CONTENTS

Finance Act 2010 received royal assent on Thursday, 8 April 2010.

Personal Tax

Salary sacrifice issues

Employer-Funded Childcare

No liability to income tax arises on provision by an employer to his employees of qualifying childcare vouchers, except to the extent (if any) that the cash equivalent of the benefit exceeds £55 per week. One of the conditions for this exemption is that the vouchers are provided under a scheme that is open to all the employees or to all those at a particular location.

Where an employer's scheme provides the vouchers as part of a salary sacrifice arrangement, employees on the National Minimum Wage (NMW) (or just above it) have to be excluded because the salary sacrifice would take them below NMW levels. Legislation is to be introduced to ensure that the exemption can still apply even if these lower-paid employees are excluded. The legislation will be backdated to 2005/06 when the exemption was first introduced.

There is also an exemption from income tax where the employer provides childcare directly rather than through vouchers. Again, retrospective legislation will preserve the exemption in cases where the childcare is provided via salary sacrifice arrangements and lower-paid employees are excluded.

Cycles and bus passes

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. HMRC's 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.

Workplace canteens

Legislation will be introduced in FA 2010 to amend ITEPA 2003 s 317 to restrict the exemption for the benefit of free or subsidised meals where an employee has an entitlement, in conjunction with salary sacrifice or flexible benefits arrangements, to employer-provided free or subsidised meals.

The existing position in relation to subsidy benefits that are quantifiable but not connected to salary sacrifice or flexible benefits arrangements will not be affected.

The change will have effect from 6 April 2011.

Special allowance charge

From April 2011, pension relief for then higher paid will be restricted so that ultimately they only benefit from basic rate relief on their premiums. The restriction will commence at £150,000 at the point the 50% rate of income tax bites, but will gradually taper tax relief on the contributions so that at £180,00 of income the relief obtained is 20%. Having announced this in April 2009, the Government has been concerned to prevent affected taxpayers from accelerating payments into the regime applying presently to maximise current relief.

FA 2009 section 72 therefore introduced Schedule 35 which created the new (temporary) special annual allowance charge which applies during 2009/10 and 2010/11 until the change described above commences. Originally affecting incomes above £150,000, it was amended by FA 2010 section 48 so that references to incomes of £150,000 were changed to £130,000 with effect from 9 December 2009.

Overview of the income test

This test looks at an individual's income to determine whether or not they are affected by the **high income excess relief charge**.

An individual is affected by the charge if:

- their 'relevant income' (broadly income after any deductions, except those for pension contributions and charitable donations, plus any relevant salary sacrifice amount) is £130,000 or over, and
- their 'gross income' (broadly income after any deductions, except those for pension contributions and charitable donations, plus the amount of pension savings less any personal contributions) is £150,000 or more.

HMRC Qs and As

Note that the same test as is described below also applies to those with incomes below £150,000 but over £130,000 using a date of 9 December 2009.

Q. I have a salary sacrifice agreement linked to a pension arrangement which I have to renew annually. If I renew it on or after 22 April 2009, will the amount of salary sacrificed need to be added back into my income, even where the amount sacrificed remain constant with my pre Budget day levels?

A. Yes. Any salary sacrifice linked to pension arrangements entered into on or after 22 April 2009 will need to be added back to your income in working out 'relevant income'.

Q. I have a salary sacrifice agreement linked to a pension arrangement that was in place before 22 April 2009 which I have to renew annually, although the agreement includes a default position that if I do nothing the salary sacrifice will continue at the same levels for the following year. If the default provision has applied as there has not been any renewed agreement on or after 22 April 2009 does the amount sacrificed have to be added back to work out relevant income?

A. No. If the default position was that the pre-22 April 2009 salary sacrifice linked to pension arrangements continues at the same pre-22 April 2009 level without any new agreement this would be an existing pre-22 April 2009 salary sacrifice and would not to be added back in to your income in working out relevant income.

Lecture P591 (16.06 Minutes)

Antique Buildings Ltd

The company owned a helicopter which was provided for personal and business use to the director, PB, between 2003 and 2006. No charge was made for his private use and he was the only person who used the helicopter.

PB declared the helicopter benefit in his returns. HMRC informed the company that it was liable to pay Class 1A National Insurance in respect of PB's private and business use of the helicopter.

The company appealed, claiming that business use should not be subject to Class 1A NI.

The issue was whether the deductions for business use were allowable for Class 1A NI charged on the company. It was common ground that Class 1A NI was payable on the full amount of the benefit of having the helicopter provided to the director.

The First-tier Tribunal surmised that the policy in 2000 when the scope of Class 1A NI was expanded beyond cars and car fuel, it would have been too difficult to allow deductions for business use unless the deduction was for the whole amount, i.e. the cost of any private use was made good before the date for payment of Class 1A NI, which in this case it was not.

The effect of ITEPA 2003, part 5, chapters 2 and 5 was that a deduction was not allowed for Class 1A unless the amount deductible was equal to the whole of ‘general earnings’.

However, the company claimed that chapter 3 applied to the helicopter, and there was not restriction on the deduction in that chapter.

The tribunal accepted the company’s contention.

The company’s appeal was allowed.

Athenaeum Club and another

Mr B (the second appellant) was appointed as assistant manager at the appellant company on a salary of £22,500, although it was mutually agreed that the company would treat him as self employed.

HMRC, however, claimed that he was an employee and that PAYE should be applied to his salary.

The First-tier Tribunal said that the club retained ultimate control over the tasks carried out by Mr B and that there was an employer/employee relationship.

It said further that an agreement between the club and Mr B to the effect that he should invoice the club on a monthly basis to indicate self employment did not change his employee status.

Referring to Mr B’s business activities beyond the appellant company, the tribunal said it was perfectly possible for an individual to be employed in one capacity at the same time as being self employed on other projects.

The taxpayers’ appeals were dismissed.

Taxation 15 March 2010

EIS relief and partnerships

On 9 December 2009, HMRC published a Technical Note on the application of EIS relief and how it relates to partnerships.

HMRC consider that S183 ITA 2007 disqualifies a company’s shares from EIS relief where the relevant trade is carried on by the company in partnership or by an LLP of which the company is a member. This is because one of the conditions for the relief is that the trade (or preparation work or research and development) may not be carried on, during the three-year period following the issue of the shares, by a person other than the issuing company or a 90% subsidiary. Where the trade is carried on by a company in partnership, HMRC now say that this test cannot be satisfied.

This view could potentially cause difficulty for those who have already received a certificate of compliance following the submission of their EIS1. However, HMRC confirm that they will not be applying their new interpretation in these circumstances and so investors should be unaffected.

Where shares have already been issued but a certificate of compliance has not yet been received, HMRC will authorise its issue only where they have given an advance assurance in accordance with Para VCM21010 of the Venture Capital Schemes Manual.

In cases where the shares have not yet been issued, the new interpretation will apply, even where a favourable advance assurance has been given. EIS relief will be denied.

Contributed by Robert Jamieson

Lecture B592 (3.50 Minutes)

EIS relief and the application of subscription monies

An individual who subscribes for shares in a company in circumstances which satisfy the EIS can obtain 20% income tax relief on a subscription of up to £500,000 in any one tax year. Furthermore, on the disposal of such shares after a period of three years, any gain is CGT-free.

One of the original conditions for the application of the EIS was a rule that at least 80% of the subscription monies had to be employed in the qualifying trade within a 12-month period, with the balance being spent in the following 12 months. Note that this requirement was relaxed in FA 2009.

The First-Tier Tribunal decision of *Skye Inns Ltd and Richards v HMRC (2009)* examines what is meant by the employment of funds in the qualifying trade.

Mr Richards had subscribed for shares in Skye Inns Ltd (Skye) in December 2001. At that time, the company intended to purchase a particular pub/restaurant. It was hoped that this acquisition would fund the losses of the other two restaurants which the company operated. Unfortunately, the purchase fell through. Had the transaction been completed, the combination of the purchase of the pub/restaurant, funding the losses of the other two restaurants and repairs and improvements to all three businesses would have easily ensured that 80% of the money subscribed by Mr Richards would have been employed in Skye's trade within the requisite period.

Although the directors continued searching for appropriate further acquisitions, they were unable to find a suitable alternative and finally reached the conclusion that the money was better spent in undertaking improvements to the company's existing properties.

HMRC argued that, where an acquisition was contemplated, the cash actually had to be used in the acquisition – merely reserving or earmarking it for the new purchase was insufficient. Indeed, they went on to say that simply entering into a contract to make the purchase did not meet this requirement. The Tribunal did not agree with this last point and took the view that exchanging contracts for a new business and binding the company to make the purchase may well be enough to satisfy the condition. Unfortunately, neither of these circumstances applied in this particular case given that there was not even a contract to acquire the new business.

The company also argued that, even though it had abandoned the intention of acquiring a new property, it was still employing the money in the trade because it was holding the funds to meet anticipated losses and to make capital improvements to the existing properties. However, there was no evidence that Skye had decided to use the money in this way until after the 12-month period had expired.

When looking at working capital requirements, the Tribunal stated that subscription monies did not have to be spent in order to satisfy the 'employed in the trade' test. Instead, the test could be passed if there was a genuine need for all the company's funds to be kept as working capital in order to meet business requirements, including the turning round of the restaurants from loss to profit. In this case, Skye had tried to argue that the gross costs of the business were met out of the subscription monies alone, with the gross trading income remaining unspent. The Tribunal concluded that the best approach was to treat the funds raised in the share issue as having been employed in the business only when they were actually used to increase the company's trading assets or when reserved to supplement the company's trading receipts.

HMRC won the case.

Contributed by Robert Jamieson

Lecture B593 (7.58 Minutes)

Dr Joanne Clinton

The taxpayer was employed by BMS in 1996. In 2003, her job was changed to the extent that she claimed it no longer matched the job she had taken on.

She considered herself to have been constructively dismissed and told her employer she expected to receive three months' salary in lieu of notice, as she was entitled.

The employer did not accept that she had been constructively dismissed, but agreed to pay her three months' salary less tax as a lump sum, as a gesture of goodwill.

When completing the relevant tax return, the taxpayer claimed that the sum was not taxable. HMRC disagreed. The taxpayer appealed.

The First-tier Tribunal, after considering the evidence, decided that the taxpayer had been constructively dismissed by the employer.

The judges' understanding was that a constructive dismissal took place where the employer acts in a way to repudiate the employment contract. This repudiation is accepted by the employee, who then gives notice to the employer.

With regard to the sum paid to the taxpayer, the tribunal noted that her original contract, which stated that one month's notice was to be given, was never amended to reflect three months' notice.

However, in fact the payment was not made under the terms and conditions of her employment.

Rather it was made as a result of the employer wishing to avoid the taxpayer taking proceedings in the employment tribunal for wrongful or unfair dismissal.

By accepting the payment, the taxpayer effectively compromised any claim she may have had for breach of contract.

Thus the payment was made either on an ex gratia basis or to settle with the taxpayer. In either event, it was exempt from tax under ITEPA 2003, s 401(1)(a).

The taxpayer's appeal was allowed.

Taxation, 19 January 2010

Hankinson v Revenue and Customs Comrs (No 2) TC 319

In 1982 the appellant, an extremely successful self-made businessman, became the managing director of the UK company, B. In 1985 he arranged a management buy-out and in 1987 he transferred his shares to non-UK resident family trusts. B was sold and the appellant remained as a director. In 1992 he reacquired B through the trusts and became chairman and chief executive. In September 1997 the trusts sold their holdings in B to a venture capital institution, whilst retaining an interest in B, and realised substantial capital gains. In February 1998 the appellant began working for M, a Dutch subsidiary of B in the Netherlands and M leased a furnished flat in Dordrecht for his use, but the appellant's wife remained in the UK at the family home. The appellant also remained as non-executive chairman of B and maintained his other investments outside the UK. In January 1999 the appellant went to Barbados for a month's holiday but became ill on the flight and required hospital treatment. He returned to the UK on 30 April 1999 but did not return to work in the Netherlands again. In March 1999 the substantial gains realised by the trusts crystallised. In his tax return for 1998/1999 the non-residence etc pages were completed to show that the appellant was not UK resident and not ordinarily resident and stated that he was "employed abroad under a full time working contract of employment". In August 1999 the appellant resigned from M and B. In January 2005 HMRC issued a discovery assessment under TMA 1970 s 29 on the basis that the appellant had been resident in the UK in 1998/1999. The assessment was made on the basis of additional material—including schedules of visits to the UK, departure times and flights, information relating to the wife's continuing residence in the UK and the appellant's Dutch tax return for 1998—which was not available in the 1998/1999 tax return. In November 2006 HMRC also issued a notice of determination that the appellant was ordinarily resident in the United Kingdom during that year. The appellant appealed against the discovery assessment and the statutory determination. He applied for a preliminary hearing to determine whether the discovery assessment was competent for the purposes of s 29 of the Taxes Management Act 1970, such hearing to be conducted separately and in advance of any hearing to determine the residence issue ([2008] STC (SCD) 377). That application was dismissed. The appellant also applied for judicial review of the applicability of IR20 ([2009] EWHC 1774 (Admin), [2009] STC 2158), and that application was adjourned pending specific findings of fact by the tribunal. At the hearing the appellant submitted: (1) he was not resident or ordinarily resident in the UK in 1998/1999. He argued: (a) the statutory tests and case law relating to residence had to be applied in the context of modern life. The state of "residence" was limited to an enquiry into the situation in a particular year of assessment and not about cultural, family and social connections, which were of less assistance in the context of modern conditions; (b) his fundamental "connection" with the UK had greatly diminished and changed from February 1998. His duties arising out of the M employment were performed outside the UK and his B role had been incidental to it; (c) the question was "Has he gone live abroad?" and the answer was, Yes; there was a distinct break in the pattern of his life. He met the criteria for TA 1988 s 335; and (d) the tribunal should depart from the "cluster facts" method of decision, in which a vast cluster of facts were put together and picked at as if each had some degree of greater weight than the others, following which the whole thing was weighed up and a decision was made; and (2) the discovery assessment was not valid. TMA 1970 s 29 required the officer to discover both that there was a loss of tax and that s 29(2) and (3) did not prevent him from making an assessment. HMRC contended: (1) the appellant was UK resident in 1998/1999. In particular, (a) the requirement to dwell permanently or for a considerable time was a relevant and useful principle in determining the question of residence; (b) the cultural, family and social connections all pointed to the appellant being resident and ordinarily resident in the UK; (c) the appellant did not satisfy TA 1988 s 335 and his UK duties were not simply incidental to his job with M. The fact that the appellant's wife was still in the UK was also relevant; and (d) on the facts the appellant had not been working full-time for M; and (2) TMA 1970 s 29 simply provided that HMRC could make an assessment if they discovered that there was a loss of tax, but that the assessment would not have effect for the recovery of the tax assessed unless certain conditions concerning that tax loss and its disclosure were met. In considering whether the conditions in sub-s (3) were met, the tribunal was not limited in its consideration to what was known at the time of the assessment.

