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Personal Tax

Car benefit where employees pay the lease rental

The appellants were directors of B Ltd ("the employer") which was a wholly owned subsidiary of the holding company, S Ltd. In 2004 S Ltd brought approximately 12 cars and leased them to the employer who, in turn, leased them to certain employees, including the appellants, under car leasing agreements. The car lease terms were arms' length with the lessor (and the tribunal proceeded on the basis that the lessor was the employer) bearing the cost of servicing, insurance and road fund licence, and the employees paying the car rental payments and for fuel. There was no restriction on the use of the cars which could be used by the employees for private purposes as well as work duties. The employees were entitled to claim a mileage allowance from the employer to cover business mileage and claims were paid at the "approved mileage allowance payments" ("AMAP") rates allowed by ITEPA 2003 s 229. HMRC raised assessments on the employees and national insurance determinations on the employer on the basis the cars, notwithstanding the leasing arrangements, gave rise to a benefit in kind; that scale benefits for both the car and the fuel were taxable and the mileage allowances gave rise to further taxable benefits. HMRC accepted that a deduction under ITEPA 2003 s 144 was available for the car lease rentals paid by the employees, and that they could be deducted under Step 8 of the calculation in s 121(1). The appellants appealed against their assessments. At the hearing HMRC submitted that: (i) the cars fell within the charge to tax under ITEPA 2003 s 114. The words "made available" in s 114 meant "capable of use"; if the employee did not own the car but had permission to use it then the car fell within that section; (ii) the cars thus fell within Ch 6 and accordingly s 120 applied; (iii) as s 120 applied, the condition in s 149(1)(b) was satisfied; as was the condition in s 149(1)(a) as the employees were paid the mileage allowances. Therefore fuel benefits arose to the employees. The employer had conceded that some of the claims paid to some of the employees did contain an element of home-to-work travel. For those employees who did not receive any payment in respect of private mileage, the fuel benefit was nil, pursuant to s 151. For those employees who did (unintentionally) receive some payments in respect of private mileage, the cash equivalent of the fuel benefit was assessed under s 150; (iv) the cars were company cars as they fell within s 236(2)(b) on the basis that "the cash equivalent of the benefit of the vehicle was to be treated as the employee's earnings for the tax year by virtue of … section 120 (benefit of car treated as earnings)"—and thus, according to s 229(4), the AMAP exemption was not available. The appellants contended that: (i) condition (a) in s 114 was not met as the car was not made available; "made available" was not an event but a process. Signing the car was an event but thereafter the employer had no control over it. The employees took over all responsibilities so it was incorrect to regard it as a "company car"; (ii) the AMAP exemption should be available for employees who did not have a car benefit under s 120 where the "Step 8" deduction eradicated any benefit; (iii) the mileage allowances should be reduced by more than just the advisory fuel rates as the employees incurred further costs in driving those business miles—namely, the car rental payments under the car leases. Costs that a car owner would normally incur (such as servicing, road fund licence etc) were borne by the employer/lessor and the only cost to the driver/employee was the car lease rental payments. A proportion of those costs should be deductible from the mileage allowances, as well as the fuel element.

The tribunal considered that the cars were made available to the employees within the meaning of ITEPA 2003 s 114 and s 114 operated so as to apply the provisions of Ch 6 to the cars in question. The words "made available (without any transfer of the property in it)" were not to be construed in a manner which meant that the conferring of any interest upon the employee sufficient to give the employee an independent right to possess and use the asset prevented the car from being "made available". As there was clear authority that that was the case for co-ownership, it followed it must also be the case for a lessor/lessee relationship. As a result the cars fell within the provisions of ITEPA 2003 Pt III, Ch 6 by virtue of s 114. The cash equivalent of the car benefit was taxable as earnings under s 120 and was calculated according to s 121. HMRC had agreed that the lease rentals paid the employees could be deducted under Step 8 of the calculation in s 121(1). For all the employees the cash equivalent of the fuel benefit was taxable as earnings by virtue of s 149. For those employees who received no payment for their private use fuel, the amount of the fuel benefit was nil under s 151. For those employees who did (inadvertently) receive payment for some private

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use fuel, the amount of the fuel benefit was calculated according to s 150. The mileage allowance payments did not constitute AMAPs within s 229, because the cars were “company vehicles” within s 236(2) and thus excluded by s 229(4), and so the relief afforded to AMAPs by s 229(1) was not available. The cash payments of mileage allowances constituted emoluments and thus earnings of the employees (s 62). HMRC had agreed that the taxable amount of the mileage allowances could be reduced by the “advisory fuel rates”. The taxable amount of the mileage allowances could not be further reduced by reference to the lease rentals paid by the employees. It followed that the appeals would be dismissed.

Appeals dismissed.

Whitby and anor v HMRC, Tribunal 18 November 2009

Compensation payments taxable?

A recent appeal heard before the First-tier Tribunal serves as a timely reminder that employee compensation payments can be earnings from the employment instead of compensation subject to the £30,000 taxable limit. The case was *Kuehne & Nagel Drinks Logistics, Mr A Stott, Mr AC Joyce v HMRC* TC314. Payments and benefits made solely in respect of termination or change in duties or change in earnings of a person’s employment (Ch 3, Pt 6, ITEPA 2003) will count as employment income if they meet certain conditions and exceed the £30,000 limit. Where the conditions are not met, for example the payment is made in consideration for something in addition to the change or termination, it will not qualify, so that gross payment may not be appropriate for the first £30,000.

The further consequence for the employer is that if such payments are regarded as ‘emoluments from employments’ they will be liable for employer’s NIC. The appellants – Kuehne & Nagel Drinks Logistics Ltd – had entered negotiations with union representatives with regard to a TUPE transfer of employees from Scottish & Newcastle. (The Transfers of Undertakings (Protection of Employment) Regulations, or TUPE, preserve employees’ terms and conditions when abusiness or undertaking is transferred to a new employer.) The employees were being obliged to move from a defined benefits pension arrangement to a defined contributions scheme and there was concern that the future accrual of pension benefits would be adversely affected. The employees, through their trade union, claimed compensation for the perceived loss they were likely to suffer through the change in pension arrangements. The company entered the negotiations because it wished to avoid strike action, which would be damaging to business, and because it wanted to try to ensure an enthusiastic workforce.

The tribunal found that the payments made were in compensation for the employees’ loss of pension rights but also an inducement for them to work willingly in the future. The tribunal judge said:

On this basis I conclude that the payment was taxable. Because it was paid and received as an incentive to work willingly and without industrial action for the joint venture company, it was an emolument from the employment. That it was also paid and received as compensation for the loss of the pension scheme does not affect this conclusion. It was paid in reference to the services the employees rendered and was in the nature of a reward or inducement for future willing service.

As the payments were made ‘in reference to the services the employees rendered’ they had to be regarded as earnings fully liable to tax (under s 394,ITEPA 2003) and to Class 1 NIC.

Taxline, February 2010, Contribution by Smith & Williamson’s National Tax Group

Salary sacrifice arrangements involving cycles and bus passes

This HMRC note provides information for employers in relation to the Cycle to Work scheme and bus pass salary sacrifice arrangements.

Summary

Some employers have implemented salary sacrifice arrangements for cycles and for bus passes with the expectation that the benefits in question are covered by a tax exemption and that there is no employer liability to National Insurance contributions (NICs). In both cases, there are conditions that must be satisfied in order for the exemption to apply. This note explains the approach that HM Revenue & Customs (HMRC) will take for past and current periods where the conditions for the relevant tax exemptions are not satisfied, so that the exemptions do not apply.

This note also refers to the guidance about the actions that employers can take to ensure that the conditions for the cycles exemption are satisfied in future.

Salary sacrifice arrangements that rely on the employment income exemption for loaned cycles

Background

These arrangements are commonly referred to as "Cycle to Work" arrangements. As explained in the detailed implementation guidance provided by the Department for Transport Cycle to Work Scheme – Implementation guidance (www.dft.gov.uk/pgr/sustainable/cycling/cycletoworkguidance/), they take advantage of a tax exemption that allows employers to loan cycles and cyclists' safety equipment to employees as a tax–free benefit.

The exemption can only apply if certain conditions are satisfied. These conditions include a requirement for the cycles or equipment to be available generally to all employees of the employer. This does not mean that every employee has to be provided with a cycle or equipment, just that the offer of cycles or equipment is open to all employees if they wish to take it up. However, there has been some confusion amongst employers about what this means in practice where cycles are only offered through salary sacrifice arrangements and some employees are excluded from access to salary sacrifice arrangements. This may happen because of other statutory considerations, such as ensuring that pay is not reduced below the level of the National Minimum Wage or because of legal barriers to under 18 year olds signing up to the type of agreement typically included in a cycle to work salary sacrifice arrangement.

HMRC's updated guidance EIM21664 (www.hmrc.gov.uk/manuals/eimanual/EIM21664.htm) and the Department for Transport's ("DfT") implementation guidance confirm that even if some employees are excluded from salary sacrifice arrangements, the offer of a cycle must still be open to them in order for the exemption to apply.

However, this does not mean that the cycles exemption cannot be satisfied where an employer uses salary sacrifice arrangements. Both the DfT guidance and HMRC's updated guidance include information about how employers can take action to ensure that the condition about the offer of a cycle being open to all employees is satisfied.

What if an employer has a Cycle to Work arrangement in place and some employees are excluded from the offer of a loaned cycle?

As explained above, the condition about availability is not satisfied in these circumstances and therefore the exemption does not apply. HMRC will take the

following approach to the exemption in circumstances where the **only** reason that the exemption does not apply is the exclusion of employees aged under 18 years or earning at or around the National Minimum Wage.

A For employees that had entered into Cycle to Work salary sacrifice arrangements by 18 December 2009, the exemption will be treated as continuing to apply until the end of each such employee's current Cycle to Work agreement.

B Any renewal of the current Cycle to Work agreement for another cycle will be treated as a new arrangement and will only be covered by the exemption if all conditions (including the availability condition) are fully satisfied.

C For any employee that had not entered into Cycle to Work salary sacrifice arrangements by 18 December 2009, the exemption will only apply if all conditions (including the availability condition) are fully satisfied.

If employers wish to ensure that the cycles exemption applies to employees who sign up to or renew Cycle to Work arrangements in future, they will need to ensure that they offer the benefit of a cycle across the workforce as a whole.

Where the conditions are not satisfied and are not treated as satisfied for an interim period as outlined in paragraph A above, the employer is responsible for including details of the taxable benefit on form P11D for each affected employee and for accounting for employer's Class 1A NIC liability.

Sale of cycles after end of loan period

The cycles exemption relates solely to cycles that are not sold to the employee. However, an employer or a third party cycle provider may choose to offer the cycle for sale to the employee after the loan has ended. If the employee is able to buy the cycle for less than its market value, the difference will liable to tax and to employer's Class 1A NIC liability.

There is currently no agreement about any simplified approach to valuing cycles and therefore each cycle that is sold in this way should be valued at the time of sale.

Where a cycle is not sold to the employee and continues to be loaned beyond the original period set out in the salary sacrifice arrangement, the tax exemption will continue to apply as long as the conditions continue to be satisfied.

Salary sacrifice arrangements that rely on the employment income exemption for support for public buses

Background

HMRC has become aware that the employment income exemption for support for public buses is being used in salary sacrifice arrangements that are aimed at providing employees with bus passes.

These salary sacrifice arrangements are based on an incorrect understanding of the conditions that need to be satisfied in order for the exemption for support for public buses to apply. The main problems that HMRC has seen with bus pass salary sacrifice arrangements are that:

– they do not relate to the provision of direct support for specified bus routes or specified bus services

– even where this sort of direct targeted support is provided, the benefit of free travel is provided by way of an area–wide bus pass (which is not covered by the exemption) instead of being limited to free travel on the particular service for which support has been provided.

The conditions that need to be satisfied for the exemption to apply are summarised in HMRC's guidance at EIM21855 (www.hmrc.gov.uk/manuals/eimanual/EIM21855.htm).

What if an employer already has a bus pass salary sacrifice arrangement in place?

There has been some confusion about the conditions that need to be satisfied in order for the exemption for support for public buses to apply and HMRC accepts that it has communicated the requirements of some of those conditions less clearly than others. For that reason, HMRC will take the following approach to the exemption where employees have already entered into bus pass salary sacrifice arrangements.

1 For employees that had entered into bus pass salary sacrifice arrangements by 18 December 2009, the exemption will be treated as continuing to apply until the end of each such employee's current bus pass salary sacrifice agreement, provided that the agreement relates to a bus pass that lasts for no more than 12 months.

2 Any renewal after 18 December 2009 of the current bus pass agreement for a new bus pass or to extend the period of the current bus pass will be treated as a new arrangement. It will only be treated as exempt if the conditions of the exemption are fully satisfied and therefore arrangements that rely on area bus passes as opposed to travel on a specific supported bus route will not qualify for exemption.

3 For any employee that had not entered into bus pass salary sacrifice arrangements by 18 December 2009, the exemption will only apply if all conditions are fully satisfied.

Where the conditions for the exemption for support for public bus services are not satisfied and are not treated as satisfied for an interim period as outlined above, the employer is responsible for including details of the taxable benefit on form P11D for each affected employee and for accounting for employer's Class 1A NIC liability.

For more information on how to complete the form P11D use the Expenses and benefits A–Z (www.hmrc.gov.uk/paye/exb/a–z/p/public–transport.htm).

Cycles and buses: what will count as salary sacrifice arrangements entered into by 18 December 2009?

This covers:

– arrangements that were actually operating before the end of 18 December 2009

– arrangements in relation to which the employee and employer had finalised a written agreement before the end of 18 December 2009, provided those arrangements were due to commence no later than 6 April 2010 and that they are limited to the provision of one cycle or to a bus pass of no longer than 12 months duration

Flexible benefit arrangements that allow employees to elect for provision of a cycle or bus pass will be treated in the same manner.

Cycles and buses: what will not count as salary sacrifice arrangements entered into by 18 December 2009?

– Any new salary sacrifice / flexible benefit arrangement entered into after 18 December 2009.

- Renewals of salary sacrifice or flexible benefit arrangements made after 18 December 2009.

