving Allowance (LESA);
- certain capital gains reliefs (including business asset roll-over relief, entrepreneurs' relief, relief for gifts of business assets, relief for loans to traders and exemptions for disposals of shares by companies with a substantial shareholding); and
- relevant earnings when calculating the maximum relief due for an individual's pension contributions.

Qualifying conditions

Certain conditions must be met in order to qualify for the tax treatment provided under the FHL rules:

- the property must be situated in the EEA;
- the business must be carried on commercially, and with a view to a profit;
- Availability: the property must be available for commercial letting as holiday accommodation to the public for at least 140 days during the relevant 12 month period;
- Letting: the property must be commercially let as holiday accommodation to members of the public for at least 70 days during the relevant 12 month period. A letting for a period of longer term occupation is not a letting as holiday accommodation for the purposes of the letting condition; and
- Pattern of occupation: not more than 155 days must fall during periods of longer term occupation.

A period of longer term occupation is a continuous period of more than 31 days during which the accommodation is let to the same person. For individuals with a continuing FHL business, the relevant 12 month period will be the tax year to 5 April.

Where the qualifying conditions are not met during the relevant period, the FHL rules do not apply for that tax year or accounting period. In that situation, the normal rules on overseas property income will apply for that tax year or accounting period.

How were Furnished Holiday Lettings in the EEA treated previously?

For tax purposes, income from furnished holiday properties that are situated outside the UK were treated as income from an ordinary overseas property business.

This treatment continues to apply to furnished holiday properties that are situated outside the EEA, and to properties within the EEA that do not satisfy the qualifying conditions.

The following countries are currently within the EEA:

Austria Liechtenstein

Belgium Latvia (since May 2004)

Bulgaria (since January 2007) Lithuania (since May 2004)

Cyprus (since May 2004) Luxembourg

Czech Republic (since May 2004) Malta (since May 2004)

Denmark Netherlands

Estonia (since May 2004) Norway

Finland Poland (since May 2004)

France Portugal

Germany Romania (since January 2007)

Greece Slovakia (since May 2004)

Hungary (since May 2004) Slovenia (since May 2004)

Iceland Spain

Ireland Sweden

Italy United Kingdom

Claims and Requests for Treatment Under the FHL Rules

You do not have to apply the FHL rules to your let furnished holiday property in the EEA (outside the UK). However, if you want the property to count as an FHL property, you cannot pick and choose which FHL treatments apply to it. It will be treated as an FHL property for all relevant tax purposes. If you do not apply FHL rules, you will be treated as owning an overseas property business for all relevant tax purposes.

HMRC will accept any claims for relief or requests for FHL treatment to apply as long as:

- the claim or request is for one of the reliefs or other treatments available under the FHL rules;
- the claim or request relates to a property situated in a country within the EEA during the relevant period;
- the letting meets all the requirements of the FHL rules, apart from being situated outside the UK; and
- where a claim or amendment of a return is required, it is made within the normal time limits for making such a claim or amending the return.

If you are within the normal time limits for amending your Self Assessment tax return, you should send HMRC an amended return. You should include any FHL income, including income from qualifying holiday accommodation in the EEA, within the Furnished Holiday Lettings section of the UK Property pages of your tax return. The normal time limit for amending income tax returns is 1 year after 31 January after the end of the tax year to which the return relates. The normal time limit for amending corporation tax returns is generally 2 years after the end of the accounting period to which the return relates.

If you cannot amend your return, but are still within the normal time limits for making the claim in question, you may do so by writing to your local HMRC office. This may apply to claims for hold-over relief, roll-over relief, relief for losses carried forward, terminal loss relief and LESA which must be claimed on or before 5 years after the 31 January following the end of the tax year in question (or within 6 years of the end of the accounting period for claims by companies).

If the FHL treatment in question does not have to be claimed before a specific time limit, then we will accept a request to apply the treatment if it is made:

- for income tax and capital gains tax, not later than 5 years after the 31 January following the end of the tax year in question; or
- for corporation tax, not later than 6 years after the end of the accounting period in question.

This applies to taper relief, retirement relief (unless the claim was made on ill-health grounds or by trustees), relief for pension contributions, and substantial shareholdings exemption.

Until 31 July 2009, HMRC accepted late amendments to:

- income tax and capital gains tax returns for the tax year ending 5 April 2007; and
- corporation tax returns for accounting periods ending on or after 31 December 2006.

As long as the amendment relates to one of the reliefs or other treatments available under the FHL rules, for a property situated in a country elsewhere within the EEA during the relevant period, and the letting meets all the other requirements of the FHL rules.

The normal rules for late claims will apply to all other late claims and amendments.

Transitional Rules

Loss relief

As a result of this change, those with qualifying FHL situated in the EEA will not be treated as starting a new activity for loss relief purposes. Any unused losses, arising from letting the furnished holiday accommodation in previous years, may continue to be brought forward and set against the profits of the property business.

Capital Allowances

Income from property and FHL are both qualifying activities for plant and machinery capital allowances purposes. Those with EEA FHL will not be treated as starting a new qualifying activity as a result of this change. There will be no deemed disposal and reacquisition at market value, any existing pools will simply continue.

Under the property income rules, no capital allowances are available for expenditure incurred in providing plant and machinery for use in a dwelling house. Under the FHL rules you may claim capital allowances on expenditure incurred in providing plant and machinery for use in a dwelling house.

Expenditure incurred in providing plant and machinery for use in an EEA FHL dwelling house will be qualifying expenditure for capital allowances purposes with effect from the latest of the following three dates:

- the property was first used as a qualifying FHL;
- the date on which the country in which the property is situated joined the EEA;and
- 1 January 1994.

Where such expenditure was incurred **on or after** the latest of these three dates, it will qualify for capital allowances in the normal way.

Where such expenditure was incurred **before** the latest of these three dates, on an asset that is still in use in the FHL dwelling house, it will be treated as though the asset had been brought into use for the purposes of a qualifying activity on the latest of the three dates, at its market value at that time.

Expenditure incurred on plant and machinery contained within an EEA FHL property before these three dates, will be treated as though it was brought into a use for the purposes of a qualifying activity on the later of those three dates.

10% Wear and tear allowance

As a result of this change, those with qualifying FHL situated in the EEA will no longer be entitled to claim a deduction under the wear and tear allowance in respect of their FHL properties.

Landlords Energy Savings Allowance (LESA)

No deduction is allowed for expenditure on energy saving items for FHL businesses. As a result of this change, those with qualifying FHL situated in the EEA will no longer be entitled to claim a deduction under the LESA in respect of their FHL properties.

Pension relief

As a result of this change, income from qualifying FHL situated in the EEA can be included within an individual's relevant earnings when calculating the maximum relief due for their pension contributions.

Capital Gains

As a result of this change, an EEA FHL business will be treated as a trade for the purposes of:

- taper relief;
- roll-over relief on replacement of business assets;
- relief for gifts of business assets;
- entrepreneurs' relief;
- relief for loans to traders;
- retirement relief (available to individuals and certain trustees for tax years up to 5 April 2003 only); and
- exemptions for disposal of shares by companies with substantial shareholding.

For capital gains purposes, you may treat assets used for the purposes of a qualifying FHL business, where the property is situated in the EEA, as a trade asset from the latest of the following three dates:

- 1 January 1994;
- the date the property was first let as a qualifying FHL; and
- the date on which the country in which the property is situated joined the EEA.

Summary of HMRC Technical Note dated 22 April 2009

Lecture B566 (29.52 Minutes)

Should traders with high business mileage steer away from incorporation?

A lot has been said about traders with high mileage being better off as a sole trader – even if their profits are significant. This theory has gained momentum recently given that corporates no longer receive a balancing allowance when they sell the car whereas sole traders do (where they have private use).

Let's put this to the test with an example...

Jim has always operated as a sole trader, as he prefers the flexibility that this gives him. He needs to travel extensively for business, and buys a brand new car every three years which is used at least 90 per cent for business purposes.

Although his capital allowances are restricted, Jim benefits from a balancing allowance each time he changes his car. The cost of running the car also attracts tax relief at Jim's highest rate. His profits are around £90,000 per annum before motoring costs, and he has asked you to reconsider his choice of trading medium given that he keeps hearing that "corporates are best".

Let us allow £1,000 pa for additional professional fees if the business converts to a limited company. It is possible that through the transfer of free goodwill to the company, Jim can effectively isolate some capital gains, in respect of the value of goodwill transferred to the company, with an effective rate of tax of 10 per cent. The gain would be represented by a loan account on which Jim can draw

at will. However, leaving goodwill aside (he feels any goodwill is probably personal and therefore not transferable to a company) we will study the impact of incorporation on Jim's motoring costs.

He is presently driving a Volvo XC60 2.4D DRIVEe SE Premium, having purchased it in April 2009 for £27,000. It has emissions of 159g/km, giving rise to a potential benefit in kind of 22 per cent of the list price of £27,000. The average running cost per mile over the three years, including depreciation and fuel, is 60p per mile (per What Car). Ninety per cent of the 20,000 miles per year that he travels are business miles.