The tribunal considered that in determining whether an individual had ceased to be resident and/or ordinarily resident in the UK, there was no acceptable alternative to the process of taking into account all the relevant evidence, however complex and extensive, and weighing up the respective facts and factors to be considered, in order to establish their relative levels of significance to the decision to be taken. Although changing communications and social conditions had to be dealt with in the context of reviewing residence, occasional residence and ordinary residence, there was no suggestion that the tests should be altered in any way to take account of such changes. In addition, where, as in the present case, the liability in question was limited to only one year of assessment, the enquiry was not limited to the situation in that particular year. There would be a degree of artificiality in confining the examination to that single year where, as was almost always likely to be the case, departure from the UK was likely to have occurred during the latter part of the preceding year of assessment. Moreover, cultural, family and social connections over a longer period were relevant to the question whether an individual was resident for tax purposes in the UK, and similarly to the question whether he was ordinarily resident in the UK. Furthermore, although TA 1988 s 334(a) referred to "purpose", the intention of the taxpayer was of limited relevance, even in that context, and the purpose of the stay abroad was to be established by means of the surrounding evidence established after the event, rather than the subjective intention of the individual concerned. Thus the process to be followed was to review the facts after the event rather than to attempt to establish the state of mind of the individual at the point of departure from the UK or at some point following departure.

The tribunal found that the appellant was resident and ordinarily resident in the UK for the year 1998/1999. In terms of TA 1988 s 334 the appellant's move to the Netherlands did not amount to anything more than occasional residence abroad. On the facts his work for M was not full time in the period 6 April 1998 to 30 January 1999; he was only available to work for M for 92 days during that period and he did not spend all of those 92 days on M's business. He was in the UK for 82 days including nights, and some of those visits were for the purposes of his duties as non-executive chairman of B. The retention of links to the UK and the limited nature of his work for M affected the nature of his stay and rendered his residence there only "occasional" and s 334 rendered him liable to assessment and charge to income tax on the basis specified in s 334(b). As the assessment for 1998/1999 related principally to tax on capital gains and s 334 related only to income tax, the appellant's chargeability depended on the presence or absence of residence and/or ordinary residence examined under common law principles. Applying those principles the pattern of the appellant's visits to the UK during 1998/1999, taken together with the family home where his wife continued to reside, was sufficient to demonstrate that he remained resident in the UK for that year. Furthermore as the appellant's employment with M was not full-time, he could not rely on TA 1998 s 335. Therefore the appellant's residence outside the UK during 1998/1999 was occasional in nature, and he had not ceased to be ordinarily resident in the UK before the beginning of 1998/19999. There was no distinct break in the pattern of his life.

For the purposes of the UK/Netherlands Double Taxation Convention (as set out in the Double Taxation Relief (Taxes on Income) (Netherlands) Order, SI 1980/1961), the tribunal found that the appellant was, at the time of the capital gain, resident in the UK alone. The words in the first sentence of art 4(1) in Sch 1 to the 1980 Order described liability to tax on the basis of residence ("by reason of his domicile, residence, place of management or any other criterion of a similar nature") as opposed to liability on a source basis. As the appellant was resident and ordinarily resident in the UK, he was a resident of the UK and not of the Netherlands for the purpose of art 4(1).

In relation to the discovery assessment under TMA 1970 s 29, the tribunal considered the relevant test to be that the officer must have an evidential basis beyond mere suspicion in order to arrive honestly at the conclusion that, on balance, there was an insufficiency. The test applying to the making of a discovery was subjective, in that the officer must have satisfied himself that that was the appropriate conclusion. However, the tests applying to the restrictions or conditions in sub-ss (2)–(5) were objective which removed them from consideration by the particular officer who made the discovery. They were matters to be tested in deciding whether the discovery assessment had been properly made. The words "the taxpayer shall not be assessed under that subsection" in s 29(2) and the corresponding words "he shall not be assessed under subsection (1) above" in s 29(3) did not mean that the officer was precluded from making a discovery assessment in the first instance; the words provided a means of testing whether the safeguards set out in s 29(2) to (5) precluded the assessment from taking effect in the taxpayer's particular circumstances, subject to the incidence of the burden of proof. In considering whether the s 29(3) conditions were met, the review was not confined to the information which was made available to the officer making the discovery assessment at the time when he made it. In respect of s 29(4) no specific time limit was mentioned. If fraudulent or negligent conduct was alleged, it would be necessary to examine the information covering the whole period up to the point of the taxpayer's final opportunity to correct matters by informing HMRC. In relation to s 29(5), a specific time limit was provided and the information under review was such documentation as at that time when the enquiry window closed. Although s 29(2) appeared to be self-standing, the words "subject to subsections (2) and (3) below" in s 29(1) meant that s 29(2) was an additional protection in a case where either the condition in s 29(4) or that in s 29(5) had been shown to be fulfilled. If neither of those conditions were to be fulfilled, it would not be necessary for the taxpayer to rely on s 29(2).

The tribunal found that the discovery assessment in the instant case was validly made. Without the disclosure of the additional items of information an officer could not reasonably have been expected, as at 31 January 2001 when the enquiry window closed, to have been aware of the insufficiency. Thus one of the conditions specified in TMA 1970 s 29(3) was fulfilled. In addition, the other condition in s 29(3) was met: the appellant's conduct in signing the return in the form it took, without then providing the information as to the time actually worked on M business and the time worked on B business and his other investments, amounted to negligent conduct within TMA 1970 s 29(4). The appellant was aware of the existence and importance of IR20; he knew or ought to have known when signing his tax return that he had not been working full-time in the Netherlands and had only been available to work for M for 92 days between 6 April 1998 and 30 January 1999, and that he had been unable to work through illness for over three months of the year. Furthermore, the appellant was not protected by s 29(2). It was clear from IR20 that if an individual went to work abroad and such employment was not full-time, or it was connected with unconnected work in the UK, he could not assume HMRC would treat him as neither resident nor ordinarily resident for the tax year in question.

Finally the tribunal found, for the purposes of the judicial review proceedings, that the appellant did not satisfy para 2.2 of IR 20 because he did not work full-time abroad; there was a significant break in work from 2 January 1999 to 5 April 1999 through illness; and his work for B meant that he had "a main employment abroad and some unconnected occupation in the UK at the same time" within the meaning of para 2.5.

The tribunal dismissed the appeals and confirmed the assessment and the statutory determination.

Appeal dismissed.

Austrian banker working in UK

An individual (T) was born in Austria in 1971. He became an investment banker. In July 1997 he began working for a bank in London. Initially he lived in rented accommodation, but in May 1998 he purchased a house in Notting Hill. On his tax returns for 1998/99 to 2000/01 he declared that he was resident in the UK, but not ordinarily resident in the UK. On his 2001/02 tax return he declared that he was ordinarily resident in the UK. In 2002 HMRC began an enquiry into his residence status, and subsequently issued a notice of determination that he had been ordinarily resident in the UK for 1998/99 to 2000/01 inclusive. T appealed, contending that he should only be treated as being ordinarily resident for 2001/02 onwards. The First-Tier Tribunal reviewed the evidence in detail, rejected this contention and dismissed T's appeal, holding that he had been ordinarily resident in the UK from 1998/99. Clark J held that, applying the principles laid down by Lord Scarman in *Barnet London Borough Council v Nilish Shah*, 'the determination of ordinary residence status requires objective examination of immediately past events, and not intention or expectation for the future'. The key question was at what point in time 'did the purpose of (T) living where he did (ie in the UK) have a sufficient degree of continuity to be described as settled'. On the evidence, T had 'become ordinarily resident during 1998/99' when he had chosen 'to remain in London for a settled purpose, namely his employment, and adopted a pattern of living which in fact continued until 2002 (and, with certain changes, subsequently)'.

A Tuczka v HMRC, FTT [2010] UKFTT 53 (TC), TC00366.

Turberville – Ordinary residence

An individual (T) was born in Scotland in 1951. He lived and worked in the UK until 1979, when he began to work for an international oil company (S). He retained ownership of a house in the UK, and was posted back to the UK in February 1997. He left S in October 1998, and in 2001 he accepted a three-year contract to work in the USA, with effect from 1 July. However he was made redundant in October 2002. In December 2002 he leased a property in Monaco. During 2002/03 he spent a total of 140 days in the UK, 22 of which were attributable to the death of his mother. HMRC issued a determination that T was ordinarily resident in the UK for both 2001/02 and 2002/03. T appealed. The First-Tier Tribunal dismissed his appeal for 2001/02, but allowed his appeal for 2002/03, holding on the evidence that he had 'continued his previous ordinary residence in the UK from 6 April 2001 to around 1 July 2001 and there was then a distinct break in his residence'. Although he had returned to the UK in late 2002 before moving to Monaco, this had been 'a time of transition' during which he did not have 'a regular order of life anywhere'.

PG Turberville v HMRC, FTT [2010] UKFTT 69 (TC), TC00381.

Deduction for clothes

A television newsreader claimed deductions for the cost of purchasing and laundering the clothing which she wore while reading the news, and for the cost of having her hair done. HMRC rejected the claim and she appealed, contending *inter alia* that she did 'not need the clothes for warmth as it is warm inside the studios, and that she would be prepared to read the news without clothes and only wears the clothes because her employer requires it'.

The First-Tier Tribunal rejected this contention and dismissed her appeal, applying the principles laid down in *Hillyer v Leeke*. Staker J did 'not accept as realistic that she could perform her duties without wearing any clothes at all if she were not required by her employer to do so'. He observed that 'the clothing in this case is ordinary everyday clothing, there is nothing about the clothing that restricts the use of any particular outfit only to work, and the appellant has not established that there is any contractual requirement for the expenditure'.

Ms Sian Williams v HMRC, FTT [2010] UKFTT 86 (TC), TC00397.

Capital Gains Tax

Associated disposals – examples of restrictions

Where an individual qualifies for entrepreneurs' relief on the disposal of, say, shares, he can also obtain relief under S169K TCGA 1992 for the associated disposal of an asset used by his company. Typically, this will be property which is personally owned by the individual and has been used by the company for business purposes, but it can also cover the sale of intellectual property such as goodwill which is held outside the company by the vending shareholder.

Conditions

Legislation requires various conditions to be satisfied before an associated disposal qualifies:

- The vendor must make the associated disposal as part of his 'withdrawal from participation' in the business carried on by the company (or partnership). It is understood that HMRC interpret this requirement in the same way as they did for the corresponding retirement relief provisions. Thus the 'withdrawal from participation' test can be met by simply disposing of *part* of his shareholding (or partnership interest) – see Para CG63995 of the Capital Gains Manual. It would appear that, in the case of shares, the disposal of a single share will suffice. There is no need for the vendor to reduce his workload.

- Throughout the one-year period prior to the disposal of the shares (or partnership interest), the relevant asset should have been used for the purposes of the trade. This rule is quite restrictive – it means that the sale of the property some time *before* the sale of, say, the shares would not qualify, given that the property would not then have been used for the purposes of the company's trade up to the date of the share sale.

Scaling relief down

In addition, entrepreneurs' relief on an associated disposal can be scaled down under S169P TCGA 1992 on a 'just and reasonable basis' to reflect cases where:

(i) the asset was used for trading purposes for only part of the period for which it was owned;

(ii) only part of the asset was used for trading purposes;

(iii) the vendor was involved in the carrying on of the trade for only part of the period for which the asset was in use by the company (or business); and

(iv) a rent was charged – but only on or after 6 April 2008 – to the company (or partnership) for its use of the property.

Relevant adjustments

In HMRC's view, the relevant adjustments are as follows:

- In (i) above, the adjustment should reflect the length of the period of business use. Thus, where a property has been owned by the vendor for 12 years but has only been used by his company for the last eight years, 8/12ths of the gain should qualify for entrepreneurs' relief.

- In (ii) above, the adjustment should reflect the part of the asset which was used for trading purposes. No guidance is given on whether, say, asset value or floor area is the more appropriate measure. The vendor is therefore free to adopt the most tax-effective approach.

- In (iii) above, the adjustment should reflect the length of time for which the vendor was involved in the carrying on of the business.

- In (iv) above, the adjustment should reflect the extent to which any rent paid on or after 6 April 2008 is less than the full market rent for that asset. Remember that rent is defined in S169S(5) TCGA 1992 as 'any form of consideration given for the use of the asset'.

Illustration

On 5 April 2010, Maurice sold his one-third interest in his family trading company to his cousin, making a gain of £115,000. He had been a shareholder director of the company for the last 10 years.

Throughout that time, he had also personally owned the property from which his company traded. For the first four years, Maurice had made no rent charge to the company, but, on the advice of his accountant, he had (since 6 April 2004) charged a full market rent. This was reduced on 6 April 2009 to two-thirds of a commercial rent.

At the same time as Maurice disposed of his shares, he also sold the property to a pension fund, making an 'associated' gain of £240,000.

He claims entrepreneurs' relief on both disposals and has made no previous claim. What is his relief?

Overall gain on property	£240,000
Gain accruing from 6 April 2000 – 5 April 2008 (8/10 x 240,000) – qualifies in full	£192,000
Gain accruing from 6 April 2008 – 5 April 2009 (1/10 x 240,000) – does not qualify	£24,000
Gain accruing from 6 April 2009 – 5 April 2010 (1/10 x 240,000) – qualifies as to one-third	£24,000

The gain on the property which attracts relief is:

	£
Gain for first eight years	192,000
Gain for final year (1/3 x 24,000)	8,000
	£200,000

Maurice's total gains attracting entrepreneurs' relief are:

	£
Property	200,000
Shares	115,000
	£315,000

The chargeable gain after entrepreneurs' relief is therefore:

		£
Gain on property		240,000
Gain on shares		115,000
		355,000
Less:	Entrepreneurs' relief (4/9 x 315,000)	140,000
		215,000
Less:	Annual CGT exemption	10,100
		£204,900
CGT @ 18%		£36,882

Where any form of rent has been charged for the use of the property, the adviser should provide a computation along these lines. They should also give their view of the average market rent for the period concerned. HMRC officers normally seek advice from the Valuation Office Agency.