Grays Timber Products Ltd v Revenue and Customs Comrs [2010] UKSC 4

G was the managing director of the taxpayer company, which was a wholly–owned subsidiary of the parent company (the group). He entered into a written service agreement with the taxpayer and was also party to a subscription and shareholders' agreement (the subscription agreement) under which he purchased ordinary shares (amounting to about 6% of the issued ordinary capital) in the group. The terms of the agreement provided, inter alia, that in the event of a disposal of 50% or more of the issued ordinary shares of the group, the other parties to the agreement were to procure that G's original shareholding be purchased, either by the group or by the purchaser of the shares. The effect of the arrangement was that G would be entitled to an extra payment (in accordance with a specified formula) in addition to the return of his original investment, disproportionately greater than the amounts received by other shareholders or his percentage of the equity share capital of the group. In the event, the entire issued ordinary shares in the group were acquired by an unconnected third party company. Under the terms of the subscription agreement (to which the group and shareholders owning over four–fifths of its ordinary shares were parties), G became entitled to a disproportionately large part of the consideration paid by the third party. The Revenue determined that the disposal of G's shares, which were employment–related securities, were for a consideration that exceeded "the market value of the employment–related securities at the time of the disposal" within the meaning of s 446X(b) of the Income Tax (Earnings and Pensions) Act 2003 (the 2003 Act). Consequently, the disposal occasioned a charge to income tax under s 446Y of the 2003 Act. The taxpayer appealed against the determination contending that the shares were sold for their market value so that the whole of the consideration received by G fell to be brought into computation of his capital gain on the disposal under ss 272(1) and 273 of the Taxation of Chargeable Gains Act 1992. The taxpayer further contended that G did not get more than market value because it was necessary to take account of the rights vested in him under the subscription agreement. The market value was what the purchaser would have paid to be put into the shoes of the vendor (G). The special commissioner dismissed the taxpayer's appeal, and the Extra Division of the Inner House of the Court of Session dismissed a further appeal. The taxpayer appealed to the Supreme Court.

The issue for determination was whether the enhanced payment that G received was taxable as employment income, subject to income tax and national insurance contribution, or was taxable as a

chargeable gain subject to capital gains tax. That issue depended primarily on the correct construction and application of ss 446X and 446Y of the 2003 Act.

In determining the market value for the purposes of the 2003 Act, attention had to be focused on the asset that required to be valued. What had to be considered was what the hypothetical purchaser would pay to acquire those rights at the relevant date (see [49] of the judgment).

In the instant case, it was the rights attached to the shares acquired by the purchaser that had to be considered. G's right to an enhanced payment had a value to him, but that right was not the subject of the transaction as it had not transmitted to the purchaser. What the purchaser had acquired and paid for was the rights attached to the shares themselves and nothing else. G's rights under the subscription agreement between him and the other shareholders, who were parties to it, were given effect when the transaction entered into, but for the purposes of s 446X of the 2003 Act, they would have to be disregarded. The rights that had been extinguished by the payment that G received, were not part of the assets acquired by the purchaser. The terms on which the shares had been issued to G were personal to him. They had not been provided for in the articles of association and they were of no interest to a hypothetical purchaser. They were also of no value to the hypothetical purchaser, and he would pay the hypothetical vendor nothing extra for them. Their purpose was to enable G to enhance the benefits available to him in recognition of his service as managing director of the taxpayer. That purpose was served when he received the enhanced share of consideration that he had been entitled to. The valuation did not have to take account of the actual sale of G's shares at a special price enhanced for reason related to G's special position as managing director. There was no escape from the conclusion that the enhanced payment that G received was caught by the 2003 Act and that it was taxable accordingly (see [40], [43], [49]–[52], [56] of the judgment). The appeal would be dismissed.

3 February 2010

Inside the Gaines-Cooper case

In a landmark case that has raised a fierce debate among the accounting community, the Court of Appeal ruled this week that HMRC did use the correct interpretation of the UK’s non-resident policy, IR20, in the case of UK born entrepreneur Robert Gaines-Cooper. AccountingWEB spoke exclusively to Gaines-Cooper’s chief legal adviser Peter Vaines of Squire, Sanders and Dempsey, who confirmed that his client is seeking leave to appeal to the Supreme Court.

Gaines-Cooper had appealed on the basis that he moved to Seychelles in 1976, but it was ruled that he never qualified for exemption from British taxes as a non-resident since he still had UK ties.

There was a domicile appeal, which went to the High Court and Court of Appeal back in 2008 but which Gaines-Cooper lost. The current case concerns the issue of residence and, with the Court of Appeal siding with HMRC’s interpretation of the law this week, Gaines-Cooper has requested leave to take the case to the Supreme Court. No decision has been made as to whether he has been granted this leave as yet.

One of the key tenets of Gaines-Cooper’s legal argument was the retrospective nature of HMRC’s actions. “Mr Gaines-Cooper’s view of the matter is that he was not aware of any implied conditions needing to be satisfied – and if those conditions had been articulated he would have satisfied them as well. For HMRC to come along later and to impose conditions which had not previously been mentioned is unfair – and it is this unfairness which was the basis of his appeal”, said Vaines.

Despite this, HMRC maintains its interpretation has not changed. An HMRC spokesperson told us: “HMRC’s interpretation of its guidance on residency in booklet IR20 was correct and the Court has agreed with HMRC that there has been no unannounced change of that interpretation”.

Severing family ties

One of the problems in this case was the fact that Gaines-Cooper maintained an estate in Oxford, where his wife and child resided – meaning he had not fully ‘cut ties’ with the UK, according to HMRC’s definition.

Vaines insists that this detail in particular is a red herring. “My client left the UK in 1976 to go to the Seychelles. He took advice and, satisfied that he had met the conditions of IR20, he left”. Unfortunately, almost 30 years later, HMRC argued that he hadn’t satisfied the conditions because he hadn’t severed all social and family ties to the UK. Gaines-Cooper argued there wasn’t such a condition in IR20, but HMRC said it was implied. “You can’t just impose this new condition and say

it was always implied", says Vaines. While HMRC may reserve the right to impose whatever conditions it chooses, backdating the rules is where the problems arise, he argues. Nonetheless, Gaines-Cooper may now be liable for taxes dating back to 1993 – the total of which could reach an estimated £30m.

The law and politics

Many commentators have suggested that a statutory residence test could be on the cards, a suggestion Vaines welcomes but says is not without its own complexities. "For my part and for the people I advise, they don't need a statutory residence test – they just need some clear rules. Tell us what the rules are and we'll abide by them".

In a case that stretches as far back as 1996, it's interesting that the final hearing (should it indeed be heard at the Supreme Court) happens to be in an election year. Could the pressure be on for HMRC to catch 'tax exiles'? "I don't think that's the case", counters Vaines. "I can see the argument, but I think the revenue and the courts should be above those things and I think they are. There might be pressure to collect more money, but I'm sure there won't be a political influence. That wouldn't be right".

AccountingWeb, 19 February 2010

Taper rules for pension contributions

These come in from 6 April 2011.when the complex anti-forestalling rules end.

They are subject to consultation with a closing date of 31 March, but as the consultation paper includes draft legislation it is unlikely that any major change will be made.

The new rules are within the basic framework of lifetime and annual allowances as follows:

Lifetime allowance

tax year	limit
2009/10	£1.75m
2010/11 to 2015/16	£1.8m

Annual allowance

tax year	limit
2009/10	£245,000
2010/11 to 2015/16	£255,000

Rate of income tax relief from 6 April 2011

From 6 April 2011 relief will be tapered away for an individual with gross income of at least £150,000. With gross income of at least £180,000 the tax relief is at the basic rate only. That will be the case irrespective of the level of contributions. It is reckoned that it will affect 300,000 individuals.

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The consultation paper proposes changes to the original plans, and in particular the tax relief restriction will apply to those with income of at least £130,000 if, when any employer pension contributions are added, it results in their gross income being at least £150,000.

Where gross income inclusive of employer pension contributions is between £150,000 and £180,000, the % charge is reduced by 1% for every £1,000 below, subject to a floor of relevant income of £130,000 exclusive of employer contributions. If the restriction is not more than 10%, only the pension contributions that attract relief at 50% are restricted. Otherwise the restriction applies to the whole contributions.

The withdrawal of higher rate relief is via a *high income excess relief charge*. To find the rate of that charge, the pension savings amount is added to the reduced net income. If the result does not exceed the basic rate limit the charge is at 0%. If it exceeds the basic rate limit but not the higher rate limit the excess is charged at 20%. If it exceeds the higher rate limit the excess is charged at 30%.

Illustrations

In 2011/12 Clive has employment income of £110,000 and other income of £25,000. He pays £10,000 gross into his pension scheme, with his employer contributing a further £20,000.

Clive's gross income = £110,000 + £25,000 + £20,000 = £155,000.

As gross income is in the band of £150,000 to £180,000 there will be a high income excess relief charge on part of the pension contributions as follows:

gross income	*£155,000*
normal relief on total contributions of £30,000:	*£5,000 @ 50% = £2,500* *£25,000 @ 40% = £10,000*
gross income in excess of £150,000	*£5,000*
restriction: £5,000 @ 1% per £1,000	*5%*
max. rate of relief: 50% - 5%	*45%*
high income excess relief charge: 5% x £5,000	*£250*

As the max. rate of relief of 45% is more than 40%, the restriction only applies to contributions that would otherwise attract relief at 50%

If Clive's relevant income was £170,000 and he pays £30,000 gross into the pension scheme (nil by employer), his position is then:

gross income	*£170,000*
normal relief on total contributions of £30,000:	*£20,000 @ 50% = £10,000* *£10,000 @ 40% = £4,000*
gross income in excess of £150,000	*£20,000*
restriction: £20,000 @ 1% per £1,000	*20%*
max. rate of relief: 50% - 20%	*30%*
high income excess relief charge: *£20,000 @ 50% - 30%* *£10,000 @ 40% - 30%*	 *£4,000* *£1,000*

As the maximum rate of relief of 30% is less than 40%, the restriction applies to all his contributions. Effective relief on £20,000 falling within the £150,000 to £180,000 band is 25%. Total relief is £14,000 - £5,000 = £9,000.

A salary sacrifice does not reduce relevant income, but it does if the sacrifice is in exchange for (say) a company car of equal value but where the tax charge is on a lower value than the salary sacrificed.

Illustration

Relevant income £140,000 for 2011/12.

If £18,000 sacrificed for a company car costing that amount, income tax charged on say 20% = £3,600.

Relevant income becomes £122,000 + £3,600 = £125,600 so full tax relief available on any pension contributions paid as the £130,000 limit is not reached.

Article by Gerry Hart

Lecture P582 (11.13 Minutes)

P11Ds, travel expenses and dispensations

HMRC requires the declaration of expenses on forms P11D where no dispensation is in place in respect of the expenses. However, when employers have not gained a dispensation, but have reimbursed travelling and other expenses to staff, the expenses will be reported on form P11D and then be the subject of a claim under S336 ITEPA 2003 on the employee tax return, so there is a good deal of cross over in this area of material between the obligations of the employer and the employee's own entries on his personal tax return.

Travelling expenses – reminder of key points

Employees may receive tax relief on payments for journeys made in the performance of the duties of the employment (S 337 ITEPA 2003). The limitations of the claim arise through S 338 which excludes private travel and ordinary commuting.

The guidance discriminates between journeys that the employee has to make in the performance of their duties, and journeys that the employee makes to or from a place they have to attend in the performance of their duties. This distinction has little practical benefit, but the guidance does make clear that where a journey is made for the convenience of the employee this will not qualify. There are a number of examples in the guidance identifying various journeys which would have qualified for deduction under the old S198 rules and still qualify. These are the journeys which are made "in the performance of the duties".

The new aspect of relief introduced by the change from ICTA 1988 to ITEPA 2003 applies to the second category of expenses, those that the employee has to incur when travelling to a place they have to attend in order to perform their duties. This will allow site based employees to claim travelling expenses to their client's sites, whether or not more than one site is attended in a working day. This contrasts with the previous rule, which excluded "site based workers" from any claim for expenses at all, and also denied the first and last journey of the day to a worker who moved between several sites in the working day.

Ordinary commuting

Without the exclusion for ordinary commuting, the new rule would allow all employees to claim home to work travel, as that is a journey they have to do in order to attend a place at which they are to perform their duties. In order to exclude ordinary commuting, a definition is included, which unfortunately brings forward more terms that need explanation. The difficulties that arise in practice with the new rules all centre around determining what is ordinary commuting and therefore a disallowed journey.

For most employees, ordinary commuting is travel between their home and their permanent workplace, but the term can mean travel between a permanent workplace and any other place which is not a workplace. A workplace is any place where the employee's attendance is necessary for the performance of the duties of that employment. The ordinary commuting rules will exclude travelling

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expenses to or from a permanent workplace when the employer occasionally requires out of hours attendance, for example to perform a stock take. However, there are concessions which might assist with late night travel and transport disruption.

This is the most important aspects of the new rules, as it determines once and for all what expenses will be allowed. This means that an employer must therefore be clear about what is a permanent workplace, and the guidance on this and the distinction from a temporary workplace is most complex.

Permanent workplace

For many employees their permanent workplace is obvious, and any occasional journeys to other locations will clearly be an allowable expense. However, the guidance provides the following assistance in other cases.

"A place where an employee works is a permanent workplace if he or she attends it regularly for the performance of the duties of the employment" This is derived directly from S 339(2) ITEPA 2003

To clarify further the guidance then excludes temporary workplaces from the definition.

"…will not be a permanent workplace if it is a temporary workplace. A temporary workplace is somewhere the employee goes only to perform a task of limited duration or for a temporary purpose." (again taken directly from the legislation in S339(3).

Attends regularly

Regular attendance is evidenced by frequent attendance, which follows a pattern, or it is the place the employee usually attends for all or almost all of the period for which he or she holds or is likely to hold that employment. The proportion of time spent at a particular workplace is a factor in determining whether it is a temporary workplace, but is not conclusive.

Attendance on only one or two days a week might constitute a permanent workplace. Further, the workplace will be a permanent workplace if it is attended only briefly, but the employee attends it in order to be allocated tasks or work for the next day or week. (The depot rule).

Limited duration

The employee might attend a workplace full time, but it will not be a permanent workplace is the attendance is to perform a task of limited duration. There is a common misunderstanding that the limited duration qualifier applies to the attendance and not the task. This may not cause any real practical difficulty, but it would be wise to be clear at the outset. The probable reason for this confusion is the "24 month rule", which is phrased in terms of the employee's attendance rather than the duration of the task.

24 month rule

A workplace cannot ever be "…a temporary workplace if the employee attends it in the course of a period of continuous work which lasts, or is likely to last, more than 24 months."

A period of continuous work is a period of work throughout which the duties of the employment are performed to a significant extent at that place. For this purpose, significant extent will be interpreted as 40% or more of the employee's working time spent at that place.

Fixed term appointments

The 24 month rule can also be misleading in that it leads the employer to suspect that any posting for less than 24 months will not be a problem. However, "limited duration" rule does not apply if the employee attends the workplace for all or almost all of their period of employment (however short). Where someone is posted to a new site prior to leaving a post, provided they have held the post for at least 5 years, the expenses will be allowable.

Temporary purpose

The second alternative qualification for a workplace to be a temporary workplace is that the purpose of attendance is temporary. This will allow attendance on a regular basis over a long period of time such as once per month for a period of 15 years, provided the purpose of each visit is self contained and temporary, such as to inspect a particular safety installation.