As a sole trader, the profits he earns are reduced by the business proportion of the annual motoring costs. If he were to incorporate, he would need to consider whether the car should be introduced into the company, or retained in private ownership, so all three outcomes will be considered below.

Jim — sole trader

2009/10	£
Profit before motoring costs	90,000
Motoring costs (18,000 miles)	10,800
Taxable profit	79,200
Personal allowance	6,475
Liable to tax and NIC	72,725
Income tax at 20%	7,480
at 40%	14,130
Class 4 NIC at 8%	3,052
at 1%	353
Class 2 NIC	127
Total tax and NIC	25,142
Post-tax income	
Profit	79,200
Less tax and NIC	25,142
Net income	54,058
Mileage costs borne privately	1,200
Net income after motoring	**52,858**

Jim — limited company (+ car)

2009/10	£
Profit	89,000
Motor expenses (100%) £12,000	
less private fuel £300	
	11,700
Class 1A NIC on car benefit	760
Salary	6,475
Taxable	70,065
Corporation tax at 21%	14,714
Net profit = dividend	55,351
Post-tax income	
Salary	6,475
Dividends	55,351
Tax on car benefit	(1,188)
Higher rate tax on dividend	(6,759)
Private fuel	(300)
Net income after motoring	**53,579**

These figures will not change significantly each year.

Jim's conclusion is that he should remain self employed. The annual tax saving via a corporate is marginal at £721, and he prefers the flexibility of being self employed.

The above example also assumes that the sole trader and corporate have the same rate of tax relief on the car but after FA 2009 the same relief will be given but the time in which it is given is much shorter for sole traders .i.e BA on disposal. This will reduce the savings that a corporate offers and seems to confirm that Jim is might as well remain a sole trader – even though he earns £90,000 pa.

This would undoubtedly change if Jim was married and were able to reduce his high rate liability by giving his wife some shares in the company.

Alternatively it might be worth leaving the car outside the company, bearing the costs privately, and drawing 40p per mile for the first 10,000 business miles a year, and 25p thereafter.

Jim — limited company (private car)

2009/10	£
Profit	89,000
Mileage allowance	6,000
Salary	6,475
Taxable	76,525
Corporation tax at 21%	16,070
Net profit = dividend	60,455
Post-tax income	
Salary	6,475
Mileage allowance	6,000
Dividends	60,455
HR tax on dividend	(6,699)
Motoring costs at 60p	(12,000)
Net income after motoring	54,231

This seems to be the optimum route and this completely side steps the FA 2009 changes to cars. When you add in the prospects of dividends to spouse the corporate becomes the overwhelming favorite – even for a client with high mileage.

Lecture B567 (14.50 Minutes)

Income shifting

Mr A, is one of two partners in a limited liability partnership (LLP); his income share is about £100,000 per year.

He set up a limited company many years ago to deal with a different strain of service business and this receives an income of about £50,000 per year. The work of the company is carried out by the employees and partners from the partnership. No charge is made to the company for this service.

Mr A has transferred 100% of the company as an outright gift to his wife who takes a dividend. The company has virtually no costs of its own and it bills approximately 100 individuals for the services that it provides.

The company has net assets of about £50,000 (consisting of debtors and cash, less corporation tax) and the two LLP partners are its only directors. The partnership is VAT registered, but the company is not.

With regards to the share transfer, is this a shift too far or is this acceptable based on where we are today?

Is there a settlement?

A number of aspects of the arrangements described here give some cause for concern. Perhaps to start with, there is no obvious commercial basis for the arrangement. The company receives income, but incurs none of the costs associated with earning it (the costs are borne by the LLP).

If this is not a commercial arrangement then the inference is that one of its main purposes is tax avoidance. After all, one of the consequences is that earned income of the LLP members (perhaps taxed at higher rates of income tax plus National Insurance) is being taxed at corporate rates.

As we know, dividends may be paid to the spouse as shareholder within the lower rate band of income with no further tax consequences. I wonder if the husband LLP member has given up a share of the LLP profit in exchange for the income sharing arrangement?

Deductibility of salaries

What interests me more is the tax position of the limited liability partnership. Apparently staff of the partnership are working on behalf of the company but presumably all their salaries are deducted in the accounts of the partnership.

If that is so, I would have thought that at the very least any deduction for the salaries should be restricted on the basis that they are not incurred wholly and exclusively for the trade of the partnership.

Taxation Forum, 11 November 2009

Tax relief for advice from a psychic

A trader's business was going badly so he sought advice from a spiritual adviser or psychic, following which business did seem to improve. Can this trader claim tax relief for advice from a psychic if that advice helped to improve his business profits?

Basic principle

The basic principle to be applied is whether the payments were made wholly and exclusively for the purposes of the trade.

If the client had sought advice from a business consultant, even if the advice was bad or from someone who turned out to be a fraud, there is little doubt that relief would be due.

HMRC's *Business Income Manual* at BIM37025 in discussing the concept of wholly and exclusively accepts that 'if the taxpayer can show that their only purpose for incurring a particular expense was for their trade, profession or vocation then it does not matter that the same result could have been achieved by different means or that the expenditure in the event fails to achieve the established purpose', and BIM42110 reiterates the importance of motive.

The crucial positive phrase in this query is that his client sought advice on 'how he could turn things around' in the business. If this person is a business coach who uses unconventional methods to deliver results a deduction may be possible.

Duality of purpose

However, can one consult a psychic without some personal benefit being integral to the outcome, particularly if the facts suggest that the counseling addressed the overall mental state of the trader rather than directing him specifically as to how to run the business.

VAT reclaim: Purpose v benefit

If VAT is charged by the mystic, can input VAT be reclaimed?

'No' because input tax can only be claimed if an expense is for the 'purpose' of a business, rather than for the 'benefit' of a business.

If a client is convinced that they should be able to reclaim input tax on his annual golf club subscriptions on the basis that he gets a lot of business leads from golf club contacts, are they right?

The purpose of the expense is because he enjoys playing golf, giving a direct link to him as an individual rather than to the business. The same situation applies with the psychic fee – it is an expense that is for personal rather than business purposes.

Operating as a limited company

If the client operated as a limited company he might stand a better chance of obtaining a tax deduction since medical expenditure and welfare counselling for staff would, on first principles, be allowable.

In a VAT case (*Nasim Mohammed t/a The Indian Palmist* (18397)), the practitioner, a clairvoyant and palmist, claimed that his services would be defined as 'counselling' in a European culture. A case could certainly be made that mental health restoration of staff was of benefit to the business, minimising costs of absence and enabling fuller concentration on employment duties.

Taxation Forum, 18 November 2009

Corporation Tax

Small Companies Simplification Review

Related Companies Simplification Review

Following the launch of the Related Companies Simplification Review at the 2007 Pre- Budget Report, the Government published an online survey on corporation tax rules for related companies to identify which areas of these rules were possible candidates for simplification. Over 140 responses were received from a range of interested parties, including professional tax advisers and representative groups. In December 2007, the Government issued an update on the review, outlining four areas identified as having potential for reform. One of these was the associated company rules as they apply to the small companies' rate of corporation tax (SCR).

At Budget 2008, the Government announced that it would modify the existing rules defining control of a company as they relate to the SCR where a director or shareholder is separately in a partnership. However, the Government recognised that this was only a first step in simplifying the rules, and has continued discussions with representative bodies and tax advisers to identify how the rules could be further reformed to ensure that they best meet their intended purpose. These discussions have identified that the main priority for further reform are the rules governing control of a company through the attribution to them of rights held by one or more of their associates.

Following these discussions, the Government announced at Budget 2009 that it would consult on this further reform of the associated company rules as they apply to the SCR.

Option for a new fragmentation test

Where a company is deemed to be associated with other companies the corporation tax thresholds are reduced accordingly. Broadly, the effect is to adjust the rate of tax to take account of all the profits of associated companies. The test for whether companies are associated are the rules governing 'control' of a company set out in Section 416 of the Income & Corporation Tax Act 1988.

As they apply to the SCR, aspects of these rules are fully in accordance with the Government's intended policy objective. For example, where companies are part of a group or controlled through rights held by the same person or persons they are associated for the purposes of access to the SCR. However, as discussed in the previous chapter, some aspects of the rules, such as the attribution of rights held between linked persons, work in an automatic, mechanical manner that serve to associate companies controlled by separate individuals, regardless of the wider economic circumstances.

Objective for a new fragmentation test

The Government's aim for reform of the existing rules is to provide a test that retains those aspects of the current test that work well within a new test that attributes rights held between linked persons only in circumstances where actual links between the companies make it appropriate to do so. Put broadly, the new test seeks to ensure that companies cannot be associated by an attribution of rights by mere 'accident of circumstance'.

Proposal for a new fragmentation test

It is important to note that the proposed new test would not amend the status of companies within the same group or under the control of the same person or persons – these would still be automatically associated. The proposed new test would only amend the circumstances in which rights held by linked persons are attributed between them to establish control.