Contributed by Robert Jamieson

Lecture P593 (19.24 Minutes)

More on Mansworth v Jelley

Where shares were acquired on the exercise of an unapproved option prior to 10 April 2003, the employee was treated as having bought those shares at market value for CGT purposes. However, as a result of the *Mansworth* decision, his base cost was enhanced by the amount on which he paid income tax. In many cases, this effectively doubled the allowable cost. On 8 January 2003, HMRC had issued a detailed statement, explaining how these bizarre consequences came about and, although the position was non-retrospectively reversed in FA 2003, a large number of taxpayers banked huge losses on the basis of this HMRC guidance.

Last year, HMRC decided that they were wrong after all. They now say that the shares' base cost should *not* be augmented by the amount chargeable to income tax on the exercise of the option. HMRC intend to apply their new understanding of the law to cases where there is an open enquiry or appeal and they indicate that those affected by this change may need either to amend their relevant self-assessment returns or to submit returns using the revised interpretation.

It is no surprise that this announcement has given rise to a number of problems and, on 11 September 2009, HMRC issued Revenue & Customs Brief 60/09 setting out answers to various questions. For the most part, the answers are perfectly reasonable, but it is a mystery why we should have to put up with this at all. Whatever the merits (or otherwise) of the original statement, it was at least based on a judicial decision. If HMRC did not want to live with the consequences of that decision, why did they not appeal against the judgment? It was a bad call, but issuing guidance and then, six years later, putting out a contradictory statement was always going to cause trouble. The point was dealt with by FA 2003 and so the sensible course of action would surely have been to leave well alone.

The new statement explains that it was not possible, before 1996/97, for losses to be determined – they can only be considered when they come to be used. Accordingly, HMRC say that, if there are any unused losses arising in respect of pre-1996/97 disposals which would have been enhanced by the application of their 2003 guidance, that enhancement will be lost. However, this scenario must be rare.

For losses which arose in the self-assessment era, the enhanced relief will continue to be available provided that the enquiry window has closed. Such losses are available for carry-forward even against gains accruing in 2009/10, notwithstanding HMRC's new view. But where an individual's tax return containing the losses is under enquiry and/or the enquiry window has not closed, the enhancement is no longer available and the losses must be reduced accordingly.

It is interesting to note that HMRC do not generally accept that their published guidance in January 2003 created any sort of legitimate expectation on the part of the taxpayer. It is difficult to understand why not. It would perhaps be fair to say that, despite any assumed legitimate expectation, no loss has been incurred by the taxpayer because, if the losses have not yet been used, the taxpayer has not suffered any detriment as a result (mere disappointment or upset not being enough). However, the concluding words of HMRC's recent announcement should be borne in mind:

> 'Whether a taxpayer has a legitimate expectation will depend upon the specific facts and circumstances of the case. Chargeable gains and allowable losses included in returns or claims should be calculated on the correct statutory basis which HMRC now understand to be as described in Revenue & Customs Brief 30/09. HMRC's primary responsibility is to apply the law correctly and collect underpaid or underdeclared tax. However, in some limited circumstances, to apply the statute may be so unfair as to amount to an abuse of power by HMRC and, in these circumstances, HMRC may be bound by its previous guidance. We will normally be bound by our previous guidance where the taxpayer can demonstrate that he or she:
>
> (i) reasonably acted in reliance on the previous guidance; and
>
> (ii) would suffer detriment from the correct application of the statute.
>
> To have acted in reliance on the advice, the taxpayer must have done, or refrained from doing, something as a direct consequence of the advice.'

It will be interesting to see how many taxpayers seek to take advantage of this concession!

Contributed by Robert Jamieson

Lecture P594 (16.09 Minutes)

Karim v Revenue and Customs Commissioners

The appellant, who was born in Tanzania but had been resident in the UK for several years, operated two care homes in Beccles. In 1991 she transferred the business to T Ltd. The appellant was the owner and director of T Ltd. Until 2000 the appellant's management of the business was direct, but in April 2000 N Ltd, a non-UK incorporated and registered company, agreed to provide professional services to T Ltd and the appellant was employed by N Ltd. The appellant's duties under the agreement were those of senior management, direction and care of the homes. In about 2000 the appellant started living in Portugal and in 2003 she started working for or with a Portuguese enterprise. In November 2003 she sold her shares in T Ltd for £250,000. The appellant also had two other properties in the UK, one of which she rented out and the other which she used as her main residence when she was in the UK. In the tax year 2003/2004 the appellant disposed of those two properties. HMRC issued an assessment to capital gains tax (CGT) of about £112,000 on those disposals, on the basis that the appellant was resident, or ordinarily resident, in the UK for the purposes of TCGA 1992 s 2(1). The appellant appealed contending (1) that she was neither resident nor ordinarily resident in the UK in that year; or (2) in the alternative, if she was found to be in the UK, it was 'for some temporary purpose only' within the meaning of TCGA 1992 s 9(3) and (4) as her mother had been ill and she was tying up her business. She submitted that (i) she had moved her focus from the UK to Portugal in 2000 and thereafter she had gradually further reduced her ties in the UK; (ii) even if she did not cease to be UK resident on 28 April 2000 it was clear that by May 2003 she had ceased to be UK resident: by that time she had extinguished her ties to the business and had taken up employment with a Portuguese company; (iii) after April 2003 her contact with the UK was limited to the severing of her links with this country: her presence here was not as a resident; and (iv) after April 2003 it could not be said that the ordinary pattern of her life was that she was resident here: ordinarily she was resident in Portugal. HMRC argued: (i) the appellant remained resident in the UK until at least 2003/04. Until 2003 she had a UK abode, had UK business interests, and was present in the UK and her Portuguese employment only started in 2003; (ii) applying the exercise for determining UK residency/non-residency set out in "IR 20 Residents and Non Residents—liability to tax in the United Kingdom"—based on the number of days spent by the taxpayer in the UK in any tax year as exceeding 91 days on average or 183 days in total—it was clear that the appellant did not take up any employment outside the UK until 2003, her employment with N Ltd was not outside the UK despite its N Ltd having a non-UK incorporated and registered office, and that in any event there was no good evidence that the 91-day-rule was satisfied.

Applying the principles established by the case law, the tribunal found that the appellant was resident in the UK during part of the relevant year of assessment, namely 2003/04. On the facts the appellant was resident in the UK between 5 April and early November and October 2003. Until about November 2003 she had a settled abode in the UK: she had lived here a long time and spent a significant amount of time in the UK and her visits were frequent. She had business to attend in the UK and family ties. The dates of her arrival and departure indicated that her visits to the UK were frequent and generally of at least several days' duration. In the period 2000 to December 2002 it was likely that the appellant visited the care homes at least twice a week, and that between January and May 2003 it was likely she visited them at least once a week or ten days. Although she might have performed a monitoring role remotely from her home in Portugal, the nature of her duties under her contract where such that they could not have been performed without regular personal presence, and the lightweight evidence of her change of focus was not enough to establish that she did not visit regularly and frequently to attend to their management. The fact that she might also have been resident in the Algarve was irrelevant. For the purposes of TCGA 1992 s 9(3) and (4), it was not proven that all of the days of her presence in the UK were because of her mother's illness, albeit some of it might have been for that purpose. The appellant also partook in business in that period—which was not a temporary purpose. Her presence after November 2003 indicated continuing purposes which were not transient or to supply passing needs. Therefore TCGA 1992 s 9(3) and (4) did not prevent the appellant being resident in the UK in 2003/04. It followed that the appeal would be dismissed.

Appeal dismissed.

Tribunal: Charles Hellier (Judge) and Elizabeth Bridge (Member), 16 December 2009

Company purchase of own shares

Ordinarily this would constitute a distribution equal to the difference between the proceeds and the original subscription price. The shareholder then pays income tax at a maximum rate which is effectively 36.1% of the “profit” for those with taxable income of at least £150,000 and that of course includes the gross equivalent of the distribution.

CGT treatment will usually create a lower tax liability, and with full entrepreneurs’ relief the maximum tax is 10% of the first £2 million of gain (18% thereafter). To qualify for CGT treatment all of the following conditions have to be met:

- purchase is wholly or mainly for the benefit of the trade
- purchase is not part of a scheme to enable owner to participate in profits without receiving a dividend, or to avoid tax
- vendor UK resident and ordinarily resident in tax year of purchase
- shares owned for at least five years (reduced to three years if inherited, and the deceased’s ownership period can also be added)
- vendor not connected with company immediately after the purchase; this involves not holding over 30% of issued ordinary share capital or of loan capital and issued share capital or of voting power, and in practice this means careful consideration of the position of associates which for this purpose excludes children (unless minors); brothers; sisters

Advance clearance is available under Section 225 TA1988, and at the same time Section 701 ITA2007 clearance should be sought under the transactions in securities anti-avoidance provisions.

The benefit of the trade test should be satisfied in any of the following circumstances:

- buying out a dissenting shareholder
- a controlling shareholder retires to make way for new management
- a shareholder who provided equity finance wants to withdraw the finance
- a shareholder dies and the new owner of the shares does not wish to keep them

HMRC’s comments on this are in *IRSP 2/82* and *Tax Bulletin 21*. Relevant points from these and other more recent sources include:

- Retention of a small sentimental stake is acceptable (say maximum of 5%). Although technically CGT treatment is available where the vendor is only substantially reducing his shareholding (so that he holds not more than 75% of the proportion he held immediately before the buy back), in many situations this would result in the trade benefit test not being met.
- Vendor could have a short-term consultancy with the company to ensure a smooth handover. HMRC nowadays seem to accept that staying on as a part-time employee does not mean that the “benefit of the trade” test is failed.
- All the requirements of the Companies Acts must be met. The prohibition on a private company providing financial assistance for such an acquisition no longer applies. There is also no longer any requirement for a company to have authorisation in its articles for a buy-back of its own shares, but the articles can prohibit or restrict it.
- The vendor could lend back some of the proceeds, but then the 30% connected persons formula may be a problem in which case a bonus issue could be made as a means of increasing the issued share capital before the buy back
- Another possible solution, where the full proceeds cannot be paid in one go, is for the company to buy back the shares in stages, but then the trade benefit test may not be met. The alternatives are:
    1. A single unconditional contract with successive tranches of the shares being sold on specified dates. State how many shares are initially being sold, and how many

are to be sold at a later specified date. The later sale is subject to the 30% test but the proceeds of that later sale do not form part of the loan capital test, as per *Tax Bulletin Issue 21*. The vendor retains voting rights until completion date and the proceeds have been paid. The 30% test therefore applies to the shares but not to the proceeds.

2. Two or more separate purchases are made because of the company's cash-flow position. Payment is made in full on the contract dates. The 30% test therefore applies to the shares only.
3. A single unconditional contract is entered into, with multiple completion dates. The beneficial ownership of the shares passes at the date of the contract but the CGT liability may be payable earlier than would otherwise be the case and this could be before all the consideration has been received. In this arrangement, the vendor would agree to waive any rights to dividends etc from the date of the contract. A clearance application would be made under Section 225 TA1988 by reference to the single disposal.

- Company law requires all of the consideration on a buy-back to be paid when due, with nothing left outstanding. HMRC accepts that where consideration is deferred under the terms of the contract until completion date, this requirement is met.

Contributed by Gerry Hart

Lecture P595 (11.38 Minutes)

Inheritance Tax and Trusts

Futter and anor v Futter and ors [2010] EWHC 449 (Ch)

Without being fully aware of the capital gains tax consequences, the first claimant trustee along with his co–trustee, the second claimant, in the exercise of their permitted discretion under the deed of trust, advanced the entirety of a trust fund to the first claimant and his children. The amounts advanced were in excess of their annual capital gains tax exempt amounts. In so doing the first claimant considered that any gains under the advance could be offset under s 89 of the Capital Gains Tax Act 1992 against personal losses and in consequence no capital gains tax charge would occur. Unfortunately s 89 did not apply in all the circumstancs as s 2(4) prohibited its application. As a result, the advancements had a very different fiscal effect to that which had been anticipated with the beneficiaries being liable for significant capital gains tax liabilities. The trustees applied for a declaration that the advancements were void and of no effect on the basis of the rule in Hastings–Bass; that being that trustees could be released from the consequences of the exercise of their discretion where they had failed to exercise that power properly. The revenue commissioners, inter alia, opposed the application.

The issue was whether the trustees could benefit from the rule in Hastings–Bass.

Where trustees had acted under a discretion given to them by the terms of the trust, in circumstances in which they were free to decide whether or not to exercise that discretion, but the effect of the exercise was different from that which they intended, the court would interfere with their action if it was clear that they would not have acted as they had done had they not failed to take into account considerations which they ought to have taken into account, or taken into account considerations which they ought not to have taken into account. The rule existed not to relieve advisors from the consequences of their mistakes, it existed to ensure that beneficiaries did not suffer by an invalid exercise of a power by trustees (see [4] and [29] of the judgment).

In the instant case, the claimants had been given discretion in circumstances in which they were free to decide whether or not to exercise it. They chose to exercise it but the effect of the exercise was different from that which they had intended. In each case the claimants believed that the gains would be attributed to the beneficiaries under s 89 of the Act could be offset by the personal losses that had been incurred and in consequence no charge to capital gains tax would arise. On the evidence it was clear that the claimants would not have acted as they had done had they not failed to consider s 2(4) of the Act. The claimants had failed to consider the true fiscal consequences, and had they done so would not have acted as they had done because minimising the capital gains tax payable on the extraction of the funds from the settlement was a priority. It was the perceived tax consequences which determined the form of advances (see [18] and [27] of the judgment).

The consequences, in the instant case, of involving the rule in Hastings Bass was to make the deed or transaction void (see [33] and [34] of the judgment). The application would be allowed.

Chancery Division Norris J 11 March 2010

Linda Frances Chadwick and another (Hobart's executors) v CRC

The executors of a will disputed HMRC's valuation of the deceased's property. Shortly after the will-maker's death, the executors had obtained valuations from two local estate agents, both of whom valued the property at £250,000. It was subsequently refurbished and is now used as a holiday home.