Multiple workplaces

It may be possible that an employee has several permanent workplaces at one time, if they spend enough time at each one to qualify. This would then exclude a claim for travelling expenses to any of them.

Indicators that a workplace would qualify as a permanent workplace include :

The employee regularly performs a significant part of his duties there

People expect to be able to contact the employee there, and

The employee has an office or desk and support services there.

The 40% rule is again used to indicate that where an employee spends 40% of his working week at a second workplace, there is the presumption that the second workplace is also a permanent workplace. Again, this may mislead, as the examples then describe employees with 5 different offices, which they visit on the same day each week. These employees have 5 permanent workplaces.

Regional appointments

Travelling employees may be able to agree a region as a workplace so that any travel within that region is tax free, and travel to that region is not tax deductible.

In order to establish this, the employee must meet all of the following conditions :

- He has no single site that is his permanent workplace, and
- He attends the area regularly, and
- He has a job where the duties are defined by reference to a particular area.

Great care needs to be taken interpreting this rule, as the example quoted by the Revenue indicates an employee who is appointed to deal with a particular geographical area, and attends each of the company's 5 offices within the county on the same day each week. This employee has 5 permanent workplaces and is not on a regional appointment.

Expenses while working from home

Tax Bulletin 79 includes a detailed article regarding tax relief for employees on expenses incurred when working from home. The article provides guidance both on the circumstances under which an employee will be able to claim tax relief on expenses incurred while working at home, and the types of expenses which will and will not attract tax relief. The article indicates that in the absence of additional evidence demonstrating a higher level of expenditure, HMRC will accept a claim of £3 (increased for 2008-09 from £2) per week in respect of heat, light and other expenses, with an additional claim possible for the business units of telephone calls. Under no circumstances can rent, council tax or mortgage interest be claimed.

Only those employees required to work from home can make any claim at all under Section 336 ITEPA 2004.

The new guidance sets out four conditions which all need to apply to allow an employee to make a claim :

- the duties that the employee performs at home are substantive duties of the employment. "Substantive duties" are duties that an employee has to carry out and that represent all or part of the central duties of the employment (this condition is unchanged),
- those duties cannot be performed without the use of appropriate facilities,
- no such appropriate facilities are available to the employee on the employer's premises (or the nature of the job requires the employee to live so far from the employer's premises that it is unreasonable to expect him or her to travel to those premises on a daily basis),
- at no time either before or after the contract is drawn up is the employee able to choose between working at the employer's premises or elsewhere.

Where a contract of employment includes a term requiring the employee to work form home, this will not change the right of claim where this is a reflection of the employee's choice rather than an

objective requirement of the duties. In practice, the third and fourth of these conditions are the most likely to cause disagreement.

Once an employee can make a claim, he will be able to claim in respect of the following expenses, incurred wholly, exclusively and necessarily in the performance of the duties :

- the additional unit costs of gas and electricity consumed while a room is being used for work,
- the metered cost of water used "in the performance of the duties" (if any),
- the unit costs of business telephone calls (including "dial up" Internet access).

Employees will not be permitted to claim for any of the following expenses :

- Council tax/rates (this is a change to the practice set out in EIM32815),
- Rent (this is a change to the practice set out in EIM32815),
- Water rates,
- Mortgage repayments/endowment premiums,
- Household insurance premiums.

Unless the employee can demonstrate clearly that the expenses open for claim exceed that amount, the sum of £3 per week plus telephone costs will be allowed, and no more. No proof of the £3 per week will be necessary, once the employee has shown that he will qualify for relief.

Tax treatment of payments towards the incidental costs of home working

Employers can now pay employees who work from home a contribution towards the additional running costs of the home incurred by the employees as a result of them basing themselves there for some or all of the working week. The tax exemption commenced in 2003/04 and is provided by Section 137 Finance Act 2003.

The amount which can be paid tax free will in any event is £3 per week, or £156 per year. Employers will not need to keep any records or make any justification of sums up to this amount. If the employer pays more than this sum, it will still attract the exemption, but the employer will need to provide evidence that the payments are in respect of reasonable additional household expenses incurred by the employee in carrying out his duties at home. (Note that there is no wholly, exclusive or necessary qualification).

There is no NIC liability on such a payment if it is tax free. Employers are recommended to seek dispensations in respect of higher payments to employees.

Approved mileage allowance payments

A new system of mileage payments in respect of business use of a privately owned car commenced on 6 April 2002. The new system replaced any alternative arrangements that employers have in place in respect of taxing or reporting such payments. The new system is now fully in place, the NIC having been legislated for to bring it in line with the tax treatment.

Record keeping

Provided payments made to employees are not more that the approved mileage rates, no benefit in kind will need to be reported on form P11D, and the payments are not reported in any way. However, Employers' Bulletin 9 indicates that HMRC expect the employer to record (in respect of each payment) the amounts paid " and the business journeys they are for." This advisory statement indicates that there is an expectation that every journey should be identifiable, not just a total monthly mileage amount.

National Insurance Contributions

The higher rate of mileage applies for NIC purposes (as in the past) so that 40p per mile can be paid in respect of all miles before a liability to Class 1 NIC arises. Once this amount has been exceeded, the amounts paid must be included in gross pay and NIC calculated on the total amounts paid in the month.

Table : Approved Mileage Allowance Payments

	Per mile
Cars + vans - First 10,000 miles	40p
Cars + vans - All miles in excess	25p
Motorcycles	24p
Bicycles	20p

Passenger rate

This rate works differently in that although employers can pay this rate per mile tax free, the employee has no right to claim a tax deduction for the amount if not paid by the employer. Where the driver takes other employees in his car on a business journey the employer will be permitted to pay an additional 5p per mile tax free for each passenger carried.

Review point : Where an employer has paid a salary increment to reflect loss of the company car, and now pays a reduced sum per mile under AMAPs, the employee (and the employer) are potentially losing the benefit of the NIC free rates. See the calculation below for an illustration.

Calculation – Car allowance paid as part of salary

Peter has received a salary increment of £2,000 per annum for giving up his company car; this amount has been taxed through the payroll in the normal way. In 2007/08 he has travelled 10,000 business miles in his own car and been paid at a rate of 18p per mile for these miles.

Clearly no taxable benefit in kind has been provided as the sums paid gross total only £1,800, and are less than the tax free amount.

In addition, Peter is able to claim for the shortfall of the tax free amount on his tax return. A claim of 10,000 x 40p - £1,800 = £2,200 is available to him. Tax relief will be awarded at his highest rate of tax.

However, if this amount had been paid to him as a mileage allowance it would not have borne NIC. The salary increment has been fully liable to NIC which cannot be recovered. Perhaps Peter and his employer should review their policy?

Benchmark scale rates for subsistence

The introduction of benchmark scale rates for subsistence payments was not widely advertised. The announcement was made in Revenue & Customs Brief 24/09. The intention is that the scale rates provide guidance on applying for dispensations for flat rate expenses, but the flat rates cannot be used without a dispensation, otherwise the payments will have to be reported on form P11D. This summarise the guidance which is in the Employment Income Manual at EIM05200 et seq. The text of R & Brief 24/09 follows :

Revenue & Customs Brief 24/09

Benchmark scale rates for day subsistence

HM Revenue & Customs (HMRC) has introduced an advisory system of benchmark scale rates which employers can use to make subsistence payments to employees who incur allowable business travel expenses free of tax and National Insurance contributions (NICs). The new advisory system will be implemented from 6 April 2009.

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

This brief sets out the framework for the system.

Overview

Under the current rules an employer is required to notify HMRC of all expenses paid to an employee, even where those expenses would be allowable, unless they have a dispensation. A dispensation is an agreement between HMRC and an employer which allows the employer to pay an agreed rate for

allowable expenses without the need to report the expenses to HMRC. An employer may apply for a dispensation by submitting a completed form P11DX. As part of this process, where business travel expenses are paid, the employer often agrees scale rates for travel and subsistence expenses with HMRC that broadly match the allowable expenditure incurred by its employees on business travel.

HMRC currently expects employers to conduct a sampling exercise before it will agree to a particular rate being included within a dispensation. The aim of the exercise is to identify a reasonable level of allowable expenditure that reflects the most common level of spending.

HMRC recognises that a sampling exercise can be burdensome and expensive for employers. It has therefore introduced an advisory system of benchmark scale rates for day subsistence payments that an employer can use without having to carry out a sampling exercise.

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

Benchmark system/rules

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

Breakfast rate (irregular early starters only) - A rate of up to £5.00 may be paid where a worker leaves home earlier than usual and before 6.00 am and incurs a cost on breakfast taken away from his home. If the employee regularly leaves home before 6.00 am because, for example, he works an early shift he would not be entitled to use the breakfast benchmark scale rate.

One meal rate (Five hour rate) - A rate of up to £5.00 may be paid where the worker has been away from his home/normal place of work for a period of at least five hours and has incurred a cost on a meal.

Two meal rate (Ten hour rate) - A rate of up to £10.00 may be paid where the worker has been away from his home/normal place of work for a period of at least ten hours and has incurred a cost on a meal or meals.

Late evening meal rate (irregular late finishers only) - A rate of up to £15.00 may be paid where the employee has to work later than usual, finishes work after 8.00 pm having worked his normal day and has to buy a meal which he would usually have at home.

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

Payments in excess of the benchmark rates

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

Qualifying conditions

Benchmark scale rates must only be used where all the qualifying conditions are met. The qualifying conditions are:

- the travel must be in the performance of an employee's duties or to a temporary place of work
- the employee should be absent from his normal place of work or home for a continuous period in excess of five hours or ten hours

- the employee should have incurred a cost on a meal (food and drink) after starting the journey

Early starter and late finisher rates

The early starter and late finisher rates are for use in exceptional circumstances only and not intended for employees with regular early or late work patterns.

Tax and NICs free scale rate payments must be limited to three meal rates in one day (or 24 hour period). A meal is defined as a combination of food and drink.

Where employees are required to start early or finish late on a regular basis, the over five hours or over ten hours rates could be paid provided all the other qualifying rules are satisfied.

Working Rule Agreements

Benchmark scale rates would not apply to employees covered by Working Rule Agreements, for which separate specific rates are already set for particular occupations.

Friends and Family Allowance

Some existing dispensations also include a tax free scale rate for staying with family and friends when employees are required to stay overnight on business. HMRC has reviewed this policy and concluded that there is no legal basis for giving tax relief because it is not linked to any specific underlying expense. Therefore, a scale rate for staying with family and friends will not be included within the advisory system or given in any new dispensations. All agreed tax and NICs free scale rates in existing dispensations covering such an allowance will be withdrawn when the dispensation comes up for review.

What you have to do if you want to pay scale rates to your employees?

You should apply to HMRC for a dispensation. You need to complete a form P11DX, which is the form used by employers to apply for a dispensation, and submit it to HMRC. On the form you need to indicate with a tick against the appropriate statement under 'Travel and Subsistence' that you intend using HMRC's benchmark scale rates to reimburse your employees' subsistence payments. By ticking this box you would be merely notifying HMRC that you intend paying HMRC's benchmark scale rates for day subsistence and that you have adequate management processes in place to ensure that payments are only made where all the qualifying conditions are met. If you want to apply to include other items of allowable expenditure in a dispensation for example fees and subscriptions, laundry, telephone charges, etc, you need to tick the appropriate boxes and supply the requested information on the form.

When can you pay a scale rate?

Scale rate payments may be made to employees who necessarily travel in the performance of their duties or have to travel to a temporary place of work. The statutory rules are in Section 336 to 342 of Income Tax (Earnings and Pensions) Act 2003. Where the employer agrees a scale rate in a dispensation, the scale rate may also be taken into account for NIC purposes.

Guidance on how the employment income travel expense rules work can be found in HMRC's Booklet 490 Employee travel – A tax and NICs guide for employers (PDF 184K).

When must you not pay tax and NICs free scale rates?

Tax and NICs free scale rates must not be paid where the employee is not travelling on a qualifying business journey. For example, when on a journey that involves ordinary commuting (or similar to ordinary commuting), or private travel.

Additionally, no tax and NICs free payment should be made if an employee does not incur an expense on meals after leaving home or his normal place of work, even if the journey was a qualifying business journey. This means that employees who do not buy a meal or who take a packed lunch from home are not entitled to a tax and NICs free payment.

Do employers have to use the benchmark scale rates?

Employers do not have to use the benchmark rates. They can reimburse their employees' actual expenditure or apply to HMRC to agree a scale rate appropriate for their business needs in a dispensation. However, where an employer wants to use a higher scale rate, it will have to undertake

a sampling exercise to show the higher rates are in line with what its employees' typically spend on subsistence and agree the rate with HMRC.

What records would an employer need to keep?

An employer will need to keep sufficient records to be able to demonstrate that the employee was entitled to the payment. An employer also needs to be able to demonstrate that routine checks are undertaken to ensure that the travel expenses rules are being followed.

What happens to existing dispensations?

Existing dispensations will remain in force until they come up for review in accordance with HMRC's rolling review programme, usually on a five year cycle. When the existing dispensation comes up for review the employer can choose to switch to benchmark scale rates or apply to continue to use a tailored rate. Where a new dispensation is requested the employer will have to go through the process of undertaking a statistically valid sampling exercise.

Uprating benchmark scale rates

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

How has HMRC arrived at the benchmark scale rates in question?

HMRC reviewed the scale rates agreed for a number of employers, both large and small, and based the rates on the most commonly agreed rates.

Why not have higher benchmark rates for London or other locations where prices are more expensive?

The benchmark rates are linked to what employers typically reimburse their employees and it would not be possible to break this down between different locations. Personal expenditure on subsistence varies significantly between employees even when working at the same location.

If an employer typically reimburses more than the benchmark rates then it will remain open to them to agree a higher rate with HMRC or to reimburse actual expenditure.

Revised guidance on checking dispensations

The guidance regarding how much effort employers are asked to put into checking dispensations once granted has been amended and is of sufficient importance to make it worthwhile repeating in full :

EIM30059 - DISPENSATIONS: CHECKING AND AUTHORISATION OF EXPENSES PAYMENTS

After a dispensation has been granted, the extent of checking undertaken by the employer will depend upon the scale of the business. They will need to demonstrate that someone other than the employee incurring the expense is responsible for ensuring that the claim made by the employee:

- Relates to qualifying travel in the case of travel and subsistence expenses
- Does not include disallowable items. The rules in S336-9 ITEPA 2003 (see EIM31600 onwards and EIM31800 onwards) will apply, and
- Is not excessive.

Dispensations incorporating actual costs supported by receipts

An employer will normally require every item of expenditure to be vouched for his own benefit - to ensure it has been incurred, and for audit purposes. But this requirement should not be regarded as applicable for trifling expenditure such as small allowances for taxi fares. The employer should be able to demonstrate that regular checks will be undertaken to ensure that only allowable expenses are being reimbursed.