The test follows the approach taken by both the Finance Act 2008 amendments to the SCR fragmentation rules and Extra Statutory Concession C9, in seeking to ensure rights held are only attributed between linked persons where links between the companies are sufficient to consider them interdependent and thus fragments of a wider whole.

The draft guidance below sets out that under the proposed new test, when establishing whether companies are associated, regard would be had for the level of economic, financial and organisational interdependence that exists between the relevant companies.

As the guidance makes clear, the outcome of each case under the proposed new test would be dependent on its own facts. The examples contained within the guidance are only illustrative, and interdependence of all three types does not have to exist for the companies to be associated. If only one type of interdependence is present to a sufficient degree then the companies would still be deemed to be associated.

Draft legislation

The proposed draft legislation is set out below.

Small companies' relief: fragmentation

(1) Section 13 of ICTA (small companies' relief) is amended as follows.

(2) In the second sentence of subsection (4) (meaning of "control" for purposes of definition of "associated company"), for "include a partner of the person" substitute "have effect for the purposes of this section".

(3) In subsection (4B) (meaning of "relevant tax planning arrangements") –

(a) in paragraph (a), for "partner" substitute "associate", and

(b) in paragraph (b), insert at the beginning "(apart from subsection (4)) would".

(4) In subsection (4C), in the definition of "relevant tax advantage", for "virtue of an increase in" substitute "obtaining, or obtaining an increase in,".

Draft guidance

This draft guidance accompanies the proposed draft legislation set out in Annex B. It will be amended in light of comments and suggestions received during the consultation period.

CTM03750 – Corporation Tax: small companies: attribution to a person of rights and powers of associates – 'fragmentation' of a business

ICTA88/s13(4), (4A), (4B) and (4C)

When you are deciding who controls a company, you should sometimes take into account not only those rights which a person (including his nominees see CTM03740) possesses or is entitled to acquire, but also the rights of some other people within s416(6).

The policy for this is that the rate of corporation tax applying to a company should reflect whether it is part of a wider whole. A wider whole can either take the form of companies controlled by the same person(s) or companies controlled by different persons that nonetheless constitute a wider whole because of the interdependencies they share with each other.

Whilst the rights of a person and his nominees are therefore always taken into account, you only take into account the rights of others in limited circumstances. Those circumstances are where there are 'relevant tax planning arrangements', either in the period concerned or in another period and the effect extends into the period concerned.

'Relevant tax planning arrangements' are defined in ICTA88/s13(4B) as any arrangements involving the person and an associate of that person which secure a relevant tax advantage.

ICTA88/s13(4C) sets out that:

- arrangements include any agreement, understanding, scheme, transaction, series of transactions whether or not legally enforceable, excepting only guarantees, securities and charges given or taken by a bank; and
- a relevant tax advantage is a reduction in the liability to corporation tax because of getting (or increasing) relief under the small companies' rate.

The statutory rules are therefore of very wide possible application, but you should bear in mind that their practical application will depend on a balanced and proportionate view of the various matters of fact and degree that may be present in a particular case.

Broadly, the rules will apply to those cases involving 'fragmentation' of the business activities which includes circumstances where related business activities have not been aggregated into the business of a single company. CTM03775 onwards gives more details and some examples.

If there are relevant tax planning arrangements, then you attribute to a person the rights of:

- associates (see CTM60150); and
- any companies which the person controls or the person and associates together control.

In both cases, the attributable rights will be inclusive of any rights of their nominees which must be attributed to the associate or company under ICTA88/s416(5) – see CTM03740. However,

you must not include the rights of 'associates of associates', that is those attributed to an associate under s416(6).

CTM03775 – Fragmentation – Relevant tax planning arrangements

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CTM03780 – Fragmentation – Fragmentation and financial, economic and organisational links

ICTA88/s13(4A), (4B) and (4C)

A company is treated as an associated company of another at a particular time if one of the two has control of the other or both are under the control of the same person (or persons).

From [the date of introduction], there are new rules that determine 'control' for the purposes of the small companies' rate ICTA88/s13. Under the new rules, attribution of rights held by associates of participators only applies where there are 'relevant tax planning arrangements'. These exist where interdependencies between the companies are such that it is appropriate to consider them associated.

The purpose of the new rules is to take the existence of other companies into account for the purposes of the small companies' rate where there is a substantive relationship between the relevant companies but not where any 'association' is an accident of circumstance, including circumstance of family relationships that do not extend into business.

Note that the new rules apply only to the attribution of rights held by associates of participators. Rights held by the participators themselves are always taken into account, whether or not there is any fragmentation.

In the rest of this guidance 'fragmentation' includes both situations where the activities of an existing business, which has been carried on by a single company, are split up between two or more companies, and situations where economic activities, which form an economic whole or are financially, economically or organisationally interdependent, are carried on by more than one company. The latter applies to existing activities and to new activities undertaken by an existing company or related companies.

When considering whether there has been any fragmentation, you should have regard to the degree of financial, economic or organisational links which exist, or have existed, or might be expected to exist between the relevant activities/companies involved. See CTM03785, CTM03790 and CTM03795.

Each case will depend on its specific circumstances. The examples in CTM03785, CTM03790 and CTM03795 illustrate the types of factor indicative of the necessary links between separate companies that are controlled by associated persons, although there will be many others.

For fragmentation to exist it is not necessary for all three types of link to exist. For example, if there is a sufficient financial link, one company will be an associated company of another even if no economic or organisational links exist.

However, even if fragmentation is not present, two companies may still be associated. For example, a husband and wife separately own the shares in and run two completely different and separate companies, but the husband is guarantor of a loan to his wife's company and as part of that guarantee is entitled to the company's assets if it is wound up. The two companies will be associated, not through the focus of the fragmentation rules – attribution of associates' rights – but because the husband will control both companies through his shareholding and rights to assets on winding up.

CTM03785 – Fragmentation – Financial links

A business is unable to operate without the necessary funds and financial backing to do so. Signs of financial interdependence include:

- Financial support given by one company, or its owner(s) to another company/ companies. The company would not be viable without support from the other(s). The support may be directly to the company concerned or indirect in, for instance, the form of guarantees or cross-guarantees.
- The separate companies share a common financial interest in the affairs of a business.

Where more than one business activity is operated from the same or adjoining premises, and the existence of one guarantees or underpins the viability of the other, the companies should be considered to be associated.

Examples

R is the major shareholder and director of Company D which provides IT consultancy services. His son, S, is the major shareholder and director of Company E which provides business management services. R provided, as a family matter rather than for business reasons, a personal guarantee in respect of a bank loan made to Company E when S set up the business. The two companies are controlled by associated individuals but there is no financial (or other) link between the companies because the guarantee has been given by R in his personal capacity and this financial support has no link to Company D. The companies are therefore not associated. If, however, R had given additional security over the assets of Company D in support of the loan to Company E, there would be a financial link between the two businesses, which would cause the companies to be 'associated'.

X is the sole shareholder and director of Company A and a 49 per cent shareholder in Company B which operates from the same sets of premises. Company A runs a chain of ice cream parlours and a fleet of ice cream vans, and Company B manufactures and sells ice cream. Company A has provided collateral for a loan taken out by Company B to buy ice cream-making equipment. No cross-charge is made by Company A in respect of shared overheads (rent, electricity, telephone). If Company A folded, Company B would not be able to continue to trade. Company B is unable to operate without the financial support provided by Company A. The two companies are in fact operating a single business and are 'associated'.

C is the major shareholder in Company Y and a 49 per cent shareholder in Company Z. The two companies operate a large public house, which is very popular for family dining as well as having a thriving wet trade. Company Y handles wet sales and Company Z, which is run by the majority shareholder, C's wife, manages the catering operation. Mrs C has financed the purchase of the assets of the catering business from a family legacy and a loan to Company Z which she is guaranteeing personally. Both businesses are insured separately. Each business fully meets its own costs, and the catering business is charged a commercial rate for the use of the shared premises, employees and facilities. Although there is no cross subsidy, the two companies share a common economic goal and premises, and Company Z would not be viable without Company Y. The two companies are accordingly 'associated'.

L is the major shareholder and director of Company M, a large road haulage company. His son P is the sole shareholder in Company Q, a business distributing DVDs, which P has built up from scratch and runs with his wife. The premises occupied by Company Q are owned by L but Company Q pays a market rent for them. The two companies are controlled by associated individuals but there is no financial (or other) link between the companies. L has never had any involvement with Company Q, and P has never had any involvement in Company M. There is no fragmentation of control and the companies are not 'associated'.

CTM03790 – Fragmentation – Economic links

Where there are direct and economic links between companies, it may be appropriate to treat them to be associated. Indicators include:

- Separate companies are seeking to realise the same economic objective.
- The activities of one company benefiting the other company/companies.
- Separate companies supplying the same circle of customers.

