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Personal Tax

50% income tax – some planning ideas for individuals

Income shifting

Income shifting structures for businesses have been dealt with in previous talks. Income shifting is of course the procedure whereby persons liable to tax at 40% or 50% divest themselves of a source of income in favour of someone who is liable at lower rates. With the recently increased differential between the additional rate of 50% and the basic rate of 20%, the attraction of being able to pass income across in these circumstances has grown considerably. This is particularly the case if an individual by shifting income to, say, his spouse is able to reduce his total income to £100,000 or less so that not only may he avoid the additional rate but he will also bring his personal allowance back into play. One simple example will suffice. Imagine a client who is a successful company director with salary and fees of £150,000. He also enjoys a substantial investment income from dividends of another £150,000 (gross). He is married and, for convenience, let us assume that his wife has no taxable income. At present, that individual has an income tax liability (after allowing for his dividend tax credits) of a little over £101,000. If he made an outright gift of his income-producing investments to his wife (and it would have to be an *outright* gift), the couple's aggregate income tax liability (again after allowing for dividend tax credits) would fall by some £23,500 to just under £78,000. And this saving would be repeated on a year-by-year basis.

Shifting income to a non-spousal recipient is a more complex matter, not least because of the CGT issues which will often arise.

Assets in joint names

In the case of a married couple living together, another relatively straightforward strategy for the spouse with the higher income is to place his or her bank accounts or portfolio investments into joint names. For income tax purposes, the couple are treated as entitled to the income in equal shares by virtue of S836 ITA 2007, even if their beneficial entitlements to the underlying assets are not equal. Remember that, if the couple's beneficial entitlements are unequal and a joint declaration is made under S837 ITA 2007 on Form 17, the income will be split according to their actual beneficial entitlements (it is not possible to choose arbitrarily how such income should be divided). However, these rules do not apply to partnership income nor to income from jointly-held shares in close companies.

Pensions

During 2010/11, it will be important for high income individuals to maintain their pre-22 April 2009 regular contributions to an approved pension scheme. This will not give rise to an anti-forestalling charge, even if the person's income is well in excess of the 'relevant income' limit of £130,000. In addition, anyone whose contributions are currently under £20,000 should consider making extra payments in 2010/11 so as to increase their aggregate contributions to that level. Since the £100,000 income threshold for tapering away the personal allowance takes account of deductions for pension contributions, higher rate taxpayers with 'relevant incomes' of less than £130,000 should pay further premiums in order to save their personal allowance and, in doing so, achieve a significantly better rate of tax relief.

Gift Aid

For those who are caught by the anti-forestalling legislation in 2010/11, it should be borne in mind that a Gift Aid donation is permitted to reduce an individual's 'relevant income' for this purpose. A judiciously timed charitable gift can therefore pull a person's income below the £130,000 threshold and, in doing so, save the special annual allowance charge which would otherwise be levied on an 'irregular' pension contribution. Gift Aid payments, which incidentally no longer have to be made to UK charities, can also be used to preserve a high income individual's personal allowance.

EIS and VCT reliefs

Given that the tax relief for pension contributions is going to be hit for all high earners after 5 April 2011, many more wealthy individuals are starting to examine the rival attractions of EIS and VCT schemes. Both these arrangements have been around for a number of years and they will continue to

be thought of as tax-efficient investment vehicles. This is particularly true for VCTs which invest in unquoted and AIM-listed companies and give tax-free capital gains as well as income. VCT investments also qualify for an initial income tax relief of 30% (the EIS is still 20%) as long as they are held for five years. The maximum investment is currently £200,000 per annum.

Contributed by Robert Jamieson

Lecture P606 (19.33 Minutes)

Tax credits – changes announced in the June Budget

There were cries of "shame" in the House when the Chancellor gave the low-down on tax credits for high earners. Known fairly widely in the tax profession, but possibly not to the general public, the combined impact of the £50,000 income limit for the family element of tax credit, and the income disregard of £25,000 per annum conspire to allow some people with income of up to £83,000 to claim tax credits. Mr Osborne has stopped the rot with a wide range of changes to the tax credit system, but has stopped short of massive change, relying on tinkering with rates and thresholds to achieve the effect he wants- to stop wealthy families gaining entitlement to this benefit and to reduce the cost of tax credits – albeit by a small margin on the £30bn a year they currently cost.