Dispensations incorporating the advisory benchmark or bespoke scale rate payments

Detailed guidance on scale rate payments is at EIM05200 onwards. The employer needs to:

- Keep sufficient records to be able to demonstrate that the employee was entitled to the scale rate payment; the employee is engaged in qualifying travel and incurs an expense.
- Be able to demonstrate that regular checks are undertaken to ensure that the travel expenses rules are being followed.

Regular checks

The checks should reflect the conditions outlined at EIM30055. The form and regularity of the checks will depend on the following factors:

- The size of the workforce.
- The complexity of the workforce - This will be particularly relevant where the workforce consists of different sections performing different tasks where the entitlement to relief may vary.
- Uncertainty about whether employees will qualify for relief - Where the temporary workplace rules apply for example (see EIM32000 onwards), employees may qualify for relief at different times and for differing durations. This should be more closely monitored.
- Unpredictable or non-standard work patterns - where scale rate payments have been agreed for irregular working, the employer may want to check that the agreed conditions for breakfast or evening rates are being met.
- The employer has no previous experience in the management of an expenses regime - Where the employer has not previously paid expenses you may wish to insist on a larger or more regular sample check.
- There is evidence that the employer has failed to manage an expenses regime effectively in the past.

The dispensation is part of arrangements such as new or updated Salary Sacrifice schemes and it may not be clear to the employee that the sacrificed sum represents reimbursed expenses.

Any other risk factors identified by the Compliance Officer.

In cases where a number of the factors listed above are present, the check will need to:

- Involve a higher proportion of the workforce,
- Incorporate a review of the completion of the time sheets and supporting receipts sufficient to satisfy the conditions outlined in EIM05200 and EIM30055 and
- Be undertaken regularly during the year. This may be monthly, quarterly or half yearly depending on the number of factors present. As soon as the review period is over, the employees should be under no obligation imposed by HMRC to retain their receipts. During any subsequent compliance visit the compliance officer would be able to ask to see details of the periodic checks and the employer should be able to clearly demonstrate that they have been undertaken.

In smaller organisations where none of the factors outlined above are present, the directors may know all about the particular expenses incurred by employees, and there may be no need for checking at all.

For personal reasons, or reasons of confidentiality, the proprietors of a business, for example, the director/shareholders, may have a free hand in deciding what they take as expenses. If so, it will not usually be appropriate to give a dispensation for them, but other employees can still be included.

One man service companies and smaller employers

Where an employer seeks a dispensation for a one man service company, or in circumstances where the application is in respect of reimbursements to a controlling director/shareholder or where there is no one employed by the company who can check the expenses reimbursed, you should ensure that:

- Expenditure is independently vouched. This can be undertaken, for example, by an accountant or bookkeeper and

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- Expenditure is allowable as a deduction from earnings (e.g. if necessarily incurred on travelling in the performance of the duties) and
- the Officer is satisfied that no additional tax is at risk,

There is no reason why a dispensation including actual expenses or benchmark rates should not be approved if these conditions are met. You should not refuse or restrict a dispensation just because it is being sought by a smaller employer.

Vouching of expenses

In some instances, lack of an independent voucher is not necessarily a bar to inclusion in a dispensation - for example, a subscription to an approved body under Section 344 ITEPA 2003 (see EIM32880).

You should, however, consider more carefully the reimbursement of subsistence costs, for example, where an independent voucher cannot be supplied. In cases of this kind it is particularly important that it should be clear from the dispensation letter (see EIM30085) that the dispensation applies to a limited class of payments only and does not cover whatever the director decides to take as expenses.

Tax may be at risk where a dispensation letter is so worded as to include items that should be excluded.

There is also amended guidance on retrospection at EIM30052.

Contributed by Rebecca Benneyworth

Lecture P584 (12.44 Minutes)

Capital Taxes

Business taper on rental property

The appellants were the joint tenants of a property given to them by their mother. Between 1984 and 2005 the appellants, working in a partnership, let out the property as fully-furnished small bedsit flatlets. It was not in dispute that the rental income from the property had always been treated (ie both pre and post the introduction of self-assessment in 1996/97) as a receipt of trading income and not income from property. In 2005 the appellants sold the property for £190,000. They claimed business asset taper relief on the capital gain arising on the disposal of the property on the basis that it was a business asset within the meaning of TCGA 1992 Sch A, para 5(1A) (as amended by FA 2003 s 160). HMRC denied the relief on the ground that the income received from the property was letting income and not trading income. The appellants appealed contending they had suffered "a monumental injustice" as HMRC had accepted that a trade had been conducted for many years and now sought to deny business asset taper relief on the eventual sale of the property. At the hearing HMRC submitted: (i) a "business asset" was defined in TCGA 1992 Sch A1, para 5(1A) and in order to qualify as a business asset the asset must be in use for the purposes of a trade. The appellants' property was not in use for the purposes of a trade and therefore did not qualify as a business asset; (ii) no evidence had been provided to suggest that services had been rendered beyond those which a landlord would normally be expected to undertake in the normal course of conducting a rental business; (iii) it was established law that property rental did not fall to be regarded as a trade; (iv) although the appellants' accountants had returned the income as partnership income for a number of years, it did not alter the principle that the letting of property did not amount to a trade; and (v) under TA 1998 s 15 the income from property was assessed under Sch A and not under Sch D as a trade.

The tribunal considered that the sum returned as partnership profit on the sale of the property was actually land and property income. The relevant income and case law clearly showed that annual profits from property had always been assessed under the rules applicable to Sch A income and not under Sch D as a trade. Sometimes, if the owners provided services and the services were separately charged or the receipts could otherwise be apportioned in part to the provision of those services, any profit derived in that regard would be taxable as profits of a trade. Otherwise, irrespective of whether the taxpayer was carrying on the business of letting furnished rooms and irrespective of whether it was a demanding and time-consuming business, it was not a trade and was taxable under Sch A. Furthermore the jurisdiction of the tribunal was confined within the boundaries prescribed by statute and it could not of its own violation extend to matters of equity falling outside its own jurisdiction and within that of the courts. Nowhere in primary or secondary legislation was there any provision for estoppel, or legitimate expectation. The principle of estoppel was ordinarily of no application in the field of revenue law because the Revenue did not normally stand in the same position to a taxpayer as one party to a commercial transaction stood to another. Questions of unfairness or legitimate expectation could only be reviewed by the courts, not the tribunal. It followed that the appeals would be dismissed.

Appeals dismissed.

Jones and anor v HMRC, Tribunal 18 November 2009

The Jefferies case

The First-Tier Tribunal's recent decision in *Jefferies v HMRC (2009)* will have the effect of modifying – hopefully radically – HMRC's approach to dealing with the CGT implications of a disposal of a residential property which also had business use (eg. a privately-owned hotel or pub).

S224(1) TCGA 1992 states that, where a private residence has been used partly for business purposes, the gain must be apportioned, with the amount attributable to private use qualifying for the principal private residence exemption. The balance of the gain (ie. the business element) is chargeable, but this must be reduced, for disposals before 6 April 2008, by the appropriate rate of taper relief. However, rather than deducting business asset taper from this part of the gain (which common sense would dictate was the logical outcome), HMRC argued that, by virtue of Para 9 Sch A1 TCGA 1992, where an asset is used for both business and non-business purposes, the gain had to be apportioned on a pro rata basis into a business and a non-business gain prior to the application of taper relief. In other words, the chargeable part, although relating solely to business use, had to be split under the mixed use rules. This followed, they said, from Para 21 Sch A1 TCGA 1992. Thus, instead of the business gain only attracting business asset taper, it had to be apportioned in such a way that the CGT relief was, in many cases, significantly diluted.

In this case, an hotel was owned in equal shares by a husband and wife partnership. It was sold in September 2006 for £855,000. After deducting acquisition and other allowable costs of £278,055, a capital gain of £576,945 remained.

Principal private residence relief was available to Mr and Mrs Jefferies. It was agreed between the parties that 35% of the hotel should be treated as allocable to their business use, with the balance of 65% qualifying as their private residence. Thus:

	£
Gain	576,945
Less: Exempt (65%)	375,015
	£201,930

This gain of £201,930 was split equally between the two taxpayers, ie. £100,965 each.

The only point at issue between the parties was how this residual gain should be taxed. HMRC advanced their well-rehearsed arguments described in (b) above. The taxpayers' position, on the other hand, was that the unrelieved portion of the gain should attract business asset taper in full. They contended that S224(1) TCGA 1992, in allocating gains arising from an asset used partly for a business and partly for a non-business purpose, attributes those gains to what they called a 'specific physical part' of the property and that this was supported by Para CG64663 of the Capital Gains Manual.

The Tribunal did not agree with this last claim. However, they went on to say that there is an explicit requirement in the taper relief legislation that all apportionments should be done on a 'just and reasonable basis'. They concluded:

'We cannot agree with HMRC that applying the apportionment principle in Para 9 Sch A1 TCGA 1992 such that only 35% of the chargeable gains should be treated as eligible for business asset taper relief is just and reasonable in these circumstances.

In the Tribunal's view, the just and reasonable apportionment which should be made under Para 9 Sch A1 TCGA 1992 is to apportion the chargeable gains on the basis that there is no proportion of the use of the asset which is a non-qualifying use.

Taking this approach, the whole of each taxpayer's chargeable gain in respect of the asset remaining after private residence relief should be treated as eligible for business asset taper relief.' Accordingly, Mr and Mrs Jefferies succeeded with their argument.

It will be important to ensure that ongoing disputes with HMRC in this regard are now concluded in the taxpayer's favour. Hoteliers, publicans, guest-house proprietors, owners of bed and breakfast establishments along with doctors and dentists who practise from their homes should all benefit from this ruling.

Article by Robert Jamieson

Lecture P583 (10.43 Minutes)

Connected Parties?

In *Kellogg Brown & Root Holdings UK (Ltd) v Revenue and Customs Commissioners*, a UK-resident subsidiary (K) of a US parent company (HC) acted as a holding company for a number of UK subsidiaries. As part of a corporate reorganisation, two of K's subsidiaries were transferred to HU, another subsidiary of HC, creating substantial capital losses for K. K claimed that the losses could be set against subsequent chargeable gains. The Revenue rejected the claim on the basis that HU and K were "connected persons" within TCGA 1992 s 18.

Dismissing K's appeal, the Court of Appeal held that under TCGA 1992 s 28(2) the disposal was made at the time the relevant contract was satisfied and that K and HU were connected at the time of the sale of the shares.

Court of Appeal, 24 February 2010

Administration

Getting ready for PAYE year end

E- filing – new obligations
The new PAYE Regulations require most employers with fewer than 50 employees to file their 2009-10 Employer Annual Returns online. However, there are a few exceptions to this requirement, those are:

a) employers who cease during the 2009-10 tax year providing that they had fewer than 50 employees and their Return reaches us by 5 April 2010
b) employers who are authorised by HMRC to deduct tax in accordance with regulation 34 of the IT (PAYE) Regulations (i.e. domestic employers operating a simplified deduction scheme) and who have not received a tax-free incentive payment for filing online previously
c) employers who are a practising member of a religious society or order whose beliefs are incompatible with the use of electronic communications
d) care and support employers – that is employers who employ someone to provide domestic or personal services at or from the employer's home.

To qualify as a 'care and support employer':

- those services must be provided to the employer or a member of the employer's family
- the recipient of those services must have a physical or mental disability, or be elderly or infirm
- the employer must not have received a tax-free incentive payment in respect of the preceding last three tax years, and
- it must be the employer who sends the Return to us (and not some other person on the employer's behalf).

There is no specific claim form so employers in categories (c) or (d) should send a written claim to their HMRC office giving full details. HMRC will then arrange for a paper P35 to be sent to you after 6 April 2010.

So many small employers who may not have filed online before – possibly up to 350,000 employers will be filing online for the first time – or seeking an exemption.

Your firm will need to consider how it wishes to approach this potential area of business as some employers make eventually seek help with year end returns.

Should I complete a Return?
You should only send an Employer Annual Return if you have been required to complete at least one P11 deductions working sheet or equivalent during the 2009-10 tax year. Employers who do not need to send us a Return must tell us so that we can update our records and avoid sending unnecessary reminders or penalty notices.

HMRC is introducing a new online facility from February 2010 that lets you do this online rather than writing to us or telephoning us. Visit www.hmrc.gov.uk/paye/payroll/year-end/no-annual-return.htm for more details.

In year e- filing
In year filing for PAYE, of forms P45 and P46, is being implemented as follows:

- Large and medium sized employers (using current measures of 50 employee or more) were required to file in year forms such as P45 and P46 electronically from 6 April 2009.
- Small employers will similarly be required to file in year online from 2011.

With regard to the PAYE obligations, the Employer's Bulletin 24 published in September 2006 indicates that the following forms became mandatory online submissions :

- **P45 part 1 :** Details of employee leaving
- **P45 part 3 :** Details of new employee
- **P46 :** New employee without a form P45
- **PENNOT :** Pension notification. (Now replaced by new form P46 (Pension))

The following forms may also be submitted online, but will not become mandatory submission :

- P9(D) - Return of expense payments and income from which tax cannot be deducted
- P11D - Return of expenses payments and benefits
- P11D(b) - Return of Class 1A National Insurance contributions
- P12 - employer's annual deduction card (simplified deduction scheme)
- P38A - Employer's Supplementary Return
- P38S – Student employees (not available on Online Return and Forms - PAYE)
- P46(Car) - car provided for the private use of an employee or director
- WNU - works number update.

The following information can be sent electronically to employers :

- P6 - notice to employer of employee tax code (or amended code) and previous pay and tax
- P9 periodic - amended code (new tax year)
- SL1 - notification to start student loan deduction
- SL2 - notification to stop student loan deduction

Employers must now provide a date of birth and gender on all forms P45 and P46. There is a "quality check" of all forms, whether electronic or paper, with forms which are incomplete or incorrect being returned to employers.

HMRC's website also lists common errors on these forms – these are :

- P45(Part 1) with no date of leaving
- P45(Part 1) which shows a cumulative tax code but no Total Taxable Pay details
- P45(Part 1) which shows a non-cumulative tax code but has no Pay details
- P45(Part 3) with no date of starting
- P46 where there is no Statement ticked

P35 Question 6

The guidance provided for this question for 2008/09 made the issue no clearer than the previous year, but it is anticipated that service businesses which are not sole traders, nor do they have employees who contribute 50% towards turnover will answer "Yes" to part one and then "No" to part 2 if IR 35 has not been operated.

<u>2009/10 guidance</u>

The guidance on page 19 of Helpbook E10 (2010) provides the following help in deciding how to answer this question. It states :

"The first question should be answered yes if:

- an individual performed services (intellectual, manual or a mixture of the two) for a client or clients, and
- the services were provided under a contract between the client and the company of which, at any time during the tax year, the individual performing the services was a shareholder or partner, and

- the service company's income was, at any time during the tax year, derived wholly or mainly (that is, more than half of it) from the services performed by the shareholders or partners personally."