Examples

A and B are brothers who have developed successful internet businesses from modest beginnings when sharing a flat together as students studying computer science. Right from the start both were very interested in the business possibilities of web site design. A is the major shareholder and director of Company P which provides professional web design services, and B is the major director and shareholder of Company Q which provides graphic design services. Although their developing businesses have benefited from the mutual exchange of ideas, especially in the early days, the brothers have had no other involvement in each other's businesses, which operate entirely independently. The link between the two companies is too tenuous to make them 'associated'.

P is the major shareholder in Company A. His wife is the major shareholder in Company B. Company A operates a wholesaling business and Company B is a retailer. Company B is Company A's sole customer. The two companies share the same economic objectives and are therefore treated as being 'associated'.

Q is the major shareholder in Company C which runs a very large Chinese restaurant in Soho. Company C also sells foodstuffs in a Chinese supermarket backed by its reputation as a restaurant. Mrs Q, who is a chef trained in France, is the sole shareholder in Company D which runs a gastronomically starred restaurant she has built up from scratch in Mayfair. Company D also imports delicacies from all over the world for sale on the internet, again backed by its reputation as a restaurant. Although Q and Mrs Q are husband and wife, and in the same trade, there is no link between their two companies, which have been trading since well before they knew each other. Their activities are not 'associated'.

M is the major shareholder in Company R, a dry cleaning business. Mrs M has opened a second dry cleaning business at the other end of the town. This is run by Company S, of which she is the sole shareholder. Company S offers specialist services in relation to wedding and evening dresses in addition to the normal range of dry cleaning facilities. Company R acts as agent for these specialist services which it does not have the ability to supply itself. In substance, Company S is an extension of Company R's business. The companies are therefore regarded as being 'associated'.

CTM03795 – Fragmentation – Organisational links

Where there are direct and immediate organisational links between separate companies, such that they could not reasonably be run by a third party at arm's length from the other(s), they may be parts of a single enterprise. Look for:

- Common management.
- Common employees.
- Common premises.
- Common equipment.

Examples

X is the director and sole shareholder of Company R which operates a chain of launderettes. His wife also runs a launderette business through Company S. Although the two companies are in the same line of business, there are no links between them and they operate entirely independently – X and Mrs X started their individual businesses long before they met and they have kept the two enterprises entirely separate. The two companies are operated by associated individuals but there is no link between them, and they are not 'associated'.

Y is the director and sole shareholder of Company L which operates a chain of launderettes. The company has been in business for over twenty years. Five years ago he married Mrs Y, who has been helping him since their marriage in the running of the business. Two years ago, she opened her own launderette which she operates through Company M. Company L has given security over its own

assets in support of a bank loan to Company M. There is an organisational and a financial link between the two businesses, which causes them to be 'associated'.

Y is the director and sole shareholder of Company A and Mrs Y is the major shareholder in Company B. The two companies operate a chain of hairdressing salons. Company A provides hairdressing services and Company B provides hairdressing products. Company A rents all the premises, employs the stylists and receptionists, and pays all the bills. There is no cross charge for the use of facilities. Credit card payments are accepted by the salons. The electronic swipe machines are in the name of Company A. There is a single bank account to which the swipe machines are attached. At the end of each day the bankings are split between the two companies and transferred to their main bank current accounts. The accounts of the two companies do not truly reflect the situation of the businesses but are just an artificial division. In substance, the two companies are part of a single organisation – there is just the one business.

Z is the director and sole shareholder of Company P. He and his son are directors of Company Q, and each owns 50 per cent of the shares. Companies P and Q run a builders' yard selling wholesale to the building trade and retail to the public from the same premises, which Z owns. Company P is the trade wholesaler and has a 'trade only' counter; Company Q sells retail at a counter with its own access and parking in the yard. Company P's buyer buys stock for both the wholesale and retail side but the product ranges, stocking levels and prices are different. There are separate phone lines for the wholesaler and retailer. Z charges Company P a commercial rental. At the end of each week Company P invoices Company Q for goods supplied at cost plus a small mark-up. There is a proportionate division of overhead costs and Company P invoices Q an additional charge for other facilities. Wages for common employees are split in proportion between the two businesses. There are separate sale terms and tills for the businesses and they operate separate bank accounts and credit and credit card facilities. Each business has its own vehicles and the costs are kept strictly separate.

Where several business activities are operated from the same or adjoining premises, and the existence of one underpins the viability of the other, it is likely that they will be treated as associates. In this case, however, while the two companies operate at arms length, there are significant organisational and economic links such that the retail business could not operate without the wholesale side. Accordingly, it is appropriate to treat them as 'associated'.

CTM03800 – Fragmentation – What HMRC do not consider to be fragmentation

In determining 'control' for the purposes of ICTA88/s13(4), the attribution of rights held by associates is not intended to apply where there is an 'accident of circumstance' but rather on whether there has been in a real sense a 'fragmentation' of business activities. Each case will depend on its specific circumstances but there is no fragmentation of control in situations where

- Separate companies are controlled by associated persons but have no financial, organisational or economic links; and
- The associated persons have not, and never have had, involvement in the affairs of the companies controlled by the other associated persons.

MRC Consultation, 30/10/2009

Lecture B569 (11.12 Minutes)

Test Claimants in the Thin Cap Group Litigation v Revenue and Customs Comrs [2009]

The claimant group of corporate taxpayers were subsidiaries of multinational groups based in the United Kingdom. They consisted of Lafarge, Volvo, IBM, Siemens and Standard Bank with headquarters in France, Sweden, United States of America, Germany and the Republic of South Africa respectively. Subsequent to the decision of the European Court of Justice of the European Communities (ECJ) in *Lankhorst–Hohorst GmbH v Finanzamt Steinfurt* [2002] All ER (D) 169 (Dec) where the ECJ held that Germany's thin capitalisation (thin cap) provisions had breached art 43 of the EC Treaty, the claimants brought a number of claims for restitution and/or compensation against the Revenue concerning the rules of thin capitalisation (thin cap). They alleged that they had suffered tax disadvantages as a result of the application of the Income and Corporation Taxes Act 1988 and, in particular, the additional corporation tax they had to pay

following the decision of the national tax authorities to disallow interest paid as a deduction against taxable profits and/or limit such deductions, and the additional tax arising as a result of those companies having converted loans to equity. By a group litigation order, the "Thin Cap Group Litigation" was established. At the trial of those claims, the judge made a reference to the ECJ. On 29 June 2006, the Advocate General delivered his opinion, and on 13 March 2007, the ECJ gave its ruling on the reference (see [2007] All ER (D) 219 (Mar)). The ECJ held that the UK's thin cap rules, at all material times, involved a difference in treatment between resident and non–resident borrowing companies which constituted a restriction on freedom of establishment; but the restriction would be justified on the ground of prevention of abusive practices so long as it did not go beyond what was necessary to attain that objective. The latter test was for the domestic court to determine. Two further questions in relation to proportionality, namely whether there was a commercial justification for the transaction and whether the arm's length test, were satisfied. Further, the ECJ held that art 43 would not be engaged where the lending company did not control the UK borrowing company, and where the ultimate parent company of both the lending and the borrowing companies was resident in a third country. In relation to the remedy of restitution, the ECJ gave similar guidance as that determined in *Test Claimants in the FII Group Litigation v Revenue and Customs Comrs* [2008] All ER (D) 307 (Nov), and having regard to the principle that a member state was required to repay charges levied in breach of Community law stated in *Amministrazione delle Finanze dello Stato v SpA San Giorgio:* 199/82[1983] ECR 3595. In relation to the remedy of compensation, the concept of "sufficiently serious breach" in *R v Secretary of State for Transport, ex p Factortame Ltd: C–48/93* [1999] 4 All ER 906 was considered.

The claimants contended, inter alia, that the UK thin cap provisions were incompatible with art 43. If the claimants' contention was made out, further issues arose as to: (i) what the effect of non–compliance with art 43 would be on the thin cap regime; (ii) whether art 43 would be engaged when the lender was a non–European Union resident; (iii) whether the remedies of restitution and compensation for breach of art 43 would apply; and (iv) what was the relevant limitation period pursuant to s 32(1)(c) of the Limitation Act 1980.

The court ruled:

(1) It was established law that the test of proportionality which was required to test a nation's thin cap provisions, pursuant to art 43 of the EC Treaty, would have to meet the test of commercial justification and the arm's length test (see [50] of the judgment).

In the instant case, the UK thin cap provisions had, at all material times, infringed art 43 because of their failure to provide a separate and independent defence of genuine commercial justification. The provisions had not been proportionate to achieve the purpose of preventing abusive tax avoidance (see [65], [69], [74], [75] and [363] of the judgment).

Accordingly, the test claimants would succeed on liability (see [75] of the judgment).

Lankhorst–Hohorst GmbH v Finanzmt Steinfurt: C–324/00 [2002] All ER (D) 169 (Dec) applied; *Marks & Spencer plc v Halsey (Inspector of Taxes):* C–446/03 [2005] All ER (D) 174 (Dec) considered; *Test Claimants in Class IV of the ACT Group Litigation v IRC: C–374/04* [2006] All ER (D) 157 (Dec) considered.