The changes will be phased in over the next 2 -3 years, so it is very important that those advisers dealing with tax credits

Changes to be implemented from April 2011

1. Taper rate – full tax credits

The taper rate applied to Working Tax Credit (WTC) and the non family element of Child tax credit (CTC) will be increased from 39% to 41% from 2011-12 awards. This is expected to show in the provisional awards for 2011-12 when made in the early part of that fiscal year.

The effect of increasing the taper rate is to reduce tax credits for higher earners. Thus a family (couple or single parent) with at least one parent working for 30 hours a week would lose all tax credits except for the family element as follows (using 2010-11 rates of tax credits):

	Income level - Taper rate	
	39%	**41%**
No children	18,215	17,640
One child no childcare	24,112	23,249
One child maximum childcare*	42,779	41,005
Two children no childcare	30,010	28,859
Two children maximum childcare*	62,010#	59,298#
Three children no childcare	35,907	34,469

* - if the family unit is a couple, both must work for at least 16 hours per week.

- the family element would also be tapered away at this level of income

2. Family element – baby rate

The family element of £545 per family (awarded if there is at least one child available for a CTC claim) is increased by £545 is there is a child under one year old in the family unit. The claim is reflected in an award commencing on the child's date of birth (provided notified within three months – but see below regarding a shorter notification period) and running until the child's first birthday. Claimants will therefore lose out by up to £545 in total per child born to the family while there is an active claim – assuming that the claims are made on time.

3. Family element – taper threshold

The threshold for taper of the family element is currently £50,000. This will reduce to £40,000 from April 2011. The effect of this would be that the family element will be tapered to zero at income of £48,134 rather than £58,134 for 2011-12 only. This income figure will in reality reduce still further as the taper rate for the family element changes (see below).

4. Taper rate – family element

From April 2011 the separate taper rate of 6.7% applying to the family element will be abolished, and all tax credits will be subject to the new 41% taper rate, so this would taper the family element in an income band of £1,329 instead of £8,134, reducing the taper point for the family element to £41,329 instead of £58,134 currently.

5. Income disregard – increases in income

When the award for the year is finalised (after the renewal has been filed) the income for the year of award is used to compute the taper. The provisional award (which has been paid in full by the time of the calculation) is based on the previous year's income, and any change in income can affect the tax credit award for the preceding year, potentially leading to a demand for repayment, although any reduction in the previous year's award is normally collected from the subsequent award.

When income increases from one year to another, the increase is subject to a "disregard", meaning that the increase is ignored in full or in part when recomputing the previous year's award. The full income is, however used when making the provisional award for the current year.

The income disregard was originally set at £2,500, but this caused huge debt problems for many claimants, so the disregard was increased to £25,000. This would mean that even if income increased by £25,000 against the previous year, the final award would still be based on the lower income. For income increases of in excess of £25,000, the award is tapered by taking the lower income figure, plus the increase in excess of £25,000.

The income disregard will reduce to £10,000 from April 2011. It is not currently clear whether this will apply to the recalculation of 2010-11 awards in April to July 2011, but it is more likely to apply when the 2011-12 awards are recalculated in the same period of 2012.

The effect of this will clearly be significant for families with income which varies significantly and is very likely to affect families where the main earner is self employed, and therefore subject to wider income fluctuations.

Example

Barney the builder had income for 2009-10 of £15,000 after capital allowances. In 2010-11 his income increased to £35,000. Barney works full time and has two children. Barney's wife is not in paid work.

Provisional award for 2010-11

		£		£
WTC	Basic rate			1,920
	Couple			1,890
	30 hours			790
CTC	Two children			4,600
Total tax credits				9,200
Taper : provisional income		15,000		
Threshold		(6,420)		
Income for taper		8,580	@39%	
				(3,346)
Family element				545
Net award				£6,399

Final award for 2010-11

	£	£
Gross award as above		9,200
Actual income	35,000	
Provisional income	15,000	
Increase	20,000	

Increase is below disregard amount so no change to taper and award made is undisturbed.