The guidance further adds that for the purposes of this question, the term "service company" includes a limited company, a limited liability partnership or a partnership but not a sole trader which provides your personal services to third parties.

Part 2

If 'Yes', have you operated the Intermediaries legislation (sometimes known as IR35) or the Managed Service Companies legislation?

The guidance states : "The second question should only be answered yes if income has been treated as deemed employment income and PAYE/NICs deducted in accordance with the Managed Service Company or Intermediaries legislation (IR35), or an engagement is within the IR35 rules but the deemed payment is nil because sufficient amounts of employment income has been paid." "In all other circumstances the answer is no"

Possible scenarios – after part 1 is answered in the affirmative :

- You have calculated the PAYE and NIC on the deemed employment payment in full, and reported it on P35 – part 2 is Yes.
- You have estimated PAYE and NIC on the deemed employment payment and reported the estimate on P35 – part 2 is Yes, and you need to indicate that the amount is provisional. Finalise by 31 January 2010 at the latest. Interest runs from 19 April on the unpaid amount of PAYE and NIC at current rate of 2.5%
- You have not calculated a deemed employment payment because all of the affected income has been paid out as employment income, so the deemed amount would be nil – part 2 is Yes.
- You have not calculated a deemed employment payment because although the answer to Part 1 was Yes, you believe that the contract terms and engagement terms and conditions put you outside IR35 and MSC legislation – part 2 is No.

New electronic functionality

Employer Bulletin 27 dated October 2007 included news that employers would be able to make certain changes online to their data held by HMRC. The following announcement summarises the changes :

"The improvements to our PAYE Online service will be made shortly, after which both you and your agent will be able to view and change details we hold about your business, online.

By introducing this facility you will be able to check and change the information we hold at any time. To update your records online however you will need to be registered and enrolled to use our PAYE Online service. Once you have logged into the service, using your User ID and Password, select the link 'About your organisation' from your PAYE Online service page.

The changes you provide here will be reflected on your records usually within 48 hours after they are entered, but this may take longer over a weekend or Bank Holiday. Details you will be able to update are:

- Add/Change/Delete Name (Trade Name only)
- Change Address
- Add/Change Contact Details (For example, daytime telephone number)
- Add Communication Details (Including name, address and communication contact details)
- Delete all Communication Details.

Employers will not however be able to add/change/delete an agent in this way. Agents must still use the online agent authorisation or employers can authorise an agent using FBI2. "

There was also news that Nil PAYE and NIC statements can also be submitted online. This saves employers from submitting blank payslips. The form to notify HMRC accounts office that no payment is due for a period is at
http://www.hmrc.gov.uk/howtopay/paye_nil.htm

Suffix V codes
There are now obsolete and employers should ensure that they have a new notice of coding reflecting the correct code for affected employees.

Student Loan Start Notices SL1 – 2010-11
In March, HMRC will issue Student Loan Start Notices for tax year 2010-11. If you use our Data Provisioning Service (DPS) Portal Viewer to receive notices, you will be able to view them in the Tax Year 'drop-down' for the year they were issued (i.e. 2009-10); despite the fact that the effective start date is within the 2010-11 tax year.

So, if you access the notices before 5 April the year will automatically default to 2009-10. After 6 April the DPS Portal Viewer will default to the 2010-11 tax year.

To view these notices after 6 April 2010 it will be necessary to select the year 2009-10 in the drop-down option then search for the data by entering the date criteria appropriate to the date they were received i.e. 'Date From 01.03.2010' – 'Date To 05.04.2010'.

New initiative to reduce Student Loan over repayments for PAYE borrowers
A new initiative to help PAYE student loan borrowers avoid over repaying their student loans has been introduced by the Student Loans Company (SLC). By moving to a Direct Debit arrangement in the last 23 months of repayment, a PAYE borrower will not over repay.

The SLC will try to contact borrowers shortly before this time to offer this option but if a borrower is aware that they are reaching this point they can contact the SLC direct and arrange to repay the balance of their loan by direct debit.

Normal terms and conditions attached to student loans still apply and borrowers must pay their direct debit on the agreed date. Failure to do so will lead to removal from the direct debit repayment scheme, a student loan start notice will be issued to the employer and the borrower will go back into PAYE repayment.

Employers will receive a SL2 Stop Notice to stop making deductions for borrowers entering into a direct debit arrangement, and form P46 will be amended so only those borrowers who are not part of a direct debit arrangement will tick the student loan box.

Updated online versions of the newly worded P46 are now available and paper copies will be available from July 2010.

Changes to code NT and D0 from April 2010
Current procedures are that code D0 is always operated on a non-cumulative (Week 1/Month 1) basis. Code NT should always be operated on a non-cumulative (Week 1/Month 1) basis unless notified otherwise by HMRC. However in response to employer requests we are changing the way that codes NT and D0 are operated and will no longer be issuing a letter where we want code NT operated on a cumulative basis. From 6 April 2010, in these type of cases, a notice of coding will show D0 (or D0 week1/month1) or NT (or NT week1/month1).

In line with other tax code notifications, forms P6 or P9 will identify whether you operate codes D0 and NT on a cumulative or noncumulative (Week 1/Month 1) basis. For example, forms P6 and P9 showing:

- code D0 indicates the code is to be operated on a cumulative basis
- code D0 Week 1/Month 1 indicates the code is to be operated on a non-cumulative basis

- code NT indicates the code is to be operated on a cumulative basis
- code NT Week 1/Month 1 indicates the code is to be operated on a non-cumulative basis.

Contributed by Rebecca Benneyworth

Lecture B581 (9.27 Minutes)

The new 2010/11 late payment regime

For many years, we have become used to the fact that if payments of PAYE and NIC were delayed but made by the end of the appropriate tax year, no penalties or for that matter interest would be charged. The only exception related to larger companies covered by the Mandatory Electronic Payment rules. That is all to change from the beginning of 2010/11.

The new legislation introduced by Schedule 56 FA 2009 covers most direct taxes including the following payroll taxes:

- Income Tax and Class 1 NICs collected via PAYE
- Class 1A NICs on benefits
- Class 1B NICs
- CIS deductions
- Student Loan deductions

Penalties must be assessed by HMRC usually within 2 years of missed deadline although in limited circumstances they could have a little longer.

Despite the fact that the legislation says HMRC "must" assess the penalty where the conditions are met, in its Frequently Asked Questions the Revenue has announced that "HMRC will apply penalties on a risk basis" rather than using an automatic assessment procedure.

The first penalty notices will not be issued until April or May 2011. In the future, once the system is up and running penalties could be issued in the year as well.

Penalties

The in year penalties themselves are shown in the table below.

No. of times payments are late in a tax year	Penalty percentage
1	No penalty
2-4	1%
5-7	2%
8-10	3%
11 or more	4%

The percentage is applied to the total amount that is late in the tax year (ignoring the first late payment).

For those that fail to make payments on a long-term basis, there are additional penalties of 5% of amounts unpaid six months after the due date and 5% more on amounts paid 12 months or more after the due date.

Class 1A and Class 1B National Insurance Contributions

There is a separate regime for Class 1A and Class 1B National Insurance Contributions, which do not become due until after the end of the tax year.

For any payment that is not made within 30 days of the due date, there will be an immediate 5% penalty. There are then further penalties of 5% of amounts unpaid six months after the due date and 5% more on amounts paid over 12 months after the due date.

Reasonable Excuse

No penalty will be charged where a taxpayer has a reasonable excuse for failure. In their frequently asked questions, HMRC express a view that in order to qualify for this relaxation, there would need to be a situation that meets the following criteria

- unusual
- the taxpayer could not reasonably have known that an event would happen; and which
- they could not do anything to prevent

the most obvious example might be a fire at the company's premises.

Unusually, the legislation considers what would not constitute a reason excuse. In particular, it identifies

- inability to pay
- where the employer relies on someone else to pay tax on their behalf
- a situation where a reasonable excuse existed but has ceased some time before.

It does however accept that if there has been a reason excuse and the reason for it has only just ended, no penalty need apply.

Financial Difficulties

The fact that a company is in financial difficulties is not good enough reason to forego the penalties. However, where a company is negotiating with the Business Payment Support Service, a penalty will not be charged if they have negotiated a Time to Pay arrangement, provided that the employer is abiding by that arrangement. Helpfully, this exemption operates from the date that the taxpayer approaches HMRC, rather than the date that they sign the agreement.

It goes without saying that anybody who is in financial difficulties should take advantage of this arrangement since it will both keep the bailiffs from the door and reduce penalties.

Appeals

The legislation allows appeals in circumstances where:

- you do not agree that you are liable to the penalty
- you disagree with the amount charged
- HMRC do not agree that you have a reasonable excuse.

Groups

This legislation does not envisage the existence of groups as such. It is predicated on PAYE references or registrations.

Therefore, if a group of companies has a single registration, the penalty regime will operate merely on the basis of that registration. However, if every company in the group had a single registration then penalties will only apply to those that failed. Unfortunately, there is no means of offset if one company overpays PAYE or NIC and another underpays it.

Contributed by Philip Fisher at PKF

Lecture P585 (11.35 Minutes)

Student loan repayments

The repayment of income contingent student loans is dealt with through the tax system. The basic system is fairly simple, and provides for recovery from those borrowers who are employed through the payroll system.

Legislation

The Regulations concerning the repayment of Student loans by borrowers who took out income contingent student loans for courses starting from September 1998 were recently reissued as a consolidated Statutory Instrument (The Education (Student Loans) (Repayment) Regulations 2009, SI 2009 No 0470). The Regulations set out the provisions under which student loans are repaid, which include the collection of loan repayments by employers, payments made through the income tax Self assessment system, and payments made direct by the borrower by direct debit.

The Regulations also set out the provisions for charging interest on student loans and what happens if the borrower is made bankrupt. The loan does not form part of the borrower's estate for bankruptcy so remains due even after the insolvency.

Outline – the basic system

Employers are notified of a requirement to operate student loan deductions on form SL1 which is issued by HMRC. The deductions must be operated from the next available payroll run – the original delay of 42 days having been abolished in 2008.

The rate of deduction is 9% and this applies to earnings over the threshold of £15,000 per annum. However, student loan deductions are operated on a pay interval basis, in the same way as National Insurance contributions, so that if an employee's pay fluctuates through the tax year they may be liable to deduction in some months and not in others. The deductions are recorded with other payroll deductions and the money paid over to HMRC with the monthly PAYE liabilities.

Other triggers to student loan deductions are :

- Engaging an employee who brings a P45 with student loan indicator ticked, and
- Engaging an employee who indicates on form P46 that they are liable to student loan deductions.

In all cases the employer must ensure that he sets the employee up correctly on the payroll to ensure that student loan deductions are recovered.

More help and illustrated examples are available in the Employer Helpbook E17 which is available from HMRC's website and the Employer CD ROM.

Investment income

Where an individual who is making repayments of a student loan through their salary has investment income, the first £2,000 is ignored, and no student loan deductions will be due in respect of the investment income. However, when investment income exceeds this amount, student loan deductions will be due on the investment income in addition to the salary. This would be collected through the self assessment system.

Student loans and self assessment

One tricky aspect which is becoming more common in self assessment is dealing with student loans. Most loans for those now coming into the workforce are dealt with through the income contingent repayment scheme, and many former students are making their repayment through their pay packet, as most are employees. However, there are a number of situations where student loans crop up on self assessment returns.

The first step is to ensure that the tick box indicating a liability to pay student loan repayments is correctly ticked for clients who have repayment obligations. When taking on a new client, it is essential to establish the position at the outset so that student loan repayments are not overlooked.

Self employed

When an individual is self employed, they will be liable to make repayments of their student loan through the self assessment system. The basic rules are fairly simple. There are no repayments due if

the annual income is no more than £15,000 in a tax year, but payments are then due at a rate of 9% on the excess. For self employed students the income taken into account is the total income, including any investment income.

An individual is liable to make repayments from the April after his course finished, so those liable to make their first payments on the 2009 tax return will be graduates from July 2007. Those who graduated in July 2008 which is the first year for which students were required to borrow their tuition fees, bringing an average annual loan to around £6,000, will be liable to make repayments on the 2010 tax return. You must make sure that the relevant box on page 2 of the tax return is ticked on the tax return to ensure that student loan repayments are included in the total tax calculated.

More than one employment

When students make repayments through their salary, the limit is applied on a pay period (monthly or weekly) basis rather than an annual basis, similar to NI contributions. Another similarity with NI is that the nil rate band of £15,000 applies to each employment to keep things simple for employers. The amounts that are deducted when an individual has two jobs are therefore correspondingly lower than if the individual had one job paying the total of the two salaries.

However, if for some reason this individual comes within self assessment, the correct student loan must be calculated, allowing only a single £15,000 annual limit, and normally resulting in additional payments falling due – in fact a maximum of £1,350 may have been underpaid as a result.

Investment income

Individuals who have made repayments through their salary but have other income which brings them within self assessment (such as investment income of more than £2,000 in a year) will be liable to 9% repayments on the total income for the tax year less the limit of £15,000. Payments may therefore be due on the additional income, and as a result of applying a pay interval threshold when earnings have fluctuated through the year.

Payments on account

The law characterises student loan repayments as tax liabilities, so calculation of payments on account, and particularly applications to reduce payments on account must take into account the student loan liabilities in addition to tax and NIC payable on self employed earnings.

Problem issue – example 1

A client has had modest (self employed) income and has a substantial student loan to pay back. Recognising that their income will generate very little in the way of repayments for the foreseeable future, the individual decides to make some voluntary payments to reduce the loan. These are arranged direct with the student loan company and are paid in this case by direct debit for a fixed amount per month.

At the end of the tax year, our client discovers that his income has increased very suddenly and significantly (due to the renegotiation of certain supply contracts) and he has a substantial student loan liability due in January. This has left him a little short as it was not anticipated, but he reasons that he has already met most of his liability through the voluntary payments that he has made.

Unfortunately, voluntary payments made direct to the student loan company are separate from the "tax" liability calculated by reference to income in excess of £15,000 in a tax year. Our client has no choice but to make an additional payment of student loan repayments in accordance with the tax rules, or face interest and penalties for failing to do so.

So, canny advice to self employed individuals (have you guessed that this client was a recently qualified dentist?) is to hold back on voluntary payments until January, and then make a single payment when the tax liability has been calculated, so that payment of voluntary payments cannot catch you unawares if your income rises unexpectedly.

Problem issue – example 2

Assume that a graduate takes up student loan facilities in full this year, and his parental contribution is assessed as the maximum amount. This provides a loan of £3,000 for tuition fees and around £3,400 for living expenses. Staying at university for three years, brings the total loan at graduation to £19,200. If the new graduate has starting pay of £18,000, repayments will be made at the rate of 9% of £3,000 per annum, or £270 per year. Interest has now started to run on the loan.