(2) In all the circumstances of the instant case, the UK thin cap provisions would not be applied in relation to transactions which had a genuine commercial justification, either in whole or in any relevant part. Furthermore, since the rules should have, at all material times, afforded taxpayers in the position of the claimants an opportunity to demonstrate the existence of a commercial purpose, but had not done so, the onus would be on the Commissioners to show that the transactions lacked any commercial purpose. To require the claimants to demonstrate that there was a commercial justification for the transactions, or the relevant part of them, possibly many years after the event, and when the issue had not arisen under the rules as they had then been understood and applied, would infringe the community principle of effectiveness. None of the transactions entered into by the test claimants had been, either wholly or in any relevant part, purely artificial arrangements devoid of any commercial justification, nor had the Commissioners sought to establish that they had been. It followed that the UK thin cap provisions would have to be disapplied in relation to all of those transactions (see [83], [84], [94] and [363] of the judgment).

Weber's Wine World Handels–GmbH v Abgabenberufungskommission Wien: C–147/01 [2003] All ER (D) 45 (Oct) considered; *Cadbury Schweppes plc v Revenue and Customs Comrs*: C–196/04 [2006] All ER (D) 48 (Sep) considered; *Vodafone 2 v Revenue and Customs Comrs* [2009] All ER (D) 209 (May) considered.

(3) Article 43 of the EC Treaty would not be engaged or breached in a situation where the UK subsidiary to which a loan was made had an EU resident parent, but the lending company was neither itself an EU resident nor the subsidiary of an EU resident parent (see [194] and [363] of the judgment).

Accordingly, in the circumstances of the instant case, the court would find in favour of the Revenue (see [363] of the judgment).

Thin Cap Group Litigation (Test Claimants in the) v IRC: C–524/04 [2007] All ER (D) 219 (Mar) applied.

(4) Apart from claims for the recovery of additional corporation tax actually paid as a result of the operation of the thin cap provisions (together with associated claims for interest or loss of use of the money so paid), the only claims which could properly be characterised as restitutionary claims under Community law in accordance with the *San Giorgio* principle would be claims based on the use of trading losses or capital allowances to set off against unlawful tax (see [218] and [363] of the judgment).

None of the claims which were not *San Giorgio* claims would be classified as restitutionary claims under English law (see [363] of the judgment).

Amministrazione delle Finanze dello Stato v SpA San Giorgio: 199/82 [1983] ECR 3595 applied; *Test Claimants in the FII Group Litigation v Revenue and Customs Comrs* [2008] All ER (D) 307 (Nov) applied; *F J Chalke Ltd v Revenue and Customs Comrs* [2009] All ER (D) 87 (May) considered.

(5) On the facts, the UK's breach of Community law had not been sufficiently serious to found liability until the ECJ delivered judgment in *Lankhorst–Hohorst* on 12 December 2002, but the requirement of a “sufficiently serious breach” would be satisfied after that date (see [336] and [363] of the judgment).

R v Secretary of State for Transport, ex p Factortame Ltd: C–48/93 [1999] 4 All ER 906 applied; *Lankhorst–Hohorst GmbH v Finanzmt Steinfurt: C–324/00* [2002] All ER (D) 169 (Dec) applied.

(6) In the instant case, the date of the judgment of the ECJ in *Lankhorst–Hohorst* would be the date from which the extended limitation period in s 32(1)(c) of the Limitation Act 1980 began to run. Before that date, it could not be considered that any mistake made by the claimants about the lawfulness of the thin cap regime could have been discovered with reasonable diligence (see [342] and [363] of the judgment).

Lankhorst–Hohorst GmbH v Finanzmt Steinfurt: C–324/00 [2002] All ER (D) 169 (Dec) applied.

Debt cap provisions also amended

The Treasury has announced a further change to rules on how groups of companies are taxed when buying back issued debt at a discount to the amount borrowed.

New legislation will ensure that when the discount on a buyback is not taxed, subsequent release of the debt where the consideration for the release is ordinary shares in the debtor or the entitlement to any such shares will see the debtor being taxed on previously untaxed discount arising on the buyback.

The Treasury has also unveiled future amendments to the debt cap provisions set out in FA 2009, Sch 15.

Legislation is to be introduced to remove accountancy mismatches in the application of the gateway test, to ensure that a consistent way of measuring liabilities is used in arriving both at a worldwide group's gross debt and the net debt of UK companies

Preference shares are to be specifically excluded from the relevant liabilities, both of the worldwide group and of UK companies, when applying the gateway test.

The definition of 'financial instrument' is to be extended to include all derivatives, such as options, swaps, futures, forwards and contracts for differences.

Companies will be permitted to elect that no debt cap disallowance is allocated to them. This will benefit companies, such as those involved in whole business securitisations, that need certainty of tax treatment in order to protect their credit ratings.

The definition of 'financing income' will be extended so that guarantee fees are included as financing income.

A group treasury company is to be redefined for the purposes of the debt cap rules to exclude trading companies performing a peripheral group treasury company function.

UK subsidiaries of tax-exempt non-departmental public bodies will be allowed to disregard interest they pay to that body for debt cap purposes.

The meaning of 'ancillary costs' relating to amounts borrowed, for the purpose of computing the available amount is to be clarified.

External borrowing undertaken by a partnership in which a UK company is a partner will be computed in a way that is consistent with the UK tax treatment of partnership debts.

Certain partnerships formed under the laws of an overseas territory will qualify for the collective investment scheme exclusion for the purposes of identifying an ultimate parent company under the debt cap rules.

Securitisation companies which come within the special tax regimes we introduced in 2005 will be excluded from the debt cap rules to ensure that the tax-neutral status of these companies is not jeopardised.

A new power will be introduced to allow the definitions of the available amount and the tested expense amount to be changed or added to through secondary legislation.

A technical paper providing further details of all of these changes is available online.

Value Added Tax

VAT Registration developments

These notes summarise a number of recent developments in the area of VAT registration:

- a "position paper" issued by the European Commission which has raised doubts about the long-term future of the rules on VAT group registration;
- several cases in the UK Tribunal about entitlement to register, requirements to register and dates of registation;
- confirmation of the new rules for payment of VAT and filing of returns for newly registered traders from April 2010.

They also include some other registration cases issues which have been disputed before the Tribunal.

Group registration

The Commission has issued a communication setting out its position on the VAT grouping rules. At present 16 of the member states allow grouping, but their rules vary widely. The Commission would like to see greater consistency in the rules which apply, in particular:

- Only taxable persons may join a VAT group. Additionally, a taxable person should only be able to join one VAT group at a time.
- The group is itself a taxable person subject to the same rights and obligations as any other taxable person and all the provisions of the VAT Directive as well as the rulings by the European Court of Justice apply to it.
- The group, as a single taxable person, should be identified for VAT purposes by a single number.
- Only companies or fixed establishments physically present in the Member State that has introduced the VAT grouping scheme may be members of a VAT group. A VAT grouping scheme should be open to all sectors of economic activity in the Member State which introduces such a scheme.
- The financial, economic and organisational links must exist simultaneously.
- The VAT group's right to deduct input VAT shall be determined on the basis of the transactions of the group as such with third parties.

One of the most important consequences of forming a VAT group is the "disappearance" from a VAT perspective of transactions between the members of the group, i.e. transactions for consideration between the individual members of the group. These transactions are considered non-existent for VAT purposes.

It is of utmost importance that Member States take all necessary measures to prevent tax evasion or avoidance, as well as abusive practices, through the use of their national VAT grouping schemes. No unjustified advantage or unjustified harm should arise from the implementation of the VAT grouping option.

The UK's rules appear to comply with most of these; however, the first condition may be breached by permitting companies which only make exempt supplies and "pure" holding companies to join groups.

IP/09/1078; http://ec.europa.eu/taxation_customs/index_en.htm

No exception

A builder exceeded the registration threshold in the 12 months to July 2006, with the result that he was liable to register from 1 September 2006. He did not realise at the time, but contacted HMRC in January 2007 to enquire about the correct action to take. He was told that he might not have to register if his future turnover would fall below the deregistration threshold. He applied for exception from registration on the basis of this advice, and several months later it was refused: HMRC

concluded that he could not have provided any evidence in September 2006 to show that his turnover would be below the relevant limits.

The Tribunal commented that the position in law was clear: the decision to refuse exception could not be faulted. The trader's main reason for appealing appeared to be dissatisfaction with the fact that he had been unable to charge his customers VAT while applying for exception, but he had been assessed to VAT on those customers' receipts when exception was refused. If he had not been advised to consider exception, or if HMRC had come to a decision more quickly, he would not have suffered this disadvantage. The Tribunal had some sympathy with him, but commented that this was not within the Tribunal's jurisdiction. If he wanted to complain about the conduct of HMRC, he would have to pursue that by other means.