More than a year later, after the refurbishment, the Revenue visited the property and proposed a value of £300,000. The appellants sent the taxman a detailed report in support of their valuation, in light of which a department inspector said he would compromise at £275,000.

The taxpayers appealed.

The tribunal judge noted that the deceased had bought the property privately rather than on the open market. Thus, the purchase price – £268,450 – did not conform to the definition of market value in IHTA 1984, s 160, and should not have been taken into account by HMRC in arriving at their valuation.

The judge decided to use sales of similar properties, also used by the Revenue, to reach a conclusion. The more expensive of these was in a different village from the property under appeal, which made comparison more difficult. However the other two led the judge to agree with the taxpayers' valuation of £250,000.

The taxpayers' appeal was allowed.

Marquess of Linlithgow and another v CRC, Court of Session

On 15 March 2006, the first appellant made two gratuitous dispositions of land in favour of himself and the second appellant as trustees of an accumulation and maintenance trust.

The dispositions were delivered to the trustees on that date, but one was recorded in the Register of Sasines in October 2006 and the other in November 2006.

HMRC said that the transfers were not potentially exempt because they were recorded after 22 March 2006, and therefore the first appellant was liable for the inheritance tax on them.

Finance Act 2006 amended IHTA 1984 to the effect that a gift into an accumulation and maintenance trust was a potentially exempt transfer only if made before 22 March 2006.

The taxpayers appealed saying that the gifts had been effected by the delivery of the dispositions and were thus potentially exempt.

The Court of Session explained that HMRC's view was that the value of heritable objects in Scotland was only transferred when they were recorded.

Delivery of a disposition did not mean that the asset had been transferred. Until it was recorded, the transferor remained beneficially entitled to it. This argument, said the court, was misconceived.

When an object was delivered, the uninfeft (unregistered) owner had power to dispose of it and was beneficially entitled to it under IHTA 1984, s 5(2). The delivery of a gratuitous disposition meant there had been a transfer of value within s 3(3).

The taxpayers' appeal was allowed.

Pitt and anor v Holt and anor [2010] EWHC 45 (Ch)

The first claimant's late husband was seriously injured in a road traffic accident. He became entitled to a significant sum of money in a compromised damages claim made in respect of that accident. The first claimant, as receiver for her husband under the Mental Health Act 1983, put those funds, which were needed for her husband's care, into a settlement. The claimant's husband subsequently died. The Revenue took the view (which was not contested) that the form of settlement adopted was such that a liability to inheritance tax arose under the Inheritance Tax Act 1984; the tax becoming payable: (i) on the creation of the settlement; (ii) on subsequent capital distributions; (iii) after ten years; and (iv) on the husband's death. The inheritance tax position had not been taken into account at all by the first claimant and her advisors when the settlement was set up (although the income tax and capital gains tax position had been considered). If it had been appreciated, it would have been clear that it would have had a serious impact on the worth of the husband's damages. However, the problem could readily have been resolved by the adoption of a different form of settlement. The first claimant applied for a declaration that she was entitled to unravel the settlement and a related assignment. She argued, relying inter alia on the rule in *Hastings–Bass*, that the settlement and assignment could be avoided because the inheritance tax position was simply ignored at the time the arrangements were made. The Revenue contended that the rule in *Hastings–Bass* did not apply in the instant context to a receiver under the Mental Health Act as opposed to a trustee, and in any event that the development of the rule in case law had taken a wrong turn.

It was held that there was no material distinction in principle between a trustee exercising a power for the benefit of a beneficiary under a trust instrument and a receiver exercising a power for the benefit of a patient pursuant to the Mental Health Act 1983. In each case the power was a fiduciary one. In each case the person exercising the power was doing so in the interests of another, but was not acting on the instructions of that other. The critical point in the instant case was whether it was for the first claimant to decide whether or not it was in her husband's interest for her to dispose of his property to trustees under a settlement. The rule in *Hastings–Bass* was applicable to the instant case. Moreover, the instant case was a clear–cut case on its facts for application of the rule in *Hastings–Bass*. First, it was obvious that anyone considering whether or not to enter into a discretionary settlement ought to take the tax, including inheritance tax, consequences into account. As it was, the value of the husband's damages was seriously reduced by a large, but wholly unnecessary, charge to inheritance tax. Secondly, it was clear that the question of inheritance tax was simply not addressed by any of the first claimant's advisers and therefore not by the first claimant herself. Thirdly, there could be no doubt that had the first claimant appreciated at the time that the settlement was going to give rise to large inheritance tax liabilities, she would not have entered into the settlement and assignment as her husband's receiver. If followed that the rule in *Hastings–Bass* applied and that the settlement and the assignment could be set aside as ineffective transactions. The application would be allowed.

Chancery division Robert Englehart QC sitting as a Deputy Judge of the High Court

21 October 2009, 18 January 2010

Administration

Adrian Waddington

The taxpayer is a chartered mechanical engineer who is an employee subject to the PAYE system.

He had received and had completed self assessment tax returns during the 1990s because he had investment income to declare and expenses to claim. The issue of these forms had then ceased, and forms P810 were issued and completed instead.

In April 2008, the taxpayer received a tax review form P810 for 2007/08, which he completed and returned to HMRC on 25 September 2008.

On 13 January 2009, HMRC wrote to the taxpayer stating that, although he had completed a form P810, he had to complete a self assessment tax return, and this was subsequently received at the end of January 2009. It included the statement to the effect that the deadline for submission of the return was three months later (effectively 29 April 2009).

The page SA102 was missing. After the taxpayer obtained the form, it was submitted on 13 April 2009 with a covering letter.

On 19 June, HMRC issued a calculation showing a tax liability of £4,390. The taxpayer had not previously received a bill of such an amount and was confused as to how this had arisen. The Revenue's helpline was unable to assist, and when the taxpayers visited the department's Hull office on 15 June he was told the computer 'was down'.

Consequently, the taxpayer had to obtain advice from an accountant; the liability was paid on 20 June 2009.

The taxpayer appealed against HMRC's issue of a surcharge of £219.52, claiming he had a reasonable excuse for late payment. The Revenue's review upheld the charge and the case went to the tribunal, which found that the taxpayer had a reasonable excuse throughout the period.

The P810 form advised him that if he had paid too much or too little tax HMRC would be in contact. The self assessment form did not 'clearly and unambiguously' notify the taxpayer of payment deadlines; the Revenue had delayed processing the firm until June 2009, by which time the 5% surcharge deadline had, unbeknown to the taxpayer, passed.

The taxpayer had done his best to understand the tax calculation, and within five days of the unproductive HMRC interview he had paid the tax. The tribunal found that 'a reasonable taxpayer would have difficulty in understanding the forms issued by the taxman in their current wording', and he had been misled by the department.

The case was distinguished from *Bancroft v Crutchfield* [2002] STC (SCD) 347, which involved a firm of solicitors who were used to completing tax returns and who had deliberately delayed submission of a return. The surcharge was consequently discharged and ordered to be repaid to the taxpayer.

Cormac Construction Ltd (TC315)

The husband set up a construction company and his wife carried out the paperwork, fitting it in with her separate full-time job and childcare arrangements for their three children.

The company was registered for gross payment status. Following a review, HMRC cancelled its registration on the basis that the company had not complied with its tax obligations and so did not satisfy the compliance test (FA 2004, Sch 11 pt 3 para 12).

The company appealed. It claimed that the wife genuinely believed that PAYE payments were due on 28th of the month, rather than 22nd and that she had to cope not only with working around her full-time job and childcare, but also the serious illness of one her children.

The First-tier Tribunal said that the mistaken belief as to the correct date of payment could not constitute reasonable excuse.

However, the difficulties that the wife, who dealt with the payments, had to cope with, i.e. juggling her full-time job and childcare duties, especially in the school holidays, did amount to a reasonable excuse for the late payments for the periods to 5 December 2007 and 5 February 2008.

The tribunal then said that under reg 32 of the Income Tax (Construction Industry Scheme) Regulations 2005 SI 2005/2045, a company satisfied the compliance test if, during the 12-month review period, there were no more than two prior late payments to the late item considered.

This effectively allowed three late payments in the period. In the instant case, with regard to the remaining late payments for which the company did not have reasonable excuse, they were made within 14 days of the due date. Thus the company was to be treated as complying with its obligations.

The company's appeal was allowed.

Appeal against penalties allowed

HMRC imposed penalties totalling £560 on an individual (F), for failing to submit his income tax returns for 2004/05 and 2005/06 until 2009. F appealed, contending that he had previously submitted the returns in question, and that the returns which he had filed online in 2009 had been duplicates. The tribunal observed that HMRC's records showed that they had received F's 2004/05 return in January 2006, but had returned it to F on the grounds that it was incomplete. HMRC had written to F at a farm although F had written to HMRC from a flat in a town. HMRC had failed to explain why they had continued writing to F at an address which differed from the one which he had given them in correspondence. F's evidence had 'a ring of truth about it' and HMRC had not proved that he had failed to submit the returns by the due date.

P Frossell v HMRC, FTT [2010] UKFTT 80 (TC), TC00392.

Pegasus Management Holdings SCA and anor v Ernst & Young (a firm)

The defendants were accountants and tax specialists. The second claimant was their client and they had advised him on his personal tax affairs and on the tax liabilities of his companies. The sale consideration was paid in loan notes. The second claimant was keen to avoid or mitigate any potential tax liability. Following advice from the defendants, the second claimant decided that he would establish a new Luxembourg company with a view to making a substantial capital subscription in it by 6 April 1998. The first claimant Luxembourg company was incorporated on 26 March 1998. The second defendant subscribed $40,000 capital in return for shares. On 31 March 1998, the first claimant resolved to increase its share capital by the creation of 1,500,000 new shares of US$100 each. The second claimant sold some of his loan notes for about $150m (then worth about £90m) and on 2 April 1998, used it to subscribe for further shares in the first claimant. As at 2 April, the first claimant's assets were represented by cash and the second claimant's by shares in the first claimant. In order to qualify for roll-over relief, the first claimant needed to invest the £90m in "qualifying trades" in the UK. It therefore had to make the first investment by 2 April 2000 (two years from the share subscription) and to invest the full amount by 2 April 2001 (a year thereafter). The second claimant took advice on that. By about October 1999, the first claimant had identified Lister Healthcare Group Ltd (Lister) as an acquisition target. The defendants knew of that by 12 November, and produced a memorandum stating, inter alia, that it would be beneficial for the acquisition to be of assets rather than shares. Despite the defendants' contrary advice, the acquisition proceeded as a purchase of Lister shares, not assets. On 9 March 2000, the defendants' advised the second claimant that, in consequence, and in order to satisfy the reinvestment relief requirements, it would be necessary for the assets and trading activities of Lister to be hived up to the first claimant after the acquisition. The defendants advised that that would not trigger immediate capital gains tax liabilities but that the first claimant would inherit Lister's original base cost of each asset. The first claimant entered into the Lister share agreement on 16 March 2000. The hive up followed. The first claimant purchased seven healthcare businesses and a property. In October 2002, the first claimant discovered a problem which meant that if it were to sell one of the businesses for less than the amount that it had paid for it, but more than that the base cost at which it was taken to have acquired the assets for corporation tax purposes, it would still be making a capital gain (the adverse consequence). On 1 November 2004, the first claimant was hived down into subsidiaries. The claimant commenced proceedings against the defendants in negligence. It alleged, inter alia, that the defendants had negligently breached the duties owed to the claimants in failing to advise them, by 2 April 1998 (the final cut-off date by when it is agreed such advice had to be given), that subsidiaries of the first claimant should be established before the second claimant's second subscription for shares; or at least that the first claimant should by then form a properly documented intention to form subsidiaries through which qualifying trades acquired in the future could or would be carried on. The judge concluded that the first claimant had no reasonable prospect of proving at trial that, prior to 2 April 1998, it had entered into any contract with the defendants for the provision of professional services to it or that the defendants owed it a duty of care in tort. He further found that authority established that in the field of professional negligence a different answer was required, namely one to the effect that in a case in which, because of a failure of the professional to exercise due care and skill, the client did not secure the benefit that he should have secured, damage was suffered when the transaction took place. In the event, he found that damage had been suffered by 2 April 1998 so as to complete the tort. The claimants appealed.

The issues were whether: (i) the tort claims were time-barred; and (ii) whether the defendants owed a duty of care to the first claimant. The claimants submitted that there was no evidence that either of them had suffered any loss at 2 April 1998 and that the burden of proving a loss rested on the defendants.

(1) Damage sufficient to complete the tort of negligence would or might be caused in a "wrong transaction" case by the fact that, as a result of the defendant's negligence, the claimant had not received what he ought to have received. It was, in particular, not necessary to show that the claimant was immediately put into a position in which he was financially worse off than he would have been had the defendant not been negligent. The "wrong transaction" cases did not represent any exception from the general tort principle that actual damage had to be suffered before the tort was complete. Moreover, there was no presumption that the non-delivery by the defendant of what the claimant ought to have received meant that the relevant damage had been suffered (see [82], [83] of the judgment).

If a professional defendant was instructed by his client to achieve a certain result and he negligently achieved a different result that was equally valuable in monetary terms but did not give the client what he ought to have received, it would be surprising if he could answer the client's claim by saying he had suffered no financial loss (see [82] of the judgment).

In the instant case, there was no certainty that the second defendant would suffer the adverse consequence. Whilst the second claimant was not inevitably doomed to suffer the adverse consequence; he had been tied into a commercially disadvantageous straitjacket. The defendants' alleged failure had caused the second claimant actual damage for the purpose of completing the tort of negligence. The judge had correctly concluded that the fact that the second claimant had emerged from the transaction without getting what he ought to have got constituted the suffering of relevant damage. In all the circumstances, the judge had reached the right conclusion on the issue as to whether the second claimant's claim was time-barred (see [80]-[82], [86] of the judgment).

Baker v Ollard and Bentley (a firm) 126 Sol Jo 593 applied; *Moore (DW) & Co Ltd v Ferrier* [1988] 1 All ER 400 considered; *Bell v Peter Browne & Co* [1990] 3 All ER 124 considered; *Knapp v Ecclesiastical Insurance Group plc and Smith* [1997] All ER (D) 44 considered.

(2) The first claimant had no real prospect of proving that the defendants owed to it a duty of care. There was no issue that merited a trial. No retainer had been entered into; there was no contact between the defendants and anyone on the first claimant's behalf during the relevant days; and there was no need for advice to be given to the first claimant on matters relating to its structure, such advice being exclusively a matter for the second claimant. In the circumstances, there was no factual basis for any finding of an assumption of responsibility by the defendants towards the first claimant. Accordingly, that part of the claimant's claim had no real prospect of success (see [78] of the judgment). The appeal would be dismissed.