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Several years later, with a wife and young family, our graduate has started his own business and is making around £30,000 per annum. His student loan repayment are £1,350, and he clearly has many years to run on his student loan. But he also has two young children, his wife works part time and their childcare costs take up most of her wages. Their tax credit award is around £2,000 per annum.

Our graduate is under pressure, and makes a silly mistake in his accounting records, meaning that his profit for the year is understated by £2,000.

An enquiry into his self assessment is started, and quickly becomes an enquiry for tax, tax credits and student loan purposes. As the misstatement of income by this particular taxpayer affects so many calculations, we should not be surprised at the following outcome :

Additional income assessed at the conclusion of the enquiry	£2,000.00
Basic rate income tax	£400.00
National insurance contributions	£160.00
Student loan repayments	£180.00
Tax credits overpaid *	£780.00
Total liability before interest and penalties	£1,520.00

The effective rate is a maximum of 76% of the understatement.

*It is probable that the £25,000 income disregard would protect claimants in many cases where there has been an excessive award of tax credits, as the new (revised) income figure would still be compared to the amount used in the provisional award and the £25,000 increase would still be available for our taxpayer. However, it is possible in some circumstances that the tax credits would also be affected.

Omitting the tick on the tax return – a simple error – cost our questioner's new client dear – in interest and penalties – but we should all be aware that with so much now based on the self assessment tax return that small errors can magnify to frightening proportions.

Worth knowing

The current rate of interest is 0% (from 1 September 2009 to 31 August 2010)

From December 2009, those within the last 23 months of repaying their loan can opt out of payment through salary and choose payment by direct debit to prevent them from overpaying due to the slow communication inherent in the repayment system. The Student Loan repayment company will contact affected individuals to notify them of this option. It will normally be beneficial to take this option, unless the individual is expecting a significant income cut.

Contributed by Rebecca Benneyworth

Lecture P581 (10.00 Minutes)

Burton v Revenue and Customs Comrs

The appellant was employed by S and was taxed at the higher rate of tax. In 2001 the appellant became an employee of IR. IR did not handle PAYE administration in–house but outsourced it to its agent, G. Throughout his employment with IR his PAYE coding, for both salary and commission, remained at BR (the basic rate coding) and as a result the appellant underpaid tax. IR subsequently ceased to trade. HMRC issued an assessment under TMA 1970 s 29 in respect of the tax year ended 5 April 2001 and the appellant appealed. The issue arose as to whether or not the appellant was liable for income tax on his earnings from his employment with IR to the extent that tax was not deducted under PAYE. The appellant contended that: (i) the primary liability to deduct PAYE was on the employer and not the employee; (ii) the Income Tax (Employments) Regulations 1993, SI 1993/744 (the PAYE Regulations) imposed statutory duties on the employer and on HMRC and that in the present case, IR, itself and through its agents G, and HMRC were in breach of those statutory duties. IR failed to provide G with the P45 which he had provided to IR, and also failed to provide a P46, in breach of regs 23(1) and 25. IR, through G, failed to provide his details—including an unsigned P46—to HMRC once it was clear that the BR had been employed in default on him as

required by regs 28 and 31. HMRC were in breach of statutory duty when they failed to amend his coding for the entire period. TMA 1970 s 59B and reg 101A could not apply if there had been such non–compliance with the PAYE Regulations; and (iii) HMRC would normally have proceeded against the employer, and that the real reason they had not done so was because IR had ceased to trade and recovery of the underpaid tax was therefore not possible. HMRC argued (i) no occasion had arisen under the PAYE Regulations which would have triggered the issue by HMRC of a revised coding in respect of the appellant. No P45 or P46 had been received by HMRC. The appellant did not submit a tax return for a relevant tax year until 19 June 2003 and he had made no contact with HMRC regarding the PAYE position; and (ii) the assets position of IR had nothing to do with the decision to assess the appellant. No direction had been made under reg 42(2) because they were satisfied there had been no under–deduction by IR. In a case where no P45 or P46 had been supplied the applicable regulation was reg 31 under which the application of code BR was appropriate. Reg 32 then provided that that code was deemed to have been issued to the employer by HMRC.

The judge considered that a breach of a statutory duty on the part of the employer, directly or through its agent, or by HMRC would not operate to eliminate the liability of an employee for an under–declaration of tax, absent a specific provision to that effect. There was nothing in the PAYE Regulations that would have the effect of removing from the employee his liability to pay tax on his earnings otherwise to the extent PAYE had been deducted at source. If the employee had a liability for an under–deduction of tax, that would not be affected by the fact, if it were the case, that the employer also had such a liability, and HMRC chose, for whatever reason, not to seek recovery from the employer. TMA 1970 s 59B and reg 101A of the PAYE Regulations applied. On the facts the appellant did not deliver a completed P46 to IR. No P45 or P46 were delivered to G. Regulation 30 could not therefore apply. Furthermore the appellant also failed to deliver a P45 to IR in respect of his immediately prior employment. The burden of proof as to delivery of the P45 was on the appellant and the only evidence that the P45 was delivered by him to IR was his own testimony; there was no other evidence that a P45 was ever in the hands of IR or G. For a P45 to have existed it would have to have been provided by S and in doing so, S would, under reg 23(1) of the PAYE Regulations, have sent Pt 1 of the P45 direct to HMRC. If that had been done, there would have been evidence of the existence of the P45. However, there was none. As a result reg 25(5) did not apply and nor did reg 30. Regulation 31 was therefore applicable, under which the liability of the employer was to deduct tax at the basic rate. IR did deduct tax at the basic rate and so there was no failure on the part of IR to deduct tax in accordance with the PAYE Regulations. Therefore no adjustment to the total net tax deducted was required under reg 101A or reg 101(4)(a) and consequently no deemed increase in the total net tax deducted. Under TMA 1970 s 59B income tax that had not been paid on account or deducted at source under PAYE was payable by the employee. It followed that the appellant was liable for the under–payments of tax and his appeal would be dismissed.

Appeal dismissed.

Muhammad v Revenue and Customs Comrs

In January 2006 HMRC opened an enquiry into the self–assessment return of the appellant, a freelance musician, for the tax year 2003–04 pursuant to TMA 1970 s 9A. On 13 April 2006 HMRC issued a closure notice under TMA 1970 s 28A making several adjustments to the self–assessment in respect of, inter alia, restriction of expenses claimed against self–employment income. HMRC also issued discovery assessments under TMA 1970 s 29 in respect of the tax years 2001–02 and 2002–03, together with further closure notices in respect of the tax years 2004–05 and 2005–06. The appellant appealed. At the hearing the officer who had conducted the enquiry gave evidence that most of the expenses claimed by the appellant were not business related—citing by way of example that he had claimed a deduction for his entire domestic telephone and electricity bills; and in respect of one year had claimed total deductions of £18,000 against turnover of £635. The officer submitted that none of the household expenditure were deductible as no room was used exclusively for business use. His best judgment was that only around 10% of some categories of expenditure was properly deductible, and none of the remainder, and he had proposed adjustments to the accounts under scrutiny accordingly. In relation to the surrounding tax years he had concluded that similar adjustments should be made in relation to the self–employment expenses claimed. He proposed a

simplification, which he believed was fair to the appellant, of taking the self–employment income for the tax years up to and including 2002–03 as giving rise, after expenses, to neither profit nor loss (so that there was no assessable self–employment income for those years but also no loss would be available for carry–forward). Losses for 2003–04 onwards would then be adjusted as proposed, all to be carried forward against future self–employment profits. The appellant submitted that he believed he had maintained all the records required by law. He accepted that claiming all his household expenditure was incorrect but he had been advised by his local business advisory service that he could claim part of those costs. He was unaware of any need to have a specific room in his house dedicated to his business and he did not work that way.

The tribunal found that the appellant was unable to discharge the burden of proof that the adjustments were wrong. His original stance that all his household expenditure was wholly and exclusively incurred for his business purposes was clearly incorrect. He had not produced convincing evidence of what expenditure was allowable. The figures proposed by HMRC were reasonable and had not been rebutted by the appellant. It followed that the appeal would be dismissed.

Appeal dismissed.

11 November 2009

Chilcott (2009)

C and G were employees of EGS (all three of which were the relevant taxpayers to the appeal). They were granted and exercised options over EGS Group company shares, and they respectively exercised those options in December and June 2001, making substantial unrealised gains. C and G advanced arguments that a notional gain had not arisen, but they eventually dropped those arguments and accepted that there were notional gains chargeable to income tax under that section in the year ended 5 April 2002. They disclosed the chargeable amounts on their self–assessment returns and paid the amount of income tax due. The exercise of the share options constituted a notional payment by the employer, who was therefore required if possible to operate pay as you earn ("PAYE"). However, EGS could not do so because it was making no payment from which tax could be deducted. In such circumstances s 203J of the Income and Corporation Taxes Act 1988 prescribed how the employer should deduct and account for the tax in cases where s 203B to 203I applied. In summary, the employer should first deduct and account from any actual payments (such as salary) made at the same time or later in the income tax period as a notional payment occurred. However, if the employer was unable to deduct a sufficient amount to cover the PAYE tax, the employer was still required to account for the tax. The legislation made no provision for how the employer might recover any balance of tax from the employee which was left as a matter between them. Section 144A of the 1988 Act did, however, make provision for a charge on the employee where the employee did not make good, within 30 days of the notional payment, the amount required to account for under s 203J. C and G did not reimburse EGS for tax payable on the notional gains within 30 days of the date that the notional gains arose. The Revenue therefore contended that a tax charge applied under s 144A of the 1988 Act and assessed C and G accordingly. Those assessments were confirmed by the Special Commissioner. The taxpayers appealed. In essence, the taxpayers argued that s 144A fell to be construed as not applying in a situation where the PAYE tax had in fact been made good by reimbursement at any time. In particular, they contended that in construing the legislation the court should have regard to Parliamentary proceedings in accordance with the principles enunciated in *Pepper v Hart.*

It was held—the legislation was clearly expressed and highly prescriptive. The meaning of the words used in s 144A of the 1988 Act was plain and contained no obscurity or ambiguity of language. The taxpayers were inviting the court to do more than construe the section: they were asking for it to be completely rewritten to reflect what they submitted it should say. In such circumstances, Parliamentary material could not aid interpretation. The case was not a *Pepper v Hart* case. The Special Commissioner's decision would be upheld for the reasons that he gave. The taxpayer's appeal would, accordingly, be dismissed.

Chancery Division Proudman J ***16 November 2009***

Footballers' image rights investigated by tax inspectors

Dozens of footballers, including England star Wayne Rooney, are being investigated over alleged tax avoidance of up to £100 million on image rights.

Inspectors from HM Revenue & Customs (HMRC) are investigating the ways top players, who earn upwards of £100,000 a week, avoid high levels of income tax through receiving separate payments for their off-field earnings — such as replica shirt sales, endorsements and promotional work. Up to a third of earnings for some players now come from the lucrative payments.

Because payments are typically made into a company set up for the player, they are subject to corporation tax, levied at 21 per cent or 28 per cent, rather than National Insurance and income tax — currently paid at up to 40 per cent, but with a new top rate of 50 per cent from April.

According to HMRC sources, the inquiry believes such arrangements may have allowed players lawfully to escape paying more than £100 million in tax.

A team from HMRC’s civil investigations unit is investigating all image rights deals of Premier League players. Peter Fairchild, private client tax director at accountancy firm Vantis, which represents all Premier League players, said: “Around 100 players from the league have had inquiries launched into their image rights arrangements.”

Players’ agents would not confirm they were under investigation but said that their arrangements complied with tax rules.

Article By Richard Edwards, Daily Telegraph 21 Feb 2010

Business Tax

Parnalls Solicitors Ltd v Revenue and Customs Comrs TC 261

On 1 January 2001 the appellant company acquired the solicitors' practice from the partnership. One of the partners, Mr P, was entitled to an annuity when he retired. The annuity obligation was not reflected in the company balance sheet on incorporation. It was documented by a deed of covenant and compromise agreement, dated 1 October 2005, between Mr P, the former partners in the partnership at the date of the appellant's acquisition of the business, and the appellant. In the deed it was specified that "[The appellant] became liable for the annuity by virtue of the transfer of all assets and liabilities of the firm … into [the appellant] on 1 January 2001". It was common ground that the obligations in respect of Mr P's annuity were assumed by the appellant as part of the transfer of the partnership business to it. The annuity was calculated at the base date of 31 December 2000 and index–linked from that date. Certain sums that had been paid by the appellant to or for the benefit of Mr P in 2002 and 2003 were taken into account. The annuity was expressed to accrue from day–to–day and was payable monthly. Payments, under deduction of tax, were made for October 2005 and November 2005. Under a deed of release dated 16 December 2005, Mr P and his wife agreed that they would release the appellant and the former partners from the obligation to pay the annuity in consideration of £1.15m. The sum was not paid immediately, but was secured by promissory note made on 16 December 2005 under which the appellant and the former partners jointly and severally promised to pay Mr P the sum of £1.15 million on demand with interest (if demanded) at 1 per cent over base. That amount was credited to a loan account on which Mr P was free to draw on demand. In their accounts the appellant showed the lump sum payment in commutation of Mr P's annuity as an extraordinary item, which it claimed as a deduction in computing its profits chargeable to corporation tax. HMRC disallowed the claim on the basis that it was an item of a capital nature and items of a capital nature had to be excluded unless specifically allowed by statute. The appellant appealed contending that (i) where a lump sum payment was made to commute or extinguish a contractual obligation to make recurring revenue payments, then the lump sum payment was prima facie a revenue payment; (ii) the tribunal should only consider the circumstances at the time the lump sum payment was provided for, not the circumstances of the original acquisition by it of the partnership business; and (iii) as the annuity payments were accepted as charge on income prior to 2005, it followed that the annuity had to be income, as it would not be a charge on income if it were a payment of a capital sum by instalments.

The tribunal found that the appellant's assumption of the obligation to pay Mr P's annuity was part of the consideration for the acquisition of the partnership business. The parties to the transfer of the partnership were the then existing parties and the appellant; there was no evidence Mr P was a party. The appellant came under a direct obligation to Mr P and his wife only in 2005 with the execution of the deed of covenant and compromise agreement. Until then, the appellant's only legal or contractual obligation was to the previous partners on the terms on which the obligation to P was assumed. The bargain was for the transfer of all assets and liabilities which, properly construed, was a bargain for the sale of the assets for a consideration which included the assumption of the liabilities. Although not quantified or otherwise recognised in accounting terms, the annuity obligations were a liability assumed in that way, and had to be considered as part of the consideration for the assets of the partnership business that were transferred to the appellant. There was a clear principle to be derived from the case law that where an obligation, whether vested or contingent, was assumed as part of the purchase price, or consideration, for the purchase of assets on a transfer of a business, payments in discharge of that obligation were capital expenditure, and not revenue expenditure. To consider the commutation in isolation, ignoring the acquisition of the partnership business and the assumption of the annuity obligations as part of that acquisition, would fail to take account of all the circumstances exiting at the time of the commutation payment or provision, which included the character of the annuity payments. Accordingly as the obligation to pay Mr P's annuity was assumed as part of the consideration for the acquisition of the partnership business, the payments of that annuity would have been capital expenditure and not a revenue expense. The treatment of the lump sum was determined by the nature of the payments it supplanted. Accordingly, the payment of the sum of £1.15 million in commutation of the annuity was not to extinguish a contractual obligation to make recurring revenue payments and was not itself a revenue payment, but extinguished an obligation to

make payments of capital expenditure and was a capital payment. Furthermore, a charge on income could be capital in the hands of the payer and income in the hands of the payee. There did not need to be symmetry between the quality of the payments in the hands of the payer and payee. On the authorities the annuity payments from the perspective of the appellant were not revenue payments, but capital. It followed that the appeal would be dismissed.