First Tier Tribunal (TC0029): Nicholas Paul Drury

No retrospective adjustment to EDR

In March 2007 company applied to be registered for VAT with an EDR of 1 April 2007, the day on which it intended to make its first taxable supply. It subsequently claimed pre-registration input tax, but this was disallowed because the goods were not still on hand at 1 April. The company then asked for the EDR to be amended to 1 February 2007 in order to permit the claim for input tax, and appealed to the Tribunal against HMRC's refusal to allow this.

The disputed input tax related to three vehicles which had been despatched to Malta, so there was no output tax to be declared even if the EDR was backdated. The company's grounds of appeal were "the Appeals Unit are being unreasonable. They are suggesting that it is ok if they make a mistake then the date of registration can be changed. However if we make a mistake it can't be changed". The Tribunal chairman did not agree: the VAT 1 had been correctly completed by the company's accountant and signed by the managing director, and HMRC had given the EDR that was applied for. The fact that the accountant and director might have made inadvertent errors in doing this, which they only noticed when HMRC investigated the first return and disallowed input tax, was of no help to them.

First Tier Tribunal (TC0083): Drosden Plantruck Ltd

A company was established to act as a project manager for a substantial property development. The contact partner of its accountants completed a VAT 1 for the company on the understanding that it was about to make a substantial taxable supply, but filled in the form as if it was a voluntary registration rather than a compulsory registration on the forward look. There were a number of anomalies in the registration form, but HMRC gave the company a current EDR. It later transpired that it had incurred pre-registration VAT on services more than six months earlier and wished to recover it as input tax. HMRC refused to allow an amendment to the EDR.

The Tribunal did not believe that the anomalies in the form were so great that HMRC ought to have investigated the request further. The form was a valid application for registration and there was no reason to allow an amendment.

First Tier Tribunal (TC0090): Lead Asset Strategies (Liverpool) Ltd

Late registration and deregistration

A married couple who operated a hotel failed to register for VAT. HMRC formed the opinion, from examination of income tax returns, that they had been required to register from 1997 and issued an assessment covering the period May 1997 to November 2005. The couple appealed, contending that their turnover had fallen below the registration threshold from April 2005 onwards and that the period from April to November 2005 should therefore be excluded from the assessment. The business was deregistered by HMRC from November 2005.

The Tribunal rejected this contention and dismissed the appeal, holding that "HMRC were justifiably not satisfied that the period between April and November 2005 was not a time when the appellants would be subject to a requirement to be registered". HMRC would have had to have been satisfied in advance that turnover would fall; in order to deregister on the basis of future drops in turnover a trader has to provide some evidence in advance, and it is difficult for a trader who has failed to register in the first place to do this retrospectively. In this case the trader was in discussions with HMRC by April 2005, but the Tribunal did not think that they or their representatives had provided enough reliable information for HMRC to be satisfied on a "forward look". The chairman considered that the deregistration date of November 2005 was generous.

The appellant also argued that the assessment had been raised more than 12 months after knowledge of sufficient facts had been in HMRC's possession. The chairman commented "It comes ill from the mouth of the Appellants to suggest otherwise when they themselves procrastinated and provided incomplete and unvouched information."

First Tier Tribunal (TC0050): Mr & Mrs D Robbie (t/a Dunlaw House Hotel)

Deregistration

An individual registered for VAT (apparently twice) and sent in some unconventional VAT returns. Although he only made a single supply (a sale of tee-shirts) for which he was never paid, so he reclaimed the output tax that he had initially accounted for, he nevertheless claimed the input tax on his expenditure on a cumulative basis. This meant that he claimed £6,902 on each of his first four VAT returns. The Tribunal report explains some other peculiarities of his view of the way the VAT system works.

The Tribunal reviewed the case and decided that the individual did not meet the "Lord Fisher tests" for carrying on a business. HMRC were therefore entitled to deregister him. He was also not entitled to recover the input tax (even once) on the purchases because he did not have enough evidence to support the input tax figure. A small amount of VAT was allowed as supported by evidence and falling between the dates when HMRC accepted his registration application and the date they deregistered him, but the majority was disallowed.

VAT Tribunal (20,982): Nicholas Nehemiah Gayle

A different kind of business split

A company owned and operated a golf driving range. In 2004 it entered into agreements, purporting to be leases, under which the range was to be operated by various individuals (including a professional golfer and two relatives of the company's controlling shareholder). The identity of the lessee changed every three months.

HMRC issued assessments on the basis that, notwithstanding the purported leases, the company was continuing to operate the driving range and was required to account for VAT on the takings. The Tribunal held on the evidence that the purported leases were "shams". The agreements were not leases but were "means by which the appellant delegated the day to day running of its own business". There were a number of defects in the documents that meant that they could not be leases (e.g. no clear definition of the premises), and the only possible reason for rotating the lessees was to avoid VAT registration. This meant that the company was making supplies to customers of the driving range, and was required to account for VAT accordingly.

Although the chairman used the word "sham" and recognised that it was a pejorative term, he said that he simply meant something that was presented in one way when it was in fact something else. He did not believe that the directors had been duplicitous or dishonest in the way that they had presented their evidence to the Tribunal. Their scheme simply did not work.

First Tier Tribunal (TC0036): Rotherham Golf Academy Ltd

Date of deregistration

A trader applied to be deregistered on 24 September 2007. HMRC accepted that his turnover was below the threshold and agreed, on 5 February 2008, to deregister him from the date they had received the letter, 26 September 2007. By that time, he had sent another letter asking to be deregistered retrospectively from the beginning of his 2007 financial year. HMRC refused, stating that the deregistration provisions only allowed them to deregister a trader from the date of application or a later date.

He appealed, arguing that the Marks & Spencer case indicated that he should be repaid VAT that had been "wrongly paid" to HMRC. The Tribunal chairman interpreted the parts of that case that he sought to rely on differently: she said they meant that the trader was entitled to rely on the proper application of national law and European law. HMRC's interpretation of Sch.1 para.13 VATA 1994 was correct, and there was no reason to regard the VAT collected by the trader up to 26 September 2007 as "wrongly paid".

VAT Tribunal (20,972): Keith Savidge (KCS t/a Car Spa)

Cancellation of registration

An individual appealed against decisions of HMRC to deregister his business and to refuse a claim for substantial amounts of input tax. The Tribunal chairman explained that the claims were completely spurious, but the trader appeared to have suffered a nervous breakdown and should be treated with sympathy and understanding. The decision recorded the chairman's view that HMRC's officers had behaved impeccably, in case the trader carried out his threat of writing to various MPs to complain about HMRC's conduct in the matter.

Given that the following arguments were the main basis of the claim, it might be considered that the Tribunal was excessively understanding:

Four additional and different lines of argument were advanced, either in dialogue with HMRC before the hearing or before us, as follows:-

- a BBC television programme had made some references to Sir Richard Branson's companies having received favourable VAT treatment, and implicitly a number of high-profile businessmen had also received such treatment so that the Appellant should do likewise;
- HMRC were stupid not to appreciate what was meant by "constructive accounting" and such accounting was readily accepted by all the large firms of accountants, and that was all that he had done in the present case;
- the Appellant was only asking for the small sum of approximately £190,000, and if HMRC would not give it to him, or at least make a down payment of £100,000, he would not be able to take up some critical course on computers at Oxford University; and that
- since the government had recently given billions to the banks in the City, it was absurd that HMRC was wasting its time, and his time (that they ought to be paying for at £500 an hour) in debating this minor claim.

VAT Tribunal (20,956): Kulwant Ajay Singh t/a Borealis

Compulsory registration

A company provided domestic care services to the public. It employed its workers under contracts of employment, but argued that this was not effective for VAT purposes because it exercised very little control over them. The status of the workers was a by-product of the regulations which prohibited agencies from using self-employed people.

HMRC prepared for a hearing of the appeal, but at the last minute discovered that the trader did not intend to attend or be represented. The chairman decided to hear the evidence rather than striking the appeal out. He concluded that HMRC were correct on technical grounds, and confirmed the compulsory registration. Costs of the hearing were awarded to HMRC.

VAT Tribunal (20,947): Westbourne Domestic Care Agency Ltd

HMRC concluded from a market trader's self-assessment income tax returns that he had exceeded the registration threshold in 2000. They issued a notice of compulsory registration backdated to that time, together with an assessment for over £50,000 and a late registration penalty. His representative appealed on the grounds that it was improper for HMRC to take information from self-assessment returns and use it to assess VAT.

The Tribunal rejected this, observing that the FA 1972 contained the following provision:

No obligation of secrecy or other restriction upon the disclosure of information imposed by statute or otherwise shall prevent either–

a: the Commissioners of Inland revenue or an authorised officer of those Commissioners; or

b: the Commissioners of Customs and Excise or an authorised officer of those Commissioners;

from disclosing information to the other Commissioners or an authorised officer of the other Commissioners for the purpose of assisting them in the performance of their duties.