Decision of Lewison J [2008] All ER (D) 101 (nov) affirmed.

Court of Appeal, Civil Division Sir Mark Potter P, Rimer LJ and Sir John Chadwick

12 March 2010

R (on the application of Valentines Homes & Construction Ltd) v CRC

A construction company failed to pay its PAYE in 2007 for the four months from May to August. HMRC issued two notices on the appellant under the Income Tax (PAYE) Regulations 2003, reg 78(4), demanding payment of the tax due within seven days of the issue of the notice.

Later, HMRC instituted proceedings in the county court against the appellant, claiming around £84,000 and a court fee of £630. The appellant admitted that it owed more than £60,000 in tax, but no more than that.

After four months, HMRC replied saying that because the appellant had not provided the actual figures in time, the department would not amend its claim. The appellant business supplied full details of how it had calculated the figure and paid the amount over to the Revenue.

As no agreement was reached with HMRC, the appellant's accountants applied for judicial review and for an application for a stay of the county court proceedings. The department accepted a payment of £63,350 without prejudice to its court claim and asked the appellant to agree to the withdrawal of the county court proceedings and of the application for judicial review.

The appellant agreed but sought costs for the judicial review application. In the absence of a response from the taxman, the appellant applied for judicial review.

A judge granted the application, but it was subsequently set aside. The appellant was then ordered to pay the costs of preparation of the acknowledgment of service, on the basis that it was not justified in applying for judicial review once the county court proceedings had been settled.

The company appealed.

The Court of Appeal said it was not an abuse of process of the court or unreasonable for the appellant to resort to a public law claim in these circumstances.

HMRC had taken more than four months in which to respond to the appellant's letter, and then, despite having detailed calculations of the tax actually due, persisted in a claim for the tax said to be due under reg 78. Initiating the claim for judicial review required substantial work, and therefore the costs of commencing the claim should be awarded to the appellant.

The appellant was awarded £6,000 for the costs of commencing the judicial review.

Business Tax

Where are we now with furnished holiday lets?

The abolition of the special rules for furnished holiday lettings have been dropped from FB 2010. The alteration of the Finance Bill came after the Conservatives threatened to delay the progress of other legislation, including the contentious Digital Economy Bill, if three planned tax changes were not withdrawn (one of which being FHLs).

This means that the existing rules under which certain holiday lettings are deemed to be a trade will continue. At the time of writing it looks as though this will include holiday lets in the EEA as well as in the UK but further clarification of the detail is expected. If a Labour government is re-elected this measure may be reintroduced, although whether it will apply for the current year remains to be seen. The Conservatives are clear that they will retain the special treatment if they are elected.

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

- loss relief;
- capital allowances;
- Landlords Energy Saving Allowance (LESA);
- certain capital gains reliefs (including business asset roll-over relief and entrepreneurs' relief; and
- relevant earnings when calculating the maximum relief due for an individual's pension contributions.

Qualifying conditions

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

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

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

Opportunity knocks

If a property in Spain (for example) meets the FHL conditions then there is potential for large UK loss claims arising from reclassifying the overseas property as an FHL.

Consider Stan who bought an investment property in Spain in October 2008. The property cost Euro 300,000 and it was furnished for Euro 20,000. Stan had a 50% deposit and secured a Euro mortgage for the balance.

The property was bought with a view to letting it as furnished holiday accommodation and Stan entered the property details on various holiday rental websites. Lettings commenced in late April 2009 and continued strongly through the summer – easily meeting the 70 day test.

Due to low gearing and strong occupancy Stan expects to make an annual profit on the rentals from 2010/11.

Stan's accountant advises him that he has a large loss claim for 2009/10 but Stan cannot see where this has come from. As far as he is concerned he made a small operating loss for the year to 5 April 2010 of Euro 4,000 but his accountant is suggesting a loss of nearer Euro 50,000 that can be carried back to the UK and offset against his other income in 2009/10.

On a subsequent telephone conversation Stan's accountant explains that the loss arises from:

1. Pre trading expenditure

   For FHLs trade is deemed to commence on first letting. As Stan commenced his lettings in late April 2009 he will be able to regard any revenue expenditure before that date as pre trading expenditure. The accountant has calculated that the mortgage interest and property running costs from October 2008 to the date of first letting were Euro 7,000.

2. The annual investment allowance (AIA)

   Stan has an AIA on the furniture of Euro 20,000.

   There is also a significant AIA claim on fixtures and fittings which are part of the Euro 300,000 purchase price. Stan's accountant believes there is at least another Euro 20,000 here but needs further details of what the apartment includes (air conditioning etc) before finalising this element of the claim.

Stan earned in excess of £100,000 in 2009/10 so the loss offset is likely to be worth around £20,000 in UK tax savings.

Conclusion

Assuming that the EEA extension rules remain then this type of loss claim will be typical. One of the key issues to a successful claim will however be the commerciality of the letting i.e. the property must be let with a view to profit.

Client's will need to satisfy HMRC that this is a property which is expected to yield an annual operating profit within five years. Projections will be required showing the annual losses/profits as occupancy increases over the first five years. Initially occupancy might only be 10 to 15 weeks and at these levels losses may be more likely. Over the years occupancy might be expected to increase to say 30 weeks in year five. If our projections show an annual profit towards the end of our five year projections then the "let with a view to profit" test should be satisfied.

Other factors will be taken into account such as the way it is marketed, the existence of well drafted rental agreements, arrangements with property managers etc but the most important will be profit.

Contributed by Dean Wootten

Lecture P592 (17.23 Minutes)

Annual Investment allowance

The annual investment allowance (AIA) has been doubled to an annual spend of £100,000 per annum with effect from 1 April 2010 for corporation tax, and 6 April 2010 for income tax. The amendment was made by Section 5 of Finance Act 2010.

Businesses which have a year end other than 31 March or 5 April will have an allowance for the period of an amount spanning the date of change calculated by time apportioning the old and the new limits. There will be a further restriction that the amount of expenditure falling before the date of change cannot exceed £50,000.

Example

Able Limited has capital expenditure of £150,000 in the year ended 31 December 2010. The expenditure is main pool expenditure, and Able qualifies for AIA in full, having no related companies to take into account. The following computations will be needed :

- Calculate the annual investment allowance for the period; this is arrived at by time apportioning the £50,000 limit by the number of days in the accounting period before the change and the new £100,000 limit by the number of days falling after the change :

  £50,000 x 90/365 + £100,000 x 275/365 = £87,671

- The timing of the expenditure must now be examined :
  - No more than £50,000 of the total of £87,671 can be awarded against expenditure in the period 1 January 2010 to 31 March 2010.
  - The balance of any expenditure in that period will potentially qualify for first year allowances of 40% (subject to the conditions being met)
  - The remaining expenditure can qualify for AIA in the period 1 April 2010 to 31 December 2010, subject to the overall limit.

So if the expenditure was all incurred in the period between 1 January 2010 and 31 March 2010, the capital allowances would be :

- AIA of £50,000 (maximum amount prior to 1 April)
- FYA of 40% on the balance of £100,000 = £40,000 (assuming qualifying expenditure)
- Total £90,000

If the expenditure all fell in the period 1 April 2010 to 31 December 2010, the allowances would be :

- AIA of £87,671, and
- Writing down allowance of 20% on the balance of £62,329 (main pool expenditure) = £12,466
- Total £100,137

Finally, if the expenditure were incurred £75,000 in the period to 31 March and £75,000 in the following 9 months, the allowances would be as follows :

- AIA of £87,671 - £50,000 of which relates to the first tranche of expenditure
- FYA of 40% on the balance of pre 1 April expenditure of £25,000 = £10,000
- WDA of 20% on the balance of post 1 April expenditure of £37,329 = £7,466
- Total £105,137

The maximum allowances would be gained by incurring all of the expenditure before 1 April other than the amount needed to top the AIA up to the maximum. Thus incurring £112,329 prior to 1 April provides AIA of £50,000, and FYA of £24,932 on the balance of £62,329. Incurring a further £37,671 after 1 April would attract a further AIA of £37,671, bringing the total allowances to £112,603.

Anti avoidance

There is also a new anti avoidance rule which prevents the sideways relief of losses in a rental business when the loss is related to AIA and “relevant tax planning arrangements” are in place. This applies to arrangements entered into on or after 24 March 2010. The provision is made by section 25 Finance Act 2010. For this purpose, relevant tax planning arrangements means that the main purpose or one of the main purposes of the arrangements is being in a position to make use of the AIA in the obtaining of a reduction in tax liability by means of property loss relief against general income.

This rule could affect those investing in commercial property who incur expenditure on fixtures which could attract AIA. This could also affect those with Furnished Holiday letting activities, as in view of the survival of that regime through the legislation terminating the regime being dropped from the Finance Act 2010, AIA would still be available on them. Sideways relief for losses incurred would therefore need to satisfy this anti avoidance test in relation to expenditure incurred on or after 24 March 2010.

Contributed by Rebecca Benneyworth

Lecture B591 (9.01 Minutes)

Corporation Tax

A review of corporate loss relief

Company trading losses are computed in the same way as trading profits. Where the adjusted trading profit figure is a loss, the trade profit assessment in the corporation tax computation will be nil. There are several different options for relieving losses and the company may have different options for relieving its trading losses.

Summary of reliefs for company trading losses

Trading losses may be relieved in the following ways:

i. Set against total profits before charges on income in the current accounting period under *s.37(3)(a), CTA 2010;*

ii. Carry back and set against total profits before non-trade charges in the preceding 12 months extended to 3 years in certain cases under *s.37(3)(b) CTA 2010 & Sch 6, FA 2009;*

iii. Carry forward to set against next available future profits from same trade under *s.45, CTA 2010;*

iv. Surrender the loss to a fellow 75% owned group company under *s.97 CTA 2010*. Group relief is not covered in this lecture or supporting notes.

Current year & carry back claims

Lossington Ltd has the following results for the year to 31 March 2010:

	£
Trading loss	(70,000)
Chargeable gains	15,000
UK property business	21,000

It had the following income in the previous year ended 31 March 2009:

	£
Trade profit	10,000
UK property business	21,000
Gift Aid payment	(1,000)

The company makes a current year claim under s.37(3)(a), CTA 2010 to utilise £36,000 of the loss as follows:

	12m to 31.3.10
	£
Trade profit	Nil
UK property business	21,000
Chargeable gains	15,000
Total profits	36,000
Current year loss	(36,000)
	-
Charge on income	Unrelieved
PCTCT	-

Lossington Limited then makes a claim to carry back losses under s.37(3)(b) CTA 2010 as follows:

	12m to 31.3.09 £
Trade profit	10,000
UK property business	21,000
Total	31,000
Current year loss (nil as there is no loss in this year)	-
	31,000
Losses carried back	(31,000)
	Nil
Non-trade charges (Gift Aid)	Unrelieved
PCTCT	Nil

The loss memorandum is as follows:

Loss Memo:	£
Total loss	70,000
Current year claim	(36,000)
	34,000
Carry back claim	(31,000)
Loss to carry forward	£3,000

The claim to carry back losses must be made no later than 31 March 2012. HMRC may extend this time limit at their discretion.

Temporary extension to 12 month loss carry back rule

FA 2009 provides for a temporary extension to the 12 month loss carry back rules. Where a loss is incurred in an accounting period ending after 23 November 2008 and before 24 November 2010 it can be carried back three years rather than 12 months.
The loss must be off-set against profits of later years before earlier years.

The maximum amount of losses that may be carried back by a company by more than 12 months is £50,000 for losses arising in the accounting periods ending after 23 November 2008 and before 24 November 2009 and £50,000 for losses arising in accounting periods ending after 23 November 2009 and before 25 November 2010. This is regardless of the number of accounting periods falling within each of those periods. Therefore, for example, if two or more loss making accounting periods ended after 23 November 2008 and before 24 November 2009, the total extended loss relief claims for those accounting periods together would be capped at £50,000.

If a loss-making accounting period falling within the above periods is less than 12 months, the £50,000 limit is pro-rated accordingly.

Prior to claiming this extended carry back, the company must first claim to offset losses against current year profits.

This relief is in addition to the usual 12 month loss carry back claim. The 12 month carry back claim continues to be uncapped and so it may be worth considering making both claims in certain circumstances.

Illustration 1

Company X Ltd has the following results:

	Y/e 31.12.06 £	Y/e 31.12.07 £	Y/e 31.12.08 £	P/e 30.6.09 £	Y/e 30.6.10 £
Trade Profit/(Loss)	100,000	90,000	(78,000)	(85,000)	(180,000)
UK Property Business	20,000	20,000	20,000	10,000	20,000
Non-trading profits (LR)	40,000	40,000	40,000	20,000	40,000

Year ended 31 December 2008

In respect of the loss for the y/e 31.12.08, the company makes a current year claim against total profits of £60,000 and a carry back claim against total profits of £150,000. This uses the loss in full as follows:

Loss Memo for y/e 31.12.08:	£
Total loss	78,000
Current year claim	(60,000)
	18,000
Carry back claim	(18,000)
Loss unrelieved	£Nil

Period ended 30 June 2009

The company makes a current year claim against total profits of £30,000 and a carry back claim.

An extended carry back claim under para 1, Sch 6 FA 2009 is made against the profits of the y/e 31.12.07. The maximum permitted amount of £50,000 is time apportioned for the short period.

Loss Memo for p/e 30.6.09:	£
Total loss	85,000
Current year claim	(30,000)
	55,000
Extended carry back claim (50,000 x 6/12)	(25,000)
Loss unrelieved	£30,000

Year ended 30 June 2010

A current year claim is made in respect of £60,000 of the loss for the year and an extended loss carry back claim is made of the maximum amount permitted of £50,000.