Had the same facts applied for the following years, the following would have applied (assuming that the gross awards are unchanged from 2010-11):

Provisional award for 2011-12

	£	£
Gross award as above		9,200
Taper : provisional income	15,000	
Threshold	(6,420)	
Income for taper	8,580 @41%	
		(3,518)
Family element		545
Net award		£6,227

Final award for 2011-12

	£	£
Gross award as above		9,200
Actual income	35,000	
Provisional income	15,000	
Increase 20,000		
Disregard	(10,000)	
Balance used for taper	10,000	
Income for taper	25,000	
Threshold	(6,420)	
Income for taper	18,580 @41%	
		(7,618)
Family element		545
Net award		£2,127

The award paid was £6,227, so Barney is facing a repayment for the previous year of £4,100, and in addition his tax credit award for 2012-13 will have continued at the same rate until renewal, so he may be facing a further repayment as follows :

2012-13

Annualised award in provisional payment	£6,227	
Actual award due (annualised)		
Gross award as above		9,200
Taper : provisional income	35,000	
Threshold	(6,420)	
Income for taper	28,580 @41%	
		(11,718)
Net of taper		NIL
Family element		545
Net award		£545

So the Family element only would be awarded – but see change 2 dealt with below.

Payments made to July 31 say	£2,076
Payment should be (for that period)	£182
Total tax credit debt – current year	£1,894
- previous year	£4,100
Tax credit debt	£5,994

This would be collected through subsequent awards – the family element being reduced to nil, but any award including ordinary CTC is reduced by a percentage rather than being taken away completely. In fact the family element would also be tapered off (see change 2 below), so the family could be faced with a demand for payment. This case is dealt with below at change 2.

6. Availability to the over 60's

From April 2011 the over 60's will be permitted to claim tax credits provided they are working for at least 16 hours per week. This is a reduction in working hours requirement, as without children in the household the minimum working requirement is 30 hours.

Changes to be implemented from April 2012 and after

1. Threshold – family element

The threshold for the separate taper of the family element having been reduced to £40,000 from April 2011, the change from April 2012 will see the separate threshold also abolished, so that a single taper calculation is performed, tapering continuously through the main WTC/CTC and then the family element.

This is best illustrated by example, and the 2012-13 tax credits for Barney dealt with above provide the following:

2012-13 provisional award

Gross award as above		9,200
Family element		545
Gross award to be tapered		9,745
Taper : provisional income	35,000	
Threshold	(6,420)	
Income for taper	28,580 @41%	
		(11,718)
Net award		£NIL

As there is now no tax credit award in payment, the debt accrued above increases as follows:

Relating to 2011-12	4,100
Relating to 2012-13	2,076
Total debt as at 31 July 2012 (say)	6,176

However, when there is no award in payment, tax credits cannot be collected through the subsequent awards, so a demand would be issued for repayment of the above sum, due and payable within 30 days. It is clear that the combined effect of these changes would be very damaging for some families, and in particular the self employed.

2. *Backdating claims*

Backdating of claims is currently possible for a period of 93 days, although backdating is not automatic and must be separately requested for both WTC and CTC. For changes notified from April 2012 the backdating period will be reduced to one month; it will thus be even more crucial to ensure that clients are aware that they need to notify changes or make claims promptly, otherwise they could lose entitlement to tax credits.

3. *Income disregard – increases in income*

The income disregard for increases in income which reduced from £25,000 to £10,000 from April 2011 will reduce once again from **April 2013** to £5,000. Clearly this will make the effect of changes in income more pronounced, and particularly affect the self employed most.

4. *Income disregard – reductions in income*

Currently, ANY reduction in income against the provisional amount used to compute the tax credit award has the effect of increasing the award for the previous year. However, from April 2012 there will be a disregard for income decreases of £2,500. This will mean that a reduction in income of £2,500 will be ignored when finalising the previous year's award, and any reduction of more than this amount will only take into account the excess.

Example

The facts used for Barney are as above, with his income year one being £15,000, and for year two only £12,000.

Two periods are considered to show the effect of the change.

Provisional award for 2011-12

	£		£
Gross award as above			9,200
Taper : provisional income	15,000		
Threshold	(6,420)		
Income for taper	8,580	@41%	
			(3,518)
Family element			545
Net award			£6,227

Final award for 2011-12

	£		£
Gross award as above			9,200
Actual income	12,000		
Provisional income	15,000		
Decrease	3,000		
There is no disregard in operation			
Income for taper	12,000		
Threshold	(6,420)		
Income for taper	5,580	@41%	
			(2,288)
Family element			545
Net award			£7,458

So a top up single payment of £1,231 would be made around July 2012.