This section was repealed with effect from 18 April 2005 by the Commissioners for Revenue and Customs Act 2005, which explicitly allows HMRC to cross-reference information but not to contravene the Data Protection Act.

The Tribunal considered that the use of the data did not contravene the DPA, and was essential for the Commissioners to carry out their functions. The appeal was dismissed.

VAT Tribunal (20,912): Webster Shrowder

Changes coming to filing and payment

HMRC have begun to publicise the forthcoming change to compulsory online filing and electronic payment for most traders which will apply from 1 April 2010. The latest issue of Working Together (aimed at agents) sets out the following:

We are planning to raise customer awareness of these changes in a variety of ways – including messages on the VAT Returns and envelopes, articles in VAT Notes, and a mailing in late 2009 to all VAT registered customers. There will be a series of nationwide events providing businesses with practical advice on the VAT online service and how to enrol. We will also be taking advantage of other departmental mailings to get the message over to customers.

From February 2010, the focus will shift from raising awareness to encouraging customers to take action. HMRC will then write to all customers affected by the changes, explaining that in future they must file online and pay electronically. The letter will explain the help and support available to them to file online for the first time, should they need it.

The HMRC publicity campaign, which will extend well into 2010, will highlight the changes, and encourage customers to register for online services and file their returns online.

We hope that all customers affected by the changes will read about them in this publicity and take appropriate action. However it would be very helpful if you could please advise your clients about the changes due in April 2010 along with their obligation to file VAT returns online and pay any VAT due electronically at an early stage. Some businesses may need to revise their security processes for checking and authorising the return before filing online, and may need your input and support in tackling this at an early date.

Working Together Issue 36

The following issue gives further details of improvements to the online service, as follows:

At present there is a service on the Government Gateway for your client to assign you as an agent to act on their behalf in order to file returns for them. From late November 2009 we are extending to the Online Agent Authorisation service (OAA) that already exists for Corporation Tax, PAYE and Self Assessment to include VAT. Under the new service your client will no longer have to enroll directly with the Government Gateway themselves to allocate you as an agent. If you use the OAA service to set up authorisations for your clients, we will send your client a letter containing a unique authorisation code. Your client should give you the code, and in doing so, is confirming that they wish you to act for them. You simply input the code online and you will be fully authorised to file online and for information disclosure by phone and paper. There is no need for a paper 64-8 since the OAA provides authorisation for online, phone and paper channels.

We plan to remove the need for agents to be VAT registered themselves, before they can file clients' VAT returns online. Our aim is to do this in time for April 2010, but we may succeed in achieving this earlier, in late November. We will keep you posted.

Working Together Issue 37

Article by Mike Thexton

Lecture B570 (18.32 Minutes)

Advisory fuel rates from 1 December 2009

These rates apply to all journeys on or after 1 December 2009 until further notice.

After discussions with the relevant trade bodies, the month's notice previously given has been withdrawn for this change. Employers are not obliged to reimburse their employees for business fuel at these rates as long as they do not exceed them overall. Employers making or collecting payments at the superseded rate because they have not been able to change their systems in time may use their judgement on whether to make or require a second payment in respect of the same period in order to apply the new rate from its effective date. However, employers should note that under the normal rules, employees are only able to avoid the car fuel benefit charge if the amount they repay in respect of private fuel at least equals the amounts based on the rates as published.

Engine size	**Petrol**	**Diesel**	**LPG**
1400cc or less	11p	11p	7p
1401cc to 2000cc	14p	11p	8p
Over 2000cc	20p	14p	12p

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

A1 Lofts Ltd v Revenue and Customs Comrs [2009] EWHC 2694 (Ch)

The taxpayer operated a loft conversion company. The taxpayer was one of four associated companies. The associated companies offered design services, pre–build work and material ordering. The taxpayer inspected the property being converted, drew up an indicative design and prepared a quote before entering into a written agreement with the customer (the customer agreement). The taxpayer's terms of business identified itself as project manager and agent of the customer. The associated companies were identified as the contractors (the contractors). The customer agreement stated that the taxpayer, would: agree the initial scheme of design and construction with the customer and generally oversee and co–ordinate the works at the property; and receive a deposit and stage payments from the customer for the purpose of making payments to the contractors, suppliers and tradesmen as well as paying itself. The contractors were not identified in the agreement and were not parties to it. All issues invoiced by the contractors were to be addressed to the customer, but were sent to the taxpayer for payment from the client account. On completion of the works, the taxpayer provided the customer with a financial statement, but that was not required to show disbursements. Where the customer defaulted on payment or otherwise breached the agreement, the taxpayer had the right to suspend the works and add to the price £100 per day of the suspension. The customer agreement stated that the taxpayer and contractors were independent contractors who worked independently of each other and contracted severally with the customer. Sometimes the customer chose his own contractor that he wanted to use, but where he did not, the taxpayer would contract with its own favoured contractors. The contractors all had standard form written agreements with the taxpayer (the contracts). The contracts were umbrella agreements that provided that work could be allocated by the taxpayer to the contractor at a price that was to be agreed at the relevant time and that those works were to be carried out in accordance with the provisions of the customer agreement. The taxpayer was not obliged to offer work to the contractor and nor was the contractor obliged to accept any work offered. A letter from the taxpayer to the contractors specified that the taxpayer was acting as agent on behalf of the customers and was not itself a contracting party. Where a customer required any additional work, they contracted directly with the relevant contractor. There was no written contract between customers and contractors. The Revenue brought proceedings before the VAT Tribunal to establish whether the taxpayer supplied a complete package to a homeowner, consisting of a finished loft conversion, or merely project management services with the individual contractors. The tribunal decided that the taxpayer supplied the

whole package and was therefore accountable for VAT on all of the building services included in the loft conversions and not merely for project management services. The taxpayer appealed.

Pursuant to ss 1 and 4 of the Value Added Tax Act 1994, the court had to identify the supplier as it was his liability to account for VAT. Where the supplier was not a taxable person, then there would be no VAT to be accounted.

It was established case law that:

– (i) Where two or more persons (A and B) were involved in the supply of goods or services to an ultimate consumer (C), different contractual structures might entail different VAT consequences.

- (ii) Those consequences would follow whether or not C knew about the contractual arrangements between A and B.

– (iii) The starting point for determining the true relationship between A, B and C was to conduct an analysis of the contractual arrangements between them.

– (iv) Where the contractual arrangements were contained wholly in written agreements, the analysis would require a construction of those agreements. Where a contract was partly written and partly oral, the analysis would require the court to assess what the parties said and did to establish the extent of the contractual obligations.

– (v) The apparent contractual arrangements would not represent the true relationship between A, B and C where the contractual arrangements were a sham; where the parties had failed to operate the contractual arrangements; or where the evidence was wholly inconsistent with the apparent contract.

– (vi) The identification of the true rights and obligations of the parties would be the same, whether the question had arisen in the context of VAT or an action for breach of contract and whether it was in a domestic or a European context.

– (vii) When the true rights and obligations of the parties had been identified, it would then be necessary to decide how those rights and obligations should have been classified for the purposes of VAT.

– (viii) That might be concluded by the terms of the contract itself. Where it was not, then the classification of the parties' rights and obligations for the purposes of VAT might involve the application of particular deeming provisions of the 1994 Act; or having decided whether the nature of the supply fell within a particular description; or whether there was one contract or more than one contract; or whether, on the true construction of a single contract, there was one supply or more than one.

– (ix) Depending upon the true relationship between A, B and C, the conclusion might be that A made a supply to B, who made an overall supply to C; or A and B might have made separate and concurrent supplies to C (see [47] of the judgment).

The tribunal had taken an unstructured approach in their consideration of the proceedings before them and had taken an incorrect view in determining that the established case law represented inconsistent approaches. The tribunal had erred in finding that the case law cited did not apply because the alleged agency was one in which the principal was the consumer and not the supplier. That was a factual distinction which was not relevant to the legal approach. The tribunal had not first identified the true legal relationship between the various parties nor construed the written customer agreement. On the true construction of whether there were proven facts which justified a departure from the agreement, the subjective understandings of the parties were not relevant. The customer agreement had contemplated that the taxpayer would engage the contractors on behalf of the customer. It was difficult to establish how the taxpayer would have performed its obligation to oversee and co–ordinate the conduct of the works unless it had engaged the contractors on behalf of the customer. It could therefore be implied that the taxpayer did engage contractors on behalf of the customer. The tribunal had not considered whether the taxpayer was authorised to engage contractors on behalf of the client in either their construction of the customer agreement or in their consideration of the wider circumstances of the matter. There had been internal inconsistencies in the ruling of the tribunal in their consideration of the entire agreement clause contained in the customer agreement and the effect that had on pre–contract explanations by the taxpayer. The tribunal did not first construe the contract then decide

whether, in the light of the facts that they had found, the written contract between the parties was a sham or was otherwise superseded by some different contract. Once the legal rights and obligations of the parties had been determined, they would then have been in a position to classify those rights and obligations for the purposes of VAT. The classification process would have required them to determine: (i) to whom the contractors supplied their services; and (ii) what services the taxpayer supplied to the client. In the absence of a finding of a sham or a departure from the written arrangements, the construction of the contracts was likely to be the finishing point as well as the starting point. The tribunal had incorrectly combined two stages of the legal analysis process. The tribunal had neither construed the agreement, nor squarely addressed the question of whether the agreement, as construed, represented the real bargain between the parties (see [49]–[53] of the judgment). The application would be allowed.