Loss Memo for y/e 30.6.10:	£
Total loss	180,000
Current year claim	(60,000)
	120,000
Extended carry back claim (max £50,000)	(50,000)
Loss unrelieved	£70,000

Summary PCTCT following loss relief claims

	Y/e 31.12.06	Y/e 31.12.07	Y/e 31.12.08	P/e 30.6.09	Y/e 30.6.10
	£	£	£	£	£
Trade Profit	100,000	90,000	-	-	-
UK Property Business	20,000	20,000	20,000	10,000	20,000
Non-trading profits (LR)	40,000	40,000	40,000	20,000	40,000
Total Profits	160,000	150,000	60,000	30,000	60,000
Less: CY claim			(60,000)	(30,000)	(60,000)
Less: carry back claim					
– y/e 31.12.08		(18,000)			
- p/e 30.6.09		(25,000)			
- y/e 30.6.10		(50,000)			
PCTCT	160,000	57,000	Nil	Nil	Nil

Losses carried forward

The amount of any trading loss which is not relieved against current or prior year profits is carried forward for offset against future profits arising from the same trade.

This is not a claim; the loss offset is automatic. Losses carried forward will be offset against all available profits from the same trade in perpetuity until the loss is exhausted.

There are anti avoidance provisions which prevent trading loss relief in certain circumstances where there has been a change of ownership of the company. For more on this see

Future profits from the trade

Losses carried forward can only be offset against future profits arising from the same trade. This is as opposed to current year trading losses which can be offset against other profits.

According to HMRC's Business Income Manual, whether a trade has changed is a question of fact for the Commissioners to decide based on principles determined by case law. Relevant factors include changes in scale (including cessation), location and nature of the trade. This is covered in some detail in the Business Income Manual at BIM 70500 and the pages following.

Multiple trades

If a company has more than one trade then the income and expenses for the trades must be streamed when computing the trading profits or losses. Where a company has more than one loss making trade, a separate loss memo must be kept for each trade.

According to HMRC's Business Income Manual, it considers that the activities carried on by a company are only likely to amount to more than one trade if:

- one activity is so different in nature from the other that it can be seen as quite separate; and
- the activities are separately organised and managed right up to Board level.

There is a substantial amount of guidance in HMRC's Business Income Manual regarding what will constitute a separate trade but overall the guidance, which is based on the considerable amount of case law on this subject, suggests that HMRC considers that a company will seldom have more than one trade.

As the existence of multiple trades in one company, as opposed to in separate companies, reduces the number of associates, it is likely to be scrutinised by HMRC where a company claims marginal relief or small companies rate. Treating a company as having more than one trade also necessitates the additional administrative burden of streaming income and expenses relating to the different trades.

First year tax credits

Loss making companies will be able to surrender the losses attributable to enhanced capital allowances (100% first year allowances) on designated energy-saving or environmentally-beneficial plant and machinery in exchange for a cash payment known as a first year tax credit from the Government. – see Sch A1, CAA 2001.

Companies will be able to claim first year tax credits in respect of qualifying expenditure incurred on or after 1 April 2008.

Eligible losses are those from a trade, an ordinary property business, an overseas property business, a furnished holiday lettings business or from managing the investments of an investment business.

The first year tax credit will be 19% of the loss surrendered subject to an upper limit which will be the greater of:

- Total PAYE and NICs liabilities for period for which the loss is surrendered;
- £250,000.

A loss may not be surrendered as a first year tax credit if it could be set-off against its own taxable profits in the loss making period or surrendered as group relief.

Any losses available to carry forward will be reduced by the amount of the loss that has been surrendered under the new rules.

A company must claim first year tax credits in a return or amended return. There will be a clawback of the tax credit if the qualifying plant and machinery for the enhanced capital allowances is sold within four years after the end of the period for which the tax credit was paid, in which case the loss will be reinstated.

Potential restrictions on trading loss relief

Relief for losses against current or preceding year profits is not allowed where:

- Losses are incurred in carrying on a trade outside the UK
- Loss is incurred in a trade which is not carried out on a commercial basis with a view to the realisation of profits
- Loss is incurred in a trade of farming or market gardening which has incurred losses in the previous five years

These rules are similar to those which apply to trading losses for unincorporated businesses.

Deferred tax

If a company has carried forward tax losses then there is a timing difference between the tax computation and the accounts. This represents a deferred tax asset because tax relief may be available in future for a loss arising in the current year. The recognition of deferred tax assets depends on the likelihood of the company making suitable taxable profits in future which may absorb the losses.

Complications with carry back and carry forward claims

<u>Apportionment</u>

Loss carry back claims are for a full 12 month period. If the previous accounting period is less than 12 months then the profits of the relevant periods will need to be apportioned.

Claim

The deadline for the claim is within two years of the end of the accounting period in which the loss was incurred. In other words, 12 months from the usual tax return filing date. This time limit is subject to variation by HMRC. Generally the claim is included on the company's tax return. Claims may be amended within 12 months from the filing date, or if the claim is not made on the tax return, within 12 months of making the claim.

Interest on repayments resulting from loss carry back claims

If the trading loss is carried back to an accounting period falling wholly within the twelve months preceding the period of the loss, then repayment interest is calculated based the later of the normal due date for the period to which the losses are carried back and the date of payment.

If a period to which a trading loss is carried back does not fall wholly within the 12 months preceding the period of the loss then repayment interest runs from the later of the due date relating to the period of the loss and the date of payment.

Companies accounting in foreign currency

Following FA 2009, if a company's functional currency is not sterling, in a period in which a loss was incurred, losses are translated at the same exchange rate as the profits against which they are offset. These provisions are covered in detail in the Corporation Tax Module.

Change in ownership

Relief for losses relieved in a subsequent or previous period is not allowed in the following circumstances:

1. Where in any period of three years there is both a change in the ownership of a company and a major change in the nature or conduct of the company's trade; or

2. At any time after the scale of the company's activities has become small or negligible and before any considerable revival there is a change in the ownership of the company.

Restriction of carry forward and carry back of losses

Where either of the above circumstances applies, a loss incurred in an accounting period beginning before the change in ownership may not be relieved against profits of an accounting period ending after the change of ownership.

Similarly, a loss incurred in an accounting period ending after the change of ownership may not be relieved against profits of an accounting period beginning before the change in ownership.

Apportionment of profits and losses are usually made on a time basis but some other basis may be more appropriate.

Rules for ascertaining change of ownership

There is a change of ownership for this purpose in the following circumstances:

- one person acquires more than half of the ordinary share capital, or
- two or more persons together acquire more than half of the ordinary share capital and each person acquires at least 5 per cent, or
- two or more persons together acquire > ½ of ordinary share capital and each person holds, taking into account existing holdings, at least 5 per cent.

In considering the application of these provisions, the following rules apply:

- Net increase in a person's holding at any two points in time falling within the three year period is deemed to be the number of shares he has acquired.
- The comparison may be made by number of shares or percentages (ie to take into account additional share issues)
- Share held by connected persons are aggregated for the purpose of determining whether a person has acquired, or holds, five per cent of the ordinary share capital
- Shares received by virtue of a will or an unsolicited gift are ignored.

“Major change in the nature or conduct of a trade”

There is little of assistance in the legislation on the meaning of “Major change in the nature or conduct of a trade”. The meaning of the phrase has been considered in various cases. HMRC’s Statement of Practice 10/91 explains which factors it takes into account in deciding whether a major change has taken place.

This considers such factors as changes to manufacturing methods, location of the business premises, changes to company suppliers, and pricing or purchasing policies.

The guidance does acknowledge the necessity for companies to keep pace with technological and other developments in order for it to remain competitive.

Situations in which there may be a major change in the nature or conduct of a trade include:

- a change in the manner of disposing of the goods.
- A major alteration in the conduct of the trade (for example a change in buying policy)
- a major change in the type of property dealt in
- a major change in the services or facilities provided
- a change from providing a service to being a primary producer

HMRC consider that a major change will usually be determined by reference to a combination of factors although it is not impossible that a single factor may imply a major change.

Lecture B594 (22.42 Minutes)

Sun Life Assurance Company of Canada (UK) Ltd v R&C Comrs

Section 393 of the Income and Corporation Taxes Act 1988, so far as material, provides: “(1) Where in any accounting period a company carrying on a trade incurs a loss in the trade, the loss shall be set off for the purposes of corporation tax against any trading income from the trade in succeeding accounting periods; and (so long as the company continues to carry on the trade) its trading income from the trade in any succeeding accounting period shall then be treated as reduced by the amount of the loss, or by so much of that amount as cannot, under this subsection or on a claim (if made) under section 393A(1), be relieved against income or profits of an earlier accounting period.”

Section 89 of the Finance Act 1989, so far as material, provides: “(1) The references in sections 88 and 88A ... to the policy holders” share of the relevant profits for an accounting period of a company carrying on life assurance business or, as the case may be, basic life assurance and general annuity business are references to the amount arrived at by deducting from those profits the Case I profits of the company for the period in respect of its life assurance business, reduced in accordance with subsection (2) below” … “(7) In this section— “Case I profits” means profits computed in accordance with the provisions of the Taxes Act 1988 applicable to Case I of Schedule D.”

One aspect of the taxpayer's business was basic life and general annuity business (BLAGAB). In the course of that business, the taxpayer undertook investment activities not only on its own behalf but on behalf of policyholders. The taxpayer was charged to tax on all the profits derived from those activities, but the policyholders' share of those profits was charged at a lower rate of tax than the rate at which the shareholders' share of the profit was charged. The imposition of two different rates of tax required the profits of the taxpayer's life assurance business to be apportioned between the policyholders and the shareholders. The policyholders' share of the profits was calculated by deducting from the profits of the life assurance business the Case I Sch D profits of the company. The taxpayer contended that, for the purposes of computing those Case I profits, for any accounting period under the Income and Corporation Taxes Act 1988, it was not merely entitled but was required to carry forward and set–off unused losses from previous years. The effect of carrying forward those losses was to extinguish Case I profits for the company's accounting periods ending 31 December 2002 and 2003. If the Case I profits were thereby reduced to nothing, the policyholders' share would not fall to be reduced and all the profits would be charged at the lower rate of tax. The Revenue and Customs Commissioners (the Revenue) contended that the taxpayer was not entitled to carry forward unused losses from previous years in computing Case I profits for the purposes of apportionment. Accordingly, the taxpayer's Case I profits were not extinguished and the resulting shareholders' proportion of the profits was subject to a higher rate of tax. The law was amended in respect of the taxpayer's next accounting period, ending 31 December 2003, so as to make specific reference to the right to carry forward losses from previous years. But the amendment applied only to losses for 2002 and later periods. The taxpayer contended that the amendment did not remove its pre–existing entitlement to carry forward the unused losses of previous years in order to compute Case I profits for the purposes of apportionment. The Revenue contended that it permitted, for the first time, the taxpayer to carry forward losses from previous years, but that right was limited to losses for 2002 and later years. The Special Commissioner decided that the taxpayer was entitled to carry forward and deduct its past years' unused losses for the accounting period ending 31 December 2002; but that the amendment in 2003 limited the losses which could be carried forward in 2003 to those which had occurred in the accounting period ending 31 December 2002. The judge reversed that decision on both issues. He found that in the 2002 accounting period, the taxpayer was not entitled to carry forward and deduct the unused losses of previous years; but if that conclusion was wrong, he took the view that the amendment did not serve to take away the taxpayer's previous right to carry forward the unused losses of previous years. He further found that s 393 of the 1988 Act was not a provision applicable to Case I of Sch D. The taxpayer appealed.

The issue was, first, whether, up to 31 December 2002, the legislation conferred a right or imposed a duty to carry forward past years' losses when computing Case I profits for the purposes of apportionment. The Revenue contended, contingently, that the second issue was whether the effect of the amendment was to make exhaustive provision for the use of the carried forward losses, and prohibit the use of such losses to the extent that they related to any accounting period before 1 January 2003. The instant appeal turned on the question whether, as a matter of construction, s 89(7) of the Finance Act 1989 permitted or required those losses to be carried forward.

(1) Section 393 was only applicable to Case I of Sch D since the relief for which it provided was restricted to income from a trade; it was, in short, specific to that single source. Case I referred only to tax in respect of a trade and s 393 relieved only trading income. In relation to BLAGAB profits, s 89(1) of the 1989 Act created a statutory hypothesis. It assumed in relation to BLAGAB, for the purposes of the deduction from the relevant profits, that there were BLAGAB profits computed in accordance with the provisions applicable to Case I. Accordingly, the Case I profits, to be deducted from relevant profits, had also to include those amounts derived from BLAGAB, alongside the pension business, life reinsurance business and overseas life assurance business, which would have been brought into charge as trading income had the company been charged on a Case I basis. The statutory hypothesis required all income which could have been charged as Case I trading income from whatever category of life assurance business to be computed as Case I profits, that was, computed in accordance with the provisions of the the 1988 Act applicable to Case I, notwithstanding the reality that none of those profits were charged on a Case I basis (see [28], [32], [38] of the judgment).

Section 89(7) of the 1989 Act posed three questions: (a) whether s 393(1) was a provision of the 1988 Act; (b) whether it was a provision applicable to Case I of Sch D; and (c) whether the Case I profits of the taxpayer computed in accordance with the provisions of the 1988 Act, including s 393. In the instant case, those questions had to be answered in the affirmative. First, s 393 was a provision of the 1998 Act. Secondly, s 393 was plainly a provision applicable to Case I of Sch D.

Thirdly, the BLAGAB profits were computed in accordance with the provisions of the 1988 Act applicable to Case I, including s 393. Therefore, the judge had been wrong to conclude that the mere fact that s 393 was a relieving provision afforded a basis for deciding that it was not a provision applicable to Case I in accordance with which the taxpayer's profits were computed. In those circumstances, since the taxpayer succeeded on the first issue, it was entitled to carry forward unused losses from previous years (see [27], [44], [45] of the judgment).

(2) The amendment removed a restriction on losses available hitherto but only in relation to accounting periods on or after 1 January 2003. Paragraph 7(2) of the 1989 Act was not of itself sufficient to limit the benefit to the taxpayer of the removal of the restriction on available losses contained in s 434A(2) of the 1988 Act. By itself s 7(2) could have had the effect of removing the restriction in relation to all losses which had accrued, even those which had accrued prior to the introduction of the amending provisions since such losses might be carried forward into accounting periods beginning on or after 1 January 2003. Paragraph 7(3), therefore, identified the losses to which the removal of the previous restriction applied. It was designed to limit the availability of the benefit to losses incurred in the accounting period in which 31 December 2002 was included or any later period. If the taxpayer had a right to set off unused losses for the purposes of s 89 of the 1989 Act calculation, there was nothing within the amendments which could operate to remove that right (see [63]–[65] of the judgment). The taxpayer's appeal would be allowed. The Revenue's contingent appeal would be dismissed.