Appeal dismissed.

10 November 2009

When does a partnership exist?

In August 1996 the appellant, an architect, came together with Mr B, who traded under the name SB, to pursue architectural work on a joint basis. In 2003 the appellant terminated the relationship with Mr B after a dispute arose following Mr B's decision to sell part of SB without giving the appellant any of the sale proceeds. In 2004 HMRC opened an enquiry into the partnership tax returns for SB for the year ended 5 April 2002 under TMA 1970 s 12AC. HMRC notified Mr B in his capacity as nominated partner, within the meaning of TMA 1970 s 12A, of the enquiry. HMRC also notified the appellant of the enquiry, on the basis that it affected his personal tax return which was to be treated as under enquiry because the partnership return was under enquiry. The appellant's representatives wrote to HMRC informing them that the appellant had commenced legal action against Mr B in respect of SB and although Mr B was the nominated partner in the past he was not in respect of the current action and stressing no action was to be taken in respect of SB which would adversely affect the appellant without his agreement. The legal claim between the appellant and Mr B was settled, in approximately 2006, on the basis of a Tomlin order under which Mr B paid the appellant approximately £250,000. Although the order did not contain an explicit finding that there was a partnership, it was written on the assumption that there was. In January 2005 and January 2006 HMRC opened enquiries into the partnership returns for the 2002–03 and 2003–04 tax years respectively. In August 2008 HMRC, after agreeing various amendments to the partnership accounts with Mr B, issued closure notices and amendments for the partnership accounts. At the same time they raised discovery assessments against the partnership for the years 1999/2000 and 2000–01 under TMA 1970 s 30B. Thereafter HMRC issued assessments against the appellant for the tax years 1998–99 to 2002–03 and amended his self–assessment returns for 2001–02 and 2003–04. The appellant appealed and two preliminary issues arose for consideration—(i) whether there was a partnership—within the meaning of the Partnership Act 1890 s 1(1)—for the years under assessment, 1998 to 2003; and (ii) if there was a partnership, whether the appellant could appeal against consequential assessments and amendments made to his self assessment returns following assessments and amendments made in respect of partnership returns. It was agreed by the parties that HMRC engaged only with Mr B in their enquiries and disputes and did not discuss the matter at all with the appellant, although they had been notified of the legal dispute between the two men. The appellant did not appear at the hearing but his representative submitted—(i) there was no partnership between Mr B and the appellant. Although it was accepted that the business was carried on with a view to profit, it was not carried on in common. The appellant shared net profits but not in a way to give rise to a partnership. Their relationship was one of principal and agent or employer and employee; (ii) if there was a partnership, it was clear that in the period between 1998–2003 Mr B was the nominated partner, but the relationship had ended acrimoniously in 2003 and so at that point Mr B ceased to be the nominated partner and HMRC should not have agreed the amendments with Mr B without reference to the appellant; and the appellant was being treated most unfairly as HMRC were assessing him on partnership profits and denying him the chance to challenge the correctness of the assessment. HMRC submitted that the scheme of the legislation was that, under TMA 1970 s 12AA, they only needed to deal with the nominated partner who was responsible for completing the return; in the present case Mr B. No other partner was liable to make a partnership return and no other partner could appeal against an assessment made on the partnership or any amendment made by them to the partnership return. There were good policy reasons for such a scheme in the legislation as HMRC needed a single reference point and could not negotiate individually with all the partners who should resolve disputes amongst themselves. The appellant's appeals could not reopen the issue of the correctness of the assessments and amendments in relation to the partnership return.

The tribunal found that for the years under assessment the appellant was in partnership with Mr B and was a partner in SB. On the facts the appellant and Mr B shared net profits and that was prima facie evidence of the existence of a partnership between them. Furthermore the appellant had failed to satisfy the tribunal on the balance of probabilities that on the facts a partnership did not exist during the years of assessment.

The tribunal considered that HMRC were correct to continue to treat Mr B as the nominated partner even after the partnership ceased. The plain words of TMA 1970 s 12AC were that the notice of enquiry was to be given to the "partner who made and delivered the return, or his successor". Section 12AA(11) indicated that there was only a "successor" where the nominated partner was no longer available. In the present case Mr B was still available so there was no question of there being a successor. In any event, there was no one else nominated by the partners and so it would be for HMRC to nominate the successor under s 12AA(11)(b)(ii) and they chose to continue to treat Mr B as the nominated partner. In respect of the discovery assessments, the notice of amendment had to be given to the partner who made the return. Section 30B(1) provided that "… as regards a partnership statement made by any person (the representative partner) … [HMRC] may … by notice to that partner so amend the partnership return"; the representative partner was Mr B as he filed the returns for those years. Accordingly, even after the partnership ceased to exist, Mr B remained the nominated partner in relation to the returns made by the partnership. HMRC were therefore correct to give the notice of amendment to Mr B.

However, the tribunal considered that any partner had the right to appeal assessments against him in relation to his liability to tax on his partnership share. TMA 1970 s 31(1)(b) gave a partner who was not the nominated partner the right to bring an appeal against a consequential amendment of his own return under TMA 1970 s 28B(4). In addition s 31(1)(d) gave any such partner the right to appeal any assessment made against him. Those appeals could put in issue the correctness of any assessment of a partnership in which the taxpayer was a partner, or the correctness of any amendment to a partnership return. That conclusion was based on the following reasons. Firstly, there was nothing in TMA 1970 to limit the scope of a taxpayer's return. Secondly, to hold otherwise would be contrary to European Convention for the Protection of Human Rights and Fundamental Freedoms. Thirdly, TMA 1970 allowed any partner to appeal against an assessment or amendment against the partnership itself.

Order accordingly on the preliminary issues.

Phillips v Revenue and Customs Comrs, 24 November 2009

Tower MCashback LLP 1 and anor v The Comrs for HMRC

In *Tower MCashback LLP 1 and another v Revenue & Customs Comrs*, two limited liability partnerships claimed capital allowances in respect of expenditure on computer software (to take advantage of the 100% allowance for the year 2003–04. 75% of the purchase price of the software was funded by "non–recourse loans" made available by the vendor of the software. HMRC rejected the claims under CAA 2001 s 45(4) and issued closure notices.

At the hearing HMRC abandoned their s 45(4) contention, but defended the closure notices on alternative grounds.

The Court of Appeal allowed HMRC's appeal in part (in relation to the closure notice issue) but found that one of the LLPs had genuinely "expended ... funds on the purchase of the software agreement and, accordingly, was entitled to a first–year allowance in respect of that expenditure".

Court of Appeal, Civil Division Arden, Scott Baker and Moses LJJ ***2 February 2010***

Time to review claims for capital allowances

On 1 April 2010 the time limit by which businesses can make tax claims which previously had a six year time limit for companies, or a five year and ten month time limit for unincorporated businesses, drops to four years. This includes error or mistake claims. In view of this change it may be helpful to review capital allowance claims among others.

While it is not possible to correct a mistake in a claim or election included in a return, it may well be possible to make a claim or election where none was previously made in respect of specific expenditure. Due to the change in time limits it will not be possible on or after 1 April 2010 for companies to make a claim to correct a mistake or error in a return for the years ended 31 March 2004, 2005 or 2006. Unincorporated businesses will not be able to make a claim to correct a mistake in a return for the tax year 2004/05 on or after 1 April 2010, but for the tax year 2005/06 claims to correct a mistake will be possible up to 5 April 2010.

With respect to claiming capital allowances it is often helpful to engage experts in this area to identify precisely what can and cannot be claimed, particularly with regard to expenditure on buildings. There are well known tax cases illustrating the dividing line. One recent case involved a claim by JD Wetherspoon plc which looked at sample claims for two pubs, for extrapolation to a claim covering 288 pubs. While the first decision on this case (*JD Wetherspoon plc v HMRC* SpC 657) was released in December 2007 (which JD Wetherspoon plc has appealed against to the High Court), a further update was released in December 2009 going into more detail on disputed areas (*JD Wetherspoon plc v HMRC* TC312). It is interesting to note some of the main points from this update. HMRC's representative recognised that the concept of determining what is 'trade specific' is 'slightly elusive'. The significance of this is illustrated in the dispute over lighting in this case. Lighting in the toilets was considered to be trade specific, creating a suitable ambience for the pub/restaurant trade and therefore qualifying for capital allowances. If the lighting had been considered 'general lighting' under the legislation in force at the time, then it would not have qualified. Under current legislation 'lighting systems' are integral features qualifying for 'special rate', or 10%, writing down allowances, unless meeting the requirements for 100% energy-efficient allowances. Further consideration may have to be given as to whether lighting is part of a system or, while being trade specific, is not part of a system but falls in another qualifying category. Alterations of a building that are incidental to the installation of plant or machinery qualify as expenditure on plant or machinery. In the case of JD Wetherspoon plc, a concrete sloping floor to aid drainage of beer spillage (which replaced a wooden floor) was held to be an alteration to a building incidental to the installation of pumping equipment which qualified for capital allowances. The replacement of a kitchen floor with a reinforced floor capable of holding kitchen equipment required for the trade was also held to be an incidental alteration qualifying for capital allowances in relation to the kitchen equipment. If a business has incurred significant expenditure on capital assets which could have qualified for capital allowances, but for which no claim has previously been made, it may well be worth reconsidering whether a full claim can now be made. Included in the definition of 'buildings' are, among other things, 'walls, floors, ceilings ...' and 'mains services, and systems, for water, electricity and gas'. On the assumption that the claim for the annual investment allowance (100% allowance on expenditure of up to £50,000) has been exhausted, whether expenditure can properly be identified as an alteration of a building in connection with installation of qualifying plant or machinery could also mean the difference between expenditure qualifying for the integral feature 10% rate of allowance, the general plant or machinery allowance of 20%, or a first-year allowance rate of 100% on certain qualifying expenditure.

Chris Lallemand, Smith & Williamson writing in Taxline, February 2010

The "New" CIS

Since its inception in the mid 1970s, the CIS has undergone several changes. Originally intended as its name first implied "The Construction Industry Tax Deduction Scheme" or CITDS was intended to curb the widespread abuse in the industry at the time of making payments without deduction.

Over the years, the CIS metamorphosed into a gross payment scheme and the most recent change, and proposed future changes will bring the whole scheme back to its original intention, i.e. to deduct tax.

There is very little paperwork in the current scheme, and the volume of paperwork, certificates, cards etc in previous versions of the scheme meant that it was ripe for fraudulent activities. Indeed, there is much anecdotal evidence, that anyone could buy gross payment certificates in the pub!

The new system has worked well but it does appear, if a recent White Paper is to be believed, that the intention is to make labour only sub-contractors employees. This would appear to be an attempt once and for all to remove the necessity for carrying out status reviews on this category of worker. From HMRC's view, it would be much simpler if they were all simply employees. There are, however issues other than tax to be considered, not the least of which are legal and employment law issues.

The withdrawal of Gross Payment status continues to cause problems. When this was originally brought in, it was hailed as "three strikes and your out", in other words, a contractor would not have his gross payment status removed if he was guilty of only three misdemeanours. This is now down to two "minor" compliance failures, or one large one. Removal of gross payment status can have catastrophic implications for a contractor not the least of which is cash flow. More and more, it would appear that businesses and particularly public sector organisations will only give work to contractors who hold gross payment status, and this could well mean that contractors, who have to be paid under deduction, will never even make it to the tender stage.

It is also now more noticeable that HMRC during CIS reviews is looking closely at the split between materials and labour on invoices submitted for payment. Obviously, there is only a requirement to account for tax on the labour only element and HMRC, is suspicious that the materials element on invoices may be "inflated".

The paying contractor is the one whose responsibility it is to ensure that the labour element is correct. Remember, if HMRC does successfully prove that there has been an inflation of materials, then it is the paying contractor to whom HMRC will look for restitution.

Al in all, the new scheme has cut down on areas of potential fraud, but with the new attack on invoice splitting, there are still some serious large problem areas, and contractors must continue to be vigilant.

Article by Brian Lovie

Lecture B582 (9.09 Minutes)

Corporation Tax

The Research & Development Partnership Ltd v Revenue and Customs Comrs

The appellant made a claim for research and development tax relief. HMRC opened an enquiry into the appellant's tax returns for the accounting period to 30 April 2005 and 30 April 2007. During both enquiries HMRC wrote to the appellant requesting information and documents relating to, inter alia, its research and development activities and a detailed analysis of its research and development tax relief claim. In both circumstances the appellant did not respond and so HMRC issued a notice under FA 1998 Sch 18, para 27 requiring it to produce the documents and information within 30 days. In light of the appellant's failure to comply with the para 27 notices, HMRC then issued fixed penalties and daily penalties. The appellant appealed against the penalties contending that it had relied on its accountant to provide the documents and information required by the para 27 notices and the accountant had failed to provide the documents. It was common ground that, following *Rowland v Revenue and Customs Comrs* [2006] STC (SCD) 536, reliance on a third party was capable of being a reasonable excuse in a direct tax context. HMRC argued that the requested information in the present case was straightforward and easily understood and it was therefore not reasonable to rely on a third party with specialist knowledge to perform it. The appellant submitted it had acted responsibly when it relied on the accountant to deal with areas of tax legislation that it could not reasonably be expected to be conversant in.

The judge considered that although reliance on a third party was capable of being a reasonable excuse for direct tax purposes, in determining whether a person had a reasonable excuse for failing to perform a particular task it was proper to have regard to the nature of that task. In the instant case the appellant was required to produce a detailed explanation of its research and development tax relief claim with reference to the research and development legislation. As the provisions of that legislation could not be described as straightforward and easily understood to those not generally acquainted with tax law, it was reasonable for the appellant to rely on its accountant to provide the information to HMRC. It was also reasonable for the appellant to expect its accountant to provide the other documents and information required by the notice together and at the same time as it was to provide the explanation of the research and development claims to HMRC. Accordingly the appellant had a reasonable excuse for its failure to comply with the notices. It followed that the appeals would be allowed and the penalties would be set aside.