The tribunal's reasoning did not stand and the matter would be remitted to the tribunal to reconsider its decision (see [53] and [54] of the judgment).

HMRC concession

In *R (on the application of the Medical Protection Society Ltd) v Revenue and Customs Comrs*, the claimant (MPS) was a professional body which provided support to its members who faced legal proceedings in relation to their practices. HMRC required MPS to account for VAT, in relation to legal services provided to it by overseas suppliers, on the reverse charge basis. MPS had received an HMRC ruling that the reverse charge would not apply to the legal services. HMRC contended that it was not bound by this ruling because MPS had not disclosed all material facts and that the ruling had been withdrawn retrospectively. MPS applied for judicial review of that decision.

The principal question was whether MPS's disclosure was full and accurate.

Dismissing the application, the High Court held that MPS had not presented the full relevant facts to HMRC.

Return of standard rate to 17.5% on 1 January 2010–measures to help business

This Brief explains two HMRC measures designed to assist businesses in implementing the return of the standard rate of VAT to 17.5%. It also includes details of the consultation currently being carried out by the Department for Business, Innovation and Skills (BIS) about a proposal to amend the Price Marking Order 2004.

Background

On 1 December 2008 the standard rate of VAT was temporarily reduced to 15%. It reverts to 17.5% on 1 January 2010. HMRC recognises that the date of the change may cause problems for certain businesses at a particularly busy time of year so we have introduced two measures to help business to implement the change. These are:

- special accounting arrangements for businesses operating beyond midnight on 31 December 2009;
- the “light touch” to be operated by HMRC audit staff in dealing with errors arising out of the rate change.

Further details on each of these are provided below.

1 Special accounting arrangements for businesses operating beyond midnight on 31 December 2009

RETAILERS

The temporary reduction of the standard rate of VAT to 15% ends on 31 December 2009. As is normal with changes to the VAT rate, the return to 17.5% will be effective from midnight on 31 December. However, HMRC recognises that making the necessary changes to account for VAT at 17.5% may cause particular problems for certain businesses operating after midnight at what can be a particularly busy time of year. For example, it would not be practical for a pub, club, restaurant or hotel hosting a New Year's Eve celebration to stop serving customers at midnight in order to adjust their tills to account for VAT at 17.5% and to amend their prices accordingly.

In order to assist businesses in this position HMRC will allow them to account for VAT at 15% on takings received up to the earlier of:

- the end of trading of the 31 December session or
- 6am on the morning of 1 January 2010.

This treatment is subject to the following conditions:

- It is restricted to those businesses open at midnight on 31 December 2009 that account for VAT at the point of sale such as businesses on a retail scheme–pubs, shops, restaurants etc. It will not apply to:

    - mail order or on–line retailers;

    - businesses that account for VAT on the basis of VAT invoices issued; or

    - pre–payments for supplies of goods or services to be provided after 6am on 1 January 2010.

- It will not apply to sales made through coin operated or similar machines (vending, amusement or gaming machines etc). In these cases businesses must follow the normal rate change rules as set out in section 10.1 of the detailed rate change guidance (www.hmrc.gov.uk/vat/forms–rates/rates/rate–rise–guidance.pdf) and account for VAT based on the date that the machine is used or by apportionment if the machine does not record the date of usage.
- It will not apply to transactions made after midnight on 31 December that would have been caught by the rate change anti–forestalling legislation (Finance Act 2009, Schedule 3) had they been made before midnight. Any such supplies will be liable to VAT at 17.5%. Further guidance on the anti–forestalling legislation is available below.
- HMRC may withdraw or restrict the application of this treatment in individual cases.

TELECOMMUNICATIONS PROVIDERS

As the hours around midnight on New Year's Eve are traditionally the busiest time of year for voice calls and text messages, it may similarly be difficult for telecommunications service providers to change their accounting and billing systems to take account of the change in the rate. HMRC will therefore allow VAT to be charged at 15% on charges for voice calls and text messages that take place and are billed up to 6am on 1 January 2010.

2 The Light Touch

The following guidance has been given to HMRC VAT audit staff about the approach to adopt in relation to errors discovered in relation to the rate change:–

WHAT IF BUSINESSES MAKE MISTAKES IMPLEMENTING THE CHANGE OF RATE (LIGHT TOUCH)?

- HMRC wants to encourage and assist businesses as they make the changes necessary to deal with the change in the standard rate.

If a business discovers that it has made material mistakes, it should correct them through the normal error correction process.

- HMRC will however be operating a "light touch" in terms of errors made in the first VAT return after the change (where the error relates to a change of rate issue). This means that in our audit plans we will not target change of rate errors that are unlikely to lead to any material net revenue loss. And if we find errors which relate to a change of rate issue we will not seek an adjustment unless we have reason to suppose that there is an overall revenue loss.
- For example, consider a fully taxable business which supplies standard–rated goods to a fully taxable customer and incorrectly charges 15% rather than 17.5%. As the detailed guidance makes clear, the customer should treat only 15% of the tax exclusive (net) price as input tax. If the customer does this there will be no overall loss of tax. When auditing the supplier, HMRC will assume that the purchaser has followed the accounting documents unless there is good reason to suppose otherwise.
- However, if the supply is or may be to a customer who is not able to recover VAT in full, then there is likely to be an overall loss of tax and HMRC will seek to adjust (issue an assessment) in the normal way.
- In situations where HMRC do need to adjust (and issue an assessment) we will take into account the difficulties the business has faced in adjusting to the change in considering whether penalties apply.

3 BIS Consultation on proposal to amend the Price Marking Order 2004

Traders are required to display clearly their prices inclusive of VAT. For a period up to 14 days, they are permitted under the Price Marking Order 2004 (SI 2004/102) to let consumers know, by way of a general notice, that an adjustment in price, to take account of the VAT change, will be made at the till.

BIS is consulting on its proposal to extend the length of time that traders can display a general notice, from 14 days to 28 days. Full details of the consultation, which closes on Monday 23 November 2009, can be obtained at the link above.

VAT—sale of subsidiary

In *Skatteverket v AB SKF (Case C-29/08)*, the applicant was the Swedish parent of various subsidiary companies. It invoiced various administrative services to the subsidiaries and paid VAT accordingly. The applicant sold a 100% subsidiary and used the proceeds to fund other activities, including the acquisition of services which would be subject to VAT.

The ECJ ruled, *inter alia*, that a disposal of shares of the type at issue was exempt from VAT under article 13B(d)(5) (Sixth Directive). A disposal, where the parent had supplied services subject to VAT to the subsidiary, would be an economic activity, but a disposal equating to the transfer of a totality of assets of an undertaking (where the member state had exercised the option under art 5(8), Sixth Directive) would not constitute an economic activity.

Revenue & Customs Brief 69/2009 Intrastat - Changes from 1 January 2010

This Revenue and Customs Brief explains how businesses trading with other EU Member States could be affected by changes from 1 January 2010.

Changes in Intrastat thresholds from 1 January 2010

- The exemption threshold for arrivals is increased from £270,000 to £600,000
- The exemption threshold for dispatches is reduced from £270,000 to £250,000

Background

Community legislation requires the UK to collect information on intra-EU trade in goods for statistical purposes and sets minimum requirements for the quantity of trade covered.

EU Member States are required to collect data on a minimum percentage of the total value of their EU trade in goods. This regulation has been amended by Council Regulation (EC) No 222/2009. Please note that the minimum requirement for Member States to collect for their arrivals (intra-EU imports) has been reduced from 97 to 95 per cent. The requirement for their dispatches (intra-EU Exports) remains at 97 per cent.

These requirements determine the level at which the exemption thresholds, which are applied independently to arrivals and dispatches, are set in the UK. Those traders with an annual intra-EU trade in goods above the specified exemption thresholds are required to provide monthly statistical returns (Intrastat Supplementary declarations).

The threshold for arrivals has been increased to £600,000 as a result of the reduction in the coverage requirement to 95 per cent. The threshold for dispatches has been reduced to £250,000 due to the current economic downturn and the consequent reduction in the number of UK businesses trading within the EU. The revised thresholds ensure that the UK obtains the percentage coverage of the value of intra-EU trade required by Community legislation whilst at the same time ensuring that the number of businesses which are required to submit monthly information is kept to a minimum.

The revised thresholds will be implemented by a Statutory Instrument. This instrument is being laid before Parliament in the coming weeks and, subject to Parliament having no objections to it, will come into force on 1 January 2010.

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