In all the circumstances, the judge had been correct on the amendment issue (see [68] of the judgment).

Decision of Patten J [2009] STC 768 reversed in part.

Court of Appeal, Civil Division Sir Anthony May P, Rix and Moses LJJ 16 April 2010

J D Wetherspoon plc v Revenue and Customs Commissioners (No 2)

The appellant company owned, operated and developed public houses throughout the UK. It appealed against a closure notice amending its corporation tax return for the accounting year to 31 July 1999 and the appeal itself dealt with whether sample items of expenditure on 288 pubs (and in respect of preliminaries concentrated on one pub), qualified as 'plant' under s 24 of the Capital Allowances Act 1990 ('CAA 1990'), or as alterations to an existing building 'incidental to the installation of machinery or plant' under CAA 1990 s 66. The Special Commissioners (see [2008] STC (SCD) 460) released a decision in principle ('the first decision') and adjourned the appeal for the parties to consider whether, in light of that decision, they could dispose of the outstanding matters by agreement. That did not prove possible and the First-Tier Tribunal heard further argument on whether certain items of expenditure qualified for allowances. In the first decision the Special Commissioners had concluded that tiles on kitchen walls did not qualify as alterations under s 66 because they did not have a sufficient nexus with the installation of equipment, such as cookers, to be incidental thereto. They also concluded that, apart from splashbacks to sinks and the immediate surrounds of lavatory basins, wipe clean tiling did not qualify under s 66. In the light of that decision, HMRC accepted that splashbacks to sinks and the immediate surrounds of lavatory basins qualified for allowances under s 66. At the resumed hearing the 'unclear' items of expenditure were, under the general heading of 'splashbacks', (a) the costs of plastering, tiling or painting walls or floors around equipment, WCs and other sanitary equipment, (b) the cost of cement and flooring to form splashbacks to sinks and lavatory basins, (c) the cost of cement and flooring to form splashbacks to predominantly kitchen equipment; under the general subheading 'Cold Store Drainage', (d) expenditure incurred in installing a cement flooring to the cold store which was created in order to chill and maintain the temperature of draft beer. Because of anticipated spillages and associated washing down, the floor had to be inclined to a new drainage channel so that liquids could be pumped out by pumping equipment within the cold store; under the general heading of 'Lighting', (d) the cost of installing light fittings in the WCs—particularly in the ladies' WCs—and the rewiring costs; under the general heading of 'Lifts and Hoists', (e) the cost of tiling to the front of the food hoists. The hoists facilitated the movement of food from the kitchen in the basement to the dining area on the first floor; and under the general heading of 'Miscellaneous Works', (f) the costs of brickwork and blockwork carried out in connection with the installation of toilet cubicles, (g) the costs of reinforcing the kitchen floor; (h) the cost of plywood used to strengthen the timber partitions in the WCs to enable sanitaryware fittings to be secured; and (i) the cost of providing a waterproof coating to the floor to the male WCs to prevent leaks permeating through to the ceiling below.

On the 'unclear' items under the general heading 'splashback', the tribunal considered that the relevant alteration to a building qualifying for allowances under s 66 was restricted to the application to the surface of the building of a splashback, which meant tiling sufficient specifically to deal with splashing which might be expected to be caused by the usual functioning of any qualifying items of machinery or plant. On that definition, the cost of a fully tiled wall or floor could not qualify as the cost of an alteration to the building incidental to the installation of machinery or plant. Neither could the cost of plastering, even where a splashback was applied, amount to a cost of the alteration to a building incidental to the installation of machinery or plant. Plastering provided a wall finish or a surface which could be painted or to which, alternatively, tiles could be applied; it was not an inherent part of the process of making the wall surfaces wipe clean. It was unreal to treat the cost of a toilet floor, albeit a wipe-clean floor, as the cost of an alteration incidental to the installations of WCs and urinals rather than the cost of the floor, and any allowances for the cost of the ceramic floor tiling in the toilets would be excluded. It was also unreal to apportion the costs of fully tiled walls between allowable costs of a notional area and non-allowable costs of the rest of the tiling, so that any allowances for ceramic tiles to walls and mosaic tiles incidental to the installation of toilets would also be excluded. Furthermore, the provision of floors could not be regarded as incidental to the installation of machinery or plant which was to be set on them. Although non-slip and wipe-clean floors were desired and necessary for the proper performance of the appellant's trade in the premises, their provision was not carried out specifically to enable any machinery or plant to be installed. The floors and their provision did not have a sufficient nexus with the installation of any equipment to enable the cost of them to be eligible for allowances under s 66. That conclusion applied to the cost of the surface of the non-slip and wipe-clean floors—both in the WCs and the kitchens—and a fortiori, to the costs of the provision of sub-surface preparation.

In relation to the costs claimed in respect of the 'Cold Store Drainage', the tribunal could not see that any of the works actually carried out to produce the inclined floor in the new cold store were not incidental to the installation of the drain, which required an inclined floor in order for it to function at all. No part of the expenditure of the actual provision of an inclined floor could be isolated out and shown not to be an alteration incidental to the installation of the drain or pumping equipment. There never was any intention to provide a level floor which was then altered to an inclined floor—it was to be an inclined floor from the start. It followed that all the expenditure involved was expenditure on alterations incidental to the installation of machinery or plant. The proportion of that total expenditure which related to the cold store area was eligible for allowances on the same basis as the costs of providing the inclined floor.

As regards to the expenditure incurred under the general heading 'Lighting', the tribunal found that the WC light fittings did serve a function in the carrying on of the appellant's trade, viz the provision of an attractive ambience in the toilets. That was particularly clear in relation to the ladies' toilets. It followed that the 'rewire toilet lighting' was eligible for allowances under s 24 to the extent that the cost concerned represents the provision of machinery or plant (wiring and fittings) rather than alterations to the building. In so far as it did represent alterations to the building, it was eligible for allowances under s 66 as the cost of alterations incidental to the installation of lighting which qualified as machinery or plant.

Under the general heading 'Lifts and hoists', the cost of tiling to the front of food hoists was not part of the wall finish in the kitchen and the claim for that allowance failed.

Finally, as regards the 'Miscellaneous Works', the tribunal found that (i) the costs of installing the toilet cubicles were alterations to the building which were incidental to the installation of the toilets and were eligible for allowances under s 66; (ii) the kitchen floor was a special floor, whose characteristics were determined by the fact that the kitchen equipment needed to be installed in the kitchen. On that basis the costs were eligible for allowances under s 66, as the cost of alterations to the building which were incidental to the installation of machinery or plant (the kitchen equipment); (iii) the cost of plywood used to strengthen the timber partitions in the WCs was an alteration incidental to the installation of machinery or plant (whether the toilets or the sanitaryware fittings which it enabled to be secured). It was eligible under s 66; and (iv) that the application of the waterproof coating was a preventative measure, to prevent future difficulties which might arise if there was leaking from the equipment in the toilet caused by their use. It was therefore not eligible for allowances.

Decision in principle.

Value Added Tax

Flat rate scheme update

This article covers recent developments in the flat rate scheme for small businesses.

Associated businesses

A company registered for VAT in October 2007 and applied to join the FRS from the outset. HMRC subsequently investigated the situation and discovered the following circumstances:

- company, R, was owned 50:50 by a married couple who each owned 25% of another company, B;
- B was the sole customer of R, which supplied it with management services;
- the other shares in B were owned by another married couple who had set up a similar separate company to charge it identical amounts for management services, but their company was VAT registered in the normal way and did not use the FRS.

HMRC decided that R was “associated with” B for the purposes of reg.55A SI 1995/2518, and was therefore ineligible to join the FRS under reg.55L. They issued a notice to terminate its authorisation to use the scheme under reg.55P and backdated the effect of that termination to the outset under reg.55Q. The directors were notified that HMRC wished to carry out interviews under the procedures laid down in Public Notice 160, which deals with allegations of dishonesty evasion, but in the end the assessment to recover the VAT was only accompanied by a s.63 misdeclaration penalty (not a s.60 evasion penalty).

A business is associated with another person for FRS purposes if it is “closely bound to it by financial, economic and organisational links”. The Tribunal’s jurisdiction is restricted to considering whether HMRC’s decision has been arrived at in a reasonable manner, i.e. the officer took into account only relevant information and did not disregard any relevant information. Accordingly, the Tribunal considered in detail the factors that the officer had recorded as indicating the links.

(1) Financial Links:

a. The directors of RDF are shareholders of BBE. (25% of BBE shares are held by Mr Clay, and 25% by Mrs Clay (both also being directors of RDF).

b. RDF's charges are dependent on what directors of BBE decide it should get. BBE's directors consider what is reasonable depending on the economic viability of BBE. This is backed up by the fact that no written contract exists between BBE and RDF, there is no record of the time or resources used by RDF re supplies to BBE, charges are not based on the quality or quantity of work done by RDF, both RDF and another company (both having directors in common with BBE) have raised invoices for identical amounts although each supplies different services to BBE.

c. The charges do not, therefore, appear to be based upon commercial reality (ie BBE and RDF do not have a normal business relationship).

d. Fees to BBE are RDF's sole source of income at present.

e. BBE premises at New Street are owned by both BBE's director's pension fund (which is partly for the benefit of Mr Clay as a director of BBE as well as RDF) and by RDF's directors.

f. RDF's directors (Mr & Mrs Clay) receive rental income from BBE for use of the property

(2) Economic Links:

a. Economic links include activities where the activities of one party are ultimately for the benefit of another.

b. BBE benefit by RDF providing the expertise to run the production shop.

c. BBE also benefit by RDF's willingness to only charge fees as and when agreed with BBE, and the extended credit granted in respect of invoices raised.

d. RDF benefit from BBE by it supplying it with its sole source of income i.e. the economic viability of RDF is dependent on that of BBE.

e. Mr Clay of RDF stated he is also hoping to expand the work of RDF through the contacts he makes through BBE and the queries he receives at BBE.

(3) Organisational Links:

a. Deodata Clay - Company Secretary and director of RDF from 4/9/07

b. Deodata Clay - Co Sec and director of BBE prior to 30/10/91

c. Roy Clay - director RDF from 4/09/07

d. Roy Clay - director of BBE from pre 30/10/91

e. There is, therefore common directorship between BBE and RDF.

f. Shareholding in BBE is 50% Mr Gee (BBE), 25% Mr Clay (RDF), 25% Mrs Clay (RDF).

g. Mr Clay is actively involved in the day to day running of both RDF and BBE. Within RDF he is an active director, and within BBE he runs the production shop - BBE relies on his expertise to review orders received, quote for jobs, deciding which jobs will be undertaken, what to charge, what to buy to meet orders, and the overseeing production/supplies. Consequently Mr Clay has a significant role in how BBE and RDF works, and strongly influences the work undertaken by both.

The Tribunal considered the company's arguments which attempted to counter these assertions, but decided that there was ample material to justify the officer's conclusions. The assessment and the penalty were confirmed.

There was also a dispute about an invoice which had been raised before R was registered for VAT. Tellingly, it had been raised by B, because R did not have the facilities to raise invoices (suggesting the economic and organisational links between the two), but represented a sale by R to B. HMRC allowed B to retain the input tax shown on this invoice and sought to collect the output tax (in full) from R. The company argued that this was in some way an abuse of the rules by HMRC to strengthen their case on the association point, but the Tribunal could not see how that could be made out.

The assessment was also raised on the basis of invoice dates rather cash received. The company could not retrospectively apply the cash accounting scheme.

First Tier Tribunal (TC00387): RDF Management Services Ltd

No retrospection

A plumber joined the flat rate scheme in 2004. In 2008 he decided that he was paying more VAT than he would do under the normal rules, and he applied to withdraw from the scheme with retrospective effect. HMRC allowed him to withdraw from the date of his application to do so, 28 May 2008.

The Tribunal held that this decision was not unreasonable and dismissed his appeal against it. Retrospection would only be allowed in exceptional circumstances, and simply paying more tax was not exceptional. The overall intention of the FRS is to be revenue neutral, so it is unsurprising that there are some losers as well as winners.

First Tier Tribunal (TC00354): B Reynolds

A company joined the FRS in March 2007, stating that it was carrying on an accountancy business (with one of the highest rates). In February 2009 it asked to be recategorised as "business services listed elsewhere" (about 3% lower). HMRC allowed this change to take effect from 1 December 2008 but refused to backdate it to March 2007. The trader appealed.

The Tribunal considered that the decision, freely taken by the appellant in March 2007, had not been unreasonable – it was not a mistake. It was therefore not possible to change it retrospectively, even though it was within the time limits for making a repayment claim. HMRC's refusal to allow retrospection had not been unreasonable.

First Tier Tribunal (TC00336): Archibald & Co Ltd

A trader used the flat rate scheme from 28 February 2003, applying the 13% rate appropriate for a takeaway food outlet. He failed to notice that the rate was reduced to 12% from 1 January 2004, and therefore overpaid VAT of £5,774 over a four-and-a-half year period. He claimed this back, but HMRC said that the cap applied.

The Tribunal held that there were no grounds to depart from the statutory limitation period. The decision was upheld.

First Tier Tribunal (TC00200): Malcolm Hutchinson t/a Clifton Fisheries

A trader registered for VAT in 1990. In March 2009 he applied to join the FRS, and asked for this to be backdated to 2003. HMRC backdated it only to January 2009, the beginning of the quarter in which the application was made. The Tribunal agreed with this approach, holding that it was entirely rational to refuse retrospection in such circumstances: the point of the FRS was to simplify the trader's records, not to save the trader money, and if the trader had chosen to file VAT returns in the normal "unsimplified" manner, the point of the FRS would not be achieved by allowing retrospective use. There were no exceptional circumstances in this case which should lead to any other conclusion.

First Tier Tribunal (TC00376): DL Skinner

Retrospection required...

A company was registered under the flat rate scheme from 1 January 2004. At that time the rate applicable to couriers was 5.5%. With effect from 1 April 2004, it was increased to 9%. In spite of HMRC notifying traders through a letter, VAT Notes and a Business Brief, the company failed to notice the change, and three years later was assessed to a shortfall of £8,758 plus interest.

The trader had no substantive grounds for appeal against the assessment apart from a sense of grievance that HMRC should have noticed the problem earlier from the returns that were submitted. The chairman had some sympathy with the sense of grievance but commented that VAT was a self-assessed tax and the trader had the ultimate responsibility for the accuracy of returns. The assessment was confirmed.