Appeals allowed.

30 November 2009

An NIC charge on dividends?

The recent case of *PA Holdings Ltd v HMRC (2009)* is more than a little alarming, given that the decision indicates that, in certain circumstances, dividends can be chargeable to NICs.

This obviously requires careful consideration, but, in the meantime, it is necessary to explain that the company, which is a large and well-known consultancy organisation, entered into a tax mitigation remuneration strategy whereby, through the medium of an employee trust, members of staff acquired shares in a company connected with their employer. Nowadays, such an arrangement would be taxable as employment income (although the rule was not in force at the time of the case). However, the figures were small.

What is more important is that the company then declared a dividend which was much larger. Even though the dividend could reasonably be said to have been derived from the employees' employment, there is a statutory override in what is now S367(2) ITTOIA 2005 which provides that dividends are always taxable as distributions – this takes priority over a charge under any other provision (eg. as earnings). As a result, the employees' income tax liability was effectively limited to a maximum of 25%.

Although these arrangements were clearly made with tax saving in mind, this was not enough to prevent the application of S367(2) ITTOIA 2005.

Unfortunately, HMRC were not finished with their argument. They said that, although the dividend receipts could not be taxed as earned income, there was no similar provision in the NIC legislation to preclude the treatment of dividends as earnings, with the result that NICs could apply. The Tribunal agreed and duly decided that the dividends were both distributions *and* emoluments – they were therefore subject to employer and employee Class 1 NICs.

This was an interesting approach by HMRC, given that Para NIM02115 of the National Insurance Manual states:

'Dividends are derived from a shareholding and not employment. They cannot therefore be classed as earnings and do not attract NICs.'

Further on, Para NIM12012 reads:

'Directors receive dividends as shareholders in the company and not in their capacity as directors. Dividends are therefore not earnings for the purposes of NICs.'

These are extracts from the current guidance published by HMRC and so it is a considerable surprise that they should be seeking to argue the opposite before the Courts.

This decision is an extremely serious one and there will undoubtedly be a lot more written about it in due course. Having said that, it is unlikely that HMRC would try and apply this principle to private company shareholder directors who take out a modest salary and a much larger dividend. Such a strategy is *not* part of an artificial tax avoidance scheme.

Contributed by Robert Jamieson

Lecture B583 (6.58 Minutes)

Corporate tax residence

Corporate tax residence is a hot topic at the moment, particularly in the context of a number of high-profile corporate migrations. HMRC's victory in *Laerstate BV v HMRC (2009)* provides a useful indication of the factors which the Courts will take into consideration in order to see whether an overseas company is really resident outside the UK.

Laerstate BV was a Dutch company wholly owned by Mr Bock who was the chief executive of Lonrho plc in the early 1990s. In December 1992, at the instigation of Mr Bock, Laerstate acquired a substantial stake in Lonrho. Four years later, the company sold that shareholding at a profit and so HMRC sought to tax this capital gain on the basis that Laerstate had been, at all relevant times, UK-resident.

For most of this period, Laerstate had two directors: Mr Bock and a Dutch businessman, Mr Trapman. However, in August 1996, Mr Bock resigned as a director of Laerstate, leaving Mr Trapman as the sole board member.

The Tribunal found that the relevant decisions in relation to Laerstate were primarily taken by Mr Bock in the UK. The company did hold board meetings outside the UK to approve some aspects of the transactions which took place and many of these were attended only by Mr Trapman. Nevertheless, it was clear that the driving force behind Laerstate was Mr Bock.

When Mr Bock was a Laerstate director, the company's Articles of Association authorised him to represent Laerstate and to create legally binding obligations on that company's behalf. At the relatively few board meetings held by Laerstate, there was little evidence that there was any real consideration of the matters before the meeting. In fact, on certain occasions, the minutes showed a misunderstanding of important details of the transactions being approved.

Once Mr Bock had resigned as a director of Laerstate, although he no longer had the authority to transact business on behalf of the company, the Tribunal held that very little had changed and that any formal decisions made by Mr Trapman as director could be disregarded given that he made such decisions without really considering the issues at all – he simply did what Mr Bock told him to do. Examination of the evidence showed that it was Mr Bock who attended meetings at Laerstate's London solicitors and that they sent their advice to him and not to Mr Trapman. Indeed, they never advised Mr Trapman. Also Mr Bock negotiated with the buying company (Anglo American plc)

over the sale of the Lonrho shares, with particular reference to the options, the timing and the price, and it was found that Mr Trapman was not kept informed of developments throughout this important period.

The Tribunal stated:

'There is no assumption that central management and control must be found where the directors meet. It is entirely a question of fact where it is found. Where a company is managed by its directors in board meetings, it will normally be where the board meetings are held. If the management is carried on outside board meetings, one needs to ask who is managing the company by making high-level decisions and where, even when this is contrary to the company's constitution.'

They went on to say that the test is not confined to looking at particular actions of the company (eg. signing documents or making board resolutions) if a more general overview of the course of business and trading shows that, as a matter of fact, central management and control abides in the UK.

An interesting further comment was:

'There is nothing to prevent a majority shareholder indicating how the directors of the company should act. If they consider the wishes and act on them, it is still their decision.'

The question is whether the directors (Mr Trapman in this instance) have the absolute minimum amount of information which a person would need in order to be able to make a decision on whether to agree to the shareholder's wishes or to choose not to sign the documentation. In this case, that would have included information and advice on whether the price was sensible. There was no such information or advice given to Mr Trapman.

As a consequence of the key decisions being taken in the UK, Laerstate was held to be UK-resident under domestic law. Under Dutch law, the company was resident in the Netherlands. For broadly the reasons described above, under the double taxation treaty between the two countries, Laerstate's place of effective management was found to be in the UK and so, for treaty purposes, the company was resident here. Hence it was liable to corporation tax on the gain arising from the sale of the Lonrho shares.

This case is a useful reminder that it is not enough just to have the formal acts of a company documented as occurring outside the UK in order to maintain that, for tax purposes, it is non-UK resident. It is essential that the directors are kept fully informed so that they can make proper decisions (whether they accede to the shareholder's wishes or not).

However, the case is helpful in that it seems to accept that, in principle, a company incorporated outside the UK can retain its foreign residence, even though the sole shareholder (who is also a director) is UK-resident – this is subject to the proviso that it is actually centrally managed and controlled from outside the UK.

There also appears to be no objection to the UK-based shareholder director being involved in high-level negotiations (as in this case concerning the sale of the Lonrho shares), provided that the other directors are adequately informed and advised before making decisions on behalf of the company. From a practical perspective, the more information which the other directors receive, the better. Likewise, the more records there are to substantiate this, the better.

Contributed by Robert Jamieson

Lecture B584 (11.12 Minutes)

Value Added Tax

Partial business use and changes to Lennartz

This article considers several recent developments in the area of input tax claims on expenditure which is partly for business purposes and partly for purposes which are not regarded as "business" for VAT. A 2009 ECJ decision (*VNLTO*) has drawn a new distinction between two different types of "non-VAT-business" use which could have significant consequences for the UK's treatment of such expenditure. That was considered in a lecture last year: this lecture concentrates on HMRC's response to that decision, and an important case on charitable expenditure.

Recent development

Lennartz accounting

HMRC have finally responded to the decision of the ECJ in *Vereniging Noordelijke Land-en Tuinbouw Organisatie v Staatssecretaris van Financien (VNLTO)* (Case C-515/07). This updates the guidance in Information Sheet 14/07, which explained the rules brought in for "*Lennartz* accounting" with effect from 1 November 2007. This refers to the choice that a trader has when something is bought for part private, part business use:
to claim a proportion of the input tax at the outset reflecting the extent of business use;

to claim the whole of the input tax at the outset and subsequently to account for output tax to reflect the private use.

The *VNLTO* case changed the understanding of *Lennartz*: previously it had been thought that a person had a right to claim all the input tax upfront if there was a mixture of "business" and "non-business" use. The ECJ ruled that this was not so: only "private" use, in the sense of something completely separate from the purposes of the registered entity, qualified for the *Lennartz* treatment. It would therefore be available to an individual who could use something for business and for wholly private purposes; but a charity would not be able to apply the treatment to something that was bought partly for "VATable purposes" and partly for activities which were within the objects of the charity, but were outside the scope of VAT.

HMRC's response is as follows:
From 22 January 2010, Lennartz accounting will only be available where:
(a) the goods are used in part for making supplies in the course of an economic activity that give a right to input VAT deduction (broadly, taxable supplies, supplies that would be taxable if made in the UK, or certain financial and insurance supplies to non-EC customers); and
(b) they are also used in part for the private purposes of the trader or his staff, or, exceptionally, for other uses which are wholly outside the purposes of the taxpayer's enterprise or undertaking.
From that date, where Lennartz accounting is not available, and goods are used (or to be used) for both economic activities and non-economic business activities, subject to the transitional provisions outlined below, the VAT incurred must be apportioned between these different activities on the basis of use (or intended use). The VAT attributed to the economic activities is input tax and is recoverable to the extent that the economic activities give rise to supplies with a right to input VAT deduction. The VAT attributed to the non-economic business activities is not input tax and cannot be recovered.
Taxpayers with assets subject to existing Lennartz accounting arrangements
Taxpayers for whom Lennartz accounting has, strictly speaking, never been available would normally be expected to unravel the mechanism and adjust both any input tax claimed and any output tax accounted for accordingly.
However, HMRC is committed to easing the administrative and financial burden on taxpayers who have already embarked on, and continue to operate, Lennartz accounting under HMRC's old policy.
Consequently, where a taxpayer has applied Lennartz accounting on the basis of HMRC's pre-VNLTO understanding of the law, the taxpayer may opt to continue using Lennartz accounting in respect of the assets concerned.
Taxpayers exercising this option must honour the full, ongoing commitment to account for output tax imposed under Lennartz accounting and HMRC will take action if a taxpayer fails to do so.

Those taxpayers who do not exercise this option must unravel the Lennartz accounting mechanism by adjusting both their output tax and corresponding input tax. They should write to their Client Relationship Manager within HMRC or the HMRC Written Enquiries Section at Alexander House, Victoria Avenue, Southend. SS99 1BD to discuss and agree a fair way of doing so. HMRC will not accept one-sided claims for repayment of the output tax only.

Taxpayers who have committed to projects anticipating the availability of Lennartz accounting

Taxpayers who are not permitted to use Lennartz accounting must apportion VAT incurred for both economic and non-economic activities on the basis of use and intended use from the date of this announcement.

However, HMRC will consider claims from taxpayers who have already entered into binding commitments for projects on the understanding that Lennartz accounting will be available. Taxpayers should contact HMRC at the addresses above.

Fleming claims

Some taxpayers (following the House of Lords' judgments in the cases of Fleming and Condé Nast) have submitted "Fleming" claims for Lennartz treatment for assets where VAT was incurred in accounting periods ending before 1 May 1997. No decisions on these claims were taken pending the issuing of this announcement. These claims will now be reviewed and, where appropriate, rejected if the taxpayer had not taken up the option to use Lennartz accounting at the time the input tax was incurred (where this was available) and/or where the VNLTO decision means that the claimants were not entitled to use Lennartz accounting as there was no EU law right to do so.

R&C Brief 02/10

Charity fundraising

Charities have to divide the VAT on their expenses into:

- business and non-business;
- taxable business and exempt business.

Until the case of *Church of England Children's Society* (High Court 2005), VAT relating to fundraising was generally regarded as wholly irrecoverable because fundraising was not a business activity. That case established that the *Kretztechnik* principle could apply: general fundraising supported the whole of an entity's activities, and the VAT in relation to it was therefore an overhead of the whole of those activities. Some of it could therefore be recovered, to the extent that it was used to make taxable supplies.

In 1995, Oxfam had agreed a method of apportioning VAT between business and non-business on a costs basis. Those costs (VAT-exclusive) which were exclusively used in business activities and those costs which were exclusively used in non-business activities were expressed as a percentage ("B over B plus non-B") and this was applied to expenses which were partly for business and partly for non-business purposes. The method was put on a formal basis by the issue of a direction from Customs in 2000.

Following the *CofE* case, HMRC accepted that Oxfam were entitled to apply the formula to fundraising costs as well as the other costs already treated as "pot". Some £2.5m was repaid to the charity as a result. However, Oxfam argued that there was a further effect of the decision which HMRC had not taken into account. Previously, the expenditure on fundraising had been included in "non-B" in the formula: now it should be excluded altogether, producing a higher percentage to be applied to a larger residual amount of VAT. The business proportion would rise from about 75% to 85% or 90%.

HMRC argued that this no longer produced a fair and reasonable result, and they said that they were entitled to revisit the formula. The agreed method included the proviso that the agreement would not apply if there was a significant change in the way the business operated, and HMRC contended that this significant change in the understanding of the law triggered that get-out. In May 2006 HMRC issued a notice withdrawing approval of the agreed method, and no replacement had yet been agreed by the time of the Tribunal hearing in 2008.

Oxfam argued that the approved method, formally agreed by HMRC in a document, constituted a binding contract from which HMRC could not retrospectively resile. Now that a proper understanding had been established of the way in which the rules ought to operate, the method should be merely mechanical. This was the result in a number of other cases such as *GUS Merchandising Corporation* in respect of retail schemes and *The Labour Party* in respect of partial exemption methods.

The Tribunal discussed this proposition in great detail, and drew an important distinction. Retail schemes and partial exemption are provided for in statute. There is no statutory detail on the

business/non-business split. The situations are therefore not comparable, and it is not right to assume that Oxfam's agreement was binding in the same way as it was for *GUS* and *Labour*. The negotiations which led to the formal document in 2000 did not appear to be the agreement of a contract but rather the ratification of an existing practice. In short, the Tribunal agreed with HMRC that they were entitled to consider the voluntary disclosure as a new claim which was subject to the principles of being fair and reasonable, rather than being required to make a repayment on the basis of a mechanical formula.

The Tribunal was not satisfied that the repayment claim was fair and reasonable. It would appear to create a recovery of some 85% of the VAT on fundraising expenditure, which appeared inconsistent with statements in the annual report that 80% of donated income was used for the relief of poverty (generally involving non-business activities). The appeal was therefore dismissed.

The charity appealed to the High Court, but the judge believed that the Tribunal's decision was justified. There was no abuse of power by the public authority in modifying the assurance earlier given, and no irrationality in that modification either.

The charity had also commenced judicial review proceedings on the basis of a "legitimate expectation". This was held over pending the result of the Tribunal hearing. The judge commented that he believed the legitimate expectation point was one that could be argued before the Tribunal; but this was in his view an extension of the traditional understanding of the Tribunal's jurisdiction in such a matter, so it would be prudent for future appellants to take both routes of appeal as a protective measure until a higher authority settled the matter.

High Court: *Oxfam v HMRC*

Contributed by Mike Thexton

Lecture B585 (29.08 Minutes)