First Tier Tribunal (TC0084): Cannon Express & Logistics Ltd

...or allowed...

A trader was registered under the flat rate scheme in respect of a riding school. She claimed a large amount of input tax on the construction of a riding arena, but found that it was not regarded as qualifying for the special deduction of input tax for capital goods costing at least £2,000 under the FRS because most of the supplies constituted services.

The Tribunal considered that one of the elements of the disputed input tax was a service incidental to the delivery of goods, and was therefore claimable even under the FRS. However, it went on to consider whether the trader should be allowed to withdraw from the FRS retrospectively, so permitting accounting under the normal rules of VAT and thus allowing recovery on the capital expenditure. HMRC had refused to allow this, commenting that a precedent case in which this had been permitted had involved a 40% loss of gross profit – this trader only suffered a 23% loss, and therefore "did not suffer hardship".

The Tribunal agreed with the appellant's main contentions, which were that:

- HMRC's guidance (Notice 733) did not make clear what a "capital asset" was for the purposes of the FRS until March 2007, after the expenditure had been incurred;
- the visiting officer who examined the returns and ruled that the input tax was not recoverable had suggested retrospective withdrawal, which is within HMRC's discretionary powers;

- the loss did cause the trader undue hardship.

In this area, the Tribunal's jurisdiction is limited to considering whether HMRC's decision was made "reasonably". The Tribunal was satisfied that it was not: in overruling the offer of the visiting officer, HMRC's policy department had not considered the underlying reasons for refusing the decision and had set an arbitrary figure of 40% of gross profit to measure hardship. The appeal was allowed to that extent.

First Tier Tribunal (TC0062): Sally March

...or restricted

Another trader succeeded in obtaining a small amount of retrospection. He had been registered for VAT for many years, and had been aware of the FRS from its outset. However, he believed that he would not benefit from using it because the trade category on his VAT registration certificate suggested to him that he would be treated as a software engineer with one of the highest flat rates. In April 2008, after correspondence with HMRC, he realised that he was not bound to choose that rate, and that his business was better described as "services not listed elsewhere" with a lower (and advantageous) flat rate.

He asked to be admitted to the FRS from the beginning of the scheme in 2002. He persuaded an officer that his misunderstanding over the significance of his registration categorisation was a sufficiently special circumstance to allow retrospection, but the officer only allowed him to go back three years.

On appeal, the Tribunal heard that HMRC did not accept that there were valid reasons to make the scheme retrospective in this case, but they would not argue the point as their officer had given a decision. However, they argued instead that the effect of the cap on repayments was that only 3 years' worth of VAT could be repaid. The trader disputed whether such a repayment fell within s.80 (and therefore would be subject to the cap), but the Tribunal agreed with HMRC – it did not make any difference whether the admission to the FRS was backdated to 2002 or 2005: only the "overpayment" arising between 2005 and 2008 could be recovered by the trader.

First Tier Tribunal (TC00386): Christopher John Sims

Manual update

HMRC have updated their online manual on the flat rate scheme, with important amendments to their policy on retrospective amendments among other things.

FRS3000 (www.hmrc.gov.uk/manuals/frsmanual/frs3000.htm)	This section has been re-written to clarify the policy on dealing with requests for retrospective admission to the scheme.
FRS4000 (www.hmrc.gov.uk/manuals/frsmanual/frs4000.htm)	This section has been re-written to clarify the policy on dealing with requests for retrospective withdrawal from the scheme.
FRS6500 (www.hmrc.gov.uk/manuals/frsmanual/frs6500.htm)	This is a new section that outlines how VAT is reclaimed on capital expenditure goods.
FRS7000 (www.hmrc.gov.uk/manuals/frsmanual/frs7000.htm)	This section is re-written to include details of the 1% reduction for businesses in the first year of registration. It also provides details of the flat rate percentages both current and historical.

www.hmrc.gov.uk/manuals/frsmanual/updates/updateindex.htm

New flat rates

When the VAT rate was cut from 17.5% to 15% on 1 December 2008, the flat rates were reduced as well. They have been increased again with effect from 1 January 2010, but not always to the same level that they were at before. The complete table is as follows:

Category of business	2010	2009	2008
Retailing food, confectionary, tobacco, newspapers or children's clothing	3.5	2	2
Post offices	4.5	2	2
Farming or agriculture that is not listed elsewhere	6	5.5	6
Pubs	6	5.5	5.5
Retailing vehicles or fuel	6	5.5	7
Wholesaling food	6.5	5	5.5
Retailing that is not listed elsewhere	6.5	5.5	6
Membership organisation	7	5.5	5.5
Wholesaling agricultural products	7	5.5	6
Retailing pharmaceuticals, medical goods, cosmetics or toiletries	7	6	7
Sport or recreation	7.5	6	7
Wholesaling that is not listed elsewhere	7.5	6	7
Printing	7.5	6.5	7.5
Repairing vehicles	7.5	6.5	7.5
Manufacturing food	8	7	7.5
Manufacturing yarn, textiles or clothing	8	7.5	8.5
Packaging	8	7.5	8.5
General building or construction services*	8.5	7.5	8.5
Hiring or renting goods	8.5	7.5	8.5
Library, archive, museum or other cultural activity	8.5	7.5	7.5
Manufacturing that is not listed elsewhere	8.5	7.5	8.5
Repairing personal or household goods	9	7.5	8.5
Mining or quarrying	9	8	9
Transport or storage, including couriers, freight, removals and taxis	9	8	9
Forestry or fishing	9.5	8	9
Travel agency	9.5	8	9
Dealing in waste or scrap	9.5	8.5	9.5
Hotel or accommodation	9.5	8.5	9.5
Manufacturing fabricated metal products	9.5	8.5	10
Computer repair services	9.5	10	11
Agricultural services	10	7	7.5
Social work	10	8	8.5
Veterinary medicine	10	8	9.5
Advertising	10	8.5	9.5
Photography	10	8.5	9.5
Publishing	10	8.5	9.5
Any other activity not listed elsewhere	10.5	9	10
Investigation or security	10.5	9	10
Boarding or care of animals	10.5	9.5	10.5

Business services that are not listed elsewhere	10.5	9.5	11
Estate agency or property management services	10.5	9.5	11
Laundry or dry-cleaning services	10.5	9.5	11
Entertainment or journalism	11	9.5	11
Catering services including restaurants and takeaways	11	10.5	12
Film, radio, television or video production	11.5	9.5	10.5
Secretarial services	11.5	9.5	11
Hairdressing or other beauty treatment services	11.5	10.5	12
Financial services	12	10.5	11.5
Management consultancy	12.5	11	12.5
Real estate activity not listed elsewhere	12.5	11	12
Architect, civil and structural engineer or surveyor	13	11	12.5
Accountancy or book-keeping	13	11.5	13
Computer and IT consultancy or data processing	13	11.5	13
Labour-only building or construction services*	13	11.5	13.5
Lawyer or legal services	13	12	13

Some of the rates have risen substantially, but some have been reduced. It is up to the trader to notice that the rates have altered and apply the right rate – any overpayment through failing to notice a reduction will be capped if not spotted for over four years.

Naturally anyone whose rate has increased should reconsider whether the scheme benefits them, and weigh up the costs of extra administration against the increased VAT liability through using the FRS. HMRC expect that some traders will leave the FRS as a result of the changes, but it is impossible to estimate how many.

There will also be complications for those who use the cash basis under the FRS. If they have charged 15% to a customer on an invoice, they should apply the 2009 flat rate to the income, even if the money is received in January. That might be even more confusing where the tax point is in December but the invoice does not carry any VAT, for example because the supply is exempt or zero-rated. The tax point should fix the appropriate rate to use, and the tax point will not always be the same as the date of receipt.

PBRN 33; SI 2009/3241

Article

There is an article in *Taxation* (4 March 2010) in which Neil Warren considers the reverse charge in general, and its interaction with the FRS in particular. Although purchases of goods from the rest of the EU must be accounted for by a FRS trader in Box 2 as an acquisition, purchases of services are not subject to the reverse charge. The use of service providers from outside the UK therefore appears to be a "legitimate" form of tax avoidance for a FRS trader.

Taxation, 4 March 2010

Article contributed by Mike Thexton

Lecture B595 (23.08 Minutes)

BAA Ltd

In 2006, a large Spanish company was set up AD to make a takeover bid for BAA, which operated several British airports. The bid was successful and AD joined BAA's VAT group.

The group claimed the input tax of more than £6 million in professional costs, which AD had incurred in relation to the takeover.

HMRC issued an assessment to recover the tax on the grounds that there was 'no direct and immediate link between the supplies on which this VAT was incurred and any taxable supplies made (or to be made)' by BAA's group.

BAA appealed.

The First-tier Tribunal ruled AD had been carrying on an economic activity even though it 'never made an actual taxable output supply in its own right'.

The judge said, 'The arrangement and negotiation of group finance facilities is an important role of a group holding company'.

While it had never been the intention that AD would make taxable supplies, the company was entitled to take advantage of the taxable transactions made by the BAA VAT group.

Thus it could be regarded as a taxable person. The input tax was therefore deductible and the taxpayer's appeal was allowed.

The decision shows that a company that has incurred professional services costs in the course of buying the share in another company may be able to recover the VAT element of those costs.

Richard Vitou of Deloitte said, 'The case has significant implications for businesses in both the corporate and private equity M&A arena whose VAT recovery on transaction costs is currently subject to challenge by HMRC. Businesses affected by this decision should now consider making claims for repayment of VAT'.

Mr Vitou added that this was subject to HMRC appealing the tribunal's decision.

FJ Chalke Ltd and another v CRC, Court of Appeal

The taxpayers were test claimants in the VAT interest cars group litigation order. They had overpaid VAT in respect of bonuses and sales of demonstrator cars. HMRC had accepted the claim, and the VAT was repaid, going back to 1973, together with simple interest.

The taxpayers then claimed compound interest should have been paid, and they made a claim in restitution. In the High Court in May 2009, the judge decided the claims were time-barred and only simple interest was due.

The taxpayers appealed.

The Court of Appeal said that the High Court judge's approach in respect of the Limitation Act 1980, s 32(1)(c) was not wrong in law, and there was no reason to invoke the EU law principle of effectiveness. Compound interest was not due.

The taxpayers' appeal was dismissed.

'This decision is perhaps not surprising, given the difficult time-limit issues faced by the taxpayers in this case', said Deloitte's David Raistrick.

He added that the decision left several points open. 'For example, it is now unclear whether a right to compound interest exists in principle, and the European Court of Justice will need to examine that point'.

Deloitte believes 'a right to compound interest does exist in principle, and taxpayers may still be able to obtain compound interest via other avenues'.

Mr Raistrick said, 'While [the latest] decision is unhelpful for taxpayers, there are reasons for optimism in the further litigation, which will clarify this very complex area'.

Deloitte mentioned that another set of taxpayers seeking compound interest will have their latest appeal heard by the Court of Appeal in June, having appealed unsuccessfully to the Tax Tribunal and the Upper Tribunal (Tax and Chancery).

Changes to zero–rate on Caravans

This Brief provides information on changes to the dimensions of caravans that will be eligible for zero–rating. It comes into effect from 20 April 2010.

This Revenue & Customs Brief announces a change to the dimensions of caravan that will be eligible to be zero–rated.

Effect of change

From 20 April 2010 the minimum width of caravan that will be eligible to be zero–rated will rise from 2.3 metres to 2.55 metres. The minimum length will remain unchanged at 7 metres.

All caravans less than 2.55 metres wide (and less than 7 metres long) will be subject to VAT at the standard rate–currently 17.5%.

This change means that from 20 April 2010, the zero–rate will cease to apply to the sale of second hand caravans that are 2.55 metres wide or less and that were originally supplied zero–rated. HMRC are currently considering the VAT treatment of the sale of these second–hand caravans and will be issuing further guidance shortly.

Background and reason for change

The legislation for the zero–rate for caravans is contained in Group 9 of Schedule 8 to the VAT Act 1994 and is directly linked to Regulation 8 of the Road Vehicles (Construction and Use) Regulations 1986 which determines the maximum size of a trailer (including caravans) that may legally be towed by cars.

Following infraction proceedings by the European Commission, the UK now needs to permit the same width trailers (including caravans) to be towed by cars on the public highway as in other parts of Europe. The Department of Transport are therefore amending Regulation 8 of the Road Vehicles (Construction and Use) Regulations 1986 to increase the maximum trailer width from 2.3 metres to 2.55 metres with effect from 20 April 2010.

Since the zero rate for caravans is directly linked to the Road Vehicles (Construction and Use) Regulations 1986, any increase in the size of trailers (including. caravans) has an automatic corresponding impact on the zero rate for caravans. From 20 April 2010, any supply of a caravan with a width of less than 2.55 and with a length of less than 7 metres will be taxable at the standard rate (17.5%).

An update to Public Notice 701/20 Caravans and Houseboats will be published in due course.

HMRC Brief 20/2010 15 April 2010

Stirling Investments

A married couple carried out an investment business as a partnership and a similar business as a company. Both entities were registered for VAT.

The company sold two properties for a profit in 2006. This profit was transferred to the partnership, after the latter sent the former an invoice for £525,000 plus VAT in respect of management charges.

The company reclaimed the VAT as input tax and the partnership accounted for it as output tax. HMRC disallowed the claim for input tax on the ground that the company had made exempt supplies in respect of the relevant properties.

The company subsequently said that transaction should not have been described as management services but was in fact a dividend payment to the partnership.

HMRC did not accept the company's assertion and issued an assessment. The company appealed.

The First-tier Tribunal accepted the company's claim that it had approached the transaction of the funds transfer to the partnership in the wrong way. It concluded that the taxpayer had made a 'true error' and this had been perpetuated by the company's and partnership's VAT returns.

There had been no intention to deceive or be dishonest. The partnership was simply a vehicle for taking surplus funds following the sale of properties and the partners were entitled to dictate that dividends should be paid into the partnership account.

The taxpayer's appeal was allowed. The tribunal added, however, that HMRC had acted reasonably in the circumstances, relying on information provided to them. They had been entitled to look to the tribunal for an interpretation of what actually happened.

This case shows the care that needs to be taken when transferring funds between businesses. Neil Warren, independent VAT consultant, said, 'Management charges are often used by accountants as a way of moving profits around between different entities.

'For VAT purposes, it is very important to identify whether an actual management service is being provided in terms of costs, salaries and other overheads being recharged to a separate company.'