Moving this on one year, the effect is as follows :

Provisional award for 2012-13

	£		£
Gross award as above			9,200
Family element			545
Gross amount for taper			9,745
Taper : provisional income	15,000		
Threshold	(6,420)		
Income for taper	8,580	@41%	
			(3,518)
Net award			£6,227

Final award for 2012-13

	£	£
Gross award as above		9,745
Actual income	12,000	
Provisional income	15,000	
Decrease	3,000	
Disregard	(2,500)	
Decrease used for taper	500	
Income for taper	14,500	
Threshold	(6,420)	
Income for taper	8,080 @41%	
		(3,313)
Net award		£6,432

So the top up payment reduces to £205 – a reduction of £1,026.

6. 50+ return to work elements

Special rates of tax credit available to the over 50's who have been out of work and applicable to their first year back in work will be abolished from April 2012. These are currently worth (per annum) £1,320 for 16 – 29 hours per week and £1,965 for 30 hours and over.

More examples of the effects of the changes

Ignoring the impact of inflationary changes, the changes in the thresholds and taper rates would have the following impact over the next two years :

- Family with two children and full time working parent, with income of £20,000 per annum
    - Current year net award £4,449
    - 2011 net award £4,177
    - 2012 net award £4,177
- Family with two children and full time working parent with income of £41,000 per annum
    - Current year net award £545
    - 2011 net award £135
    - 2012 net award £Nil
- Family of two children with maximum childcare claim for both with income of £48,000
    - Current year net award £6,009
    - 2011 net award £5,464
    - 2012 net award £4,632

Clearly, however, some of the worst excesses of the tax credit system will be eliminated by the reduction in the income disregard.

The following example may suffice:

Income disregards

John has two children and the family's normal income is £30,000. John plans to invest £25,000 in a new zero emissions vehicle on which he will receive 100% First year allowances, thus reducing his income for tax credit purposes to £5,000.

His tax credit claims are as follows (under the current system):

2010/11	Provisional award based on income of £30,000	£549
	Final award based on actual income of £5,000	£9,745
2011/12	Provisional award based on income of £5,000	£9,745
	Final award based on income of £30,000 (disregard increase)	£9,745

Total value of additional tax credit award towards purchase of vehicle £18,390 (as the family element would have been available in any event)

Under the new rules, the following awards would be made (taper rate also changes) :

2010/11	Provisional award based on income of £30,000	£549
	Final award based on actual income of £5,000	£9,745
2011/12	Provisional award based on income of £5,000	£9,745
	Final award based on income of £30,000 (disregard £10,000 of increase)	£4,177
OR (2013/14)	Final award based on income of £30,000 (disregard £5,000 of increase)	£2,127

So the tax credit contribution to the purchase of the vehicle is £12,824 when the income disregard reduces to £10,000 and £10,774 when it reduces to £5,000. The income reduction disregard has minimal effect here as the net income after the reduction is below the taper threshold of £6,420.

Contributed by Rebecca Benneyworth

Lecture P607 (18.10 Minutes)

Revenue and Customs Commissioners v PA Holdings Ltd

The defendant taxpayer was a United Kingdom-resident company whose subsidiaries and branches provided consultancy services. The taxpayer was employee-owned, in that its shares were held by employees or by trusts for employees' benefit (employee trusts). Annually, the taxpayer paid a substantial proportion of its profits into employee trusts from which awards were made to employees under discretionary bonus schemes. In 1999, a new bonus scheme was implemented, pursuant to which bonuses were to be paid as dividends of a UK-resident company and, in consequence, taxed as distributions. A deed was executed in December 1999 establishing a new employee benefit trust (the 1999 trust) appointing, as trustee, a particular company (M). The stated purpose of the 1999 trust was 'to motivate and encourage employees in the performance of their duties by the provision of bonuses and incentives and other rewards at the discretion of the trustees'. The taxpayer transferred approximately £24m to M for payment into the 1999 trust, recording the payment as 'staff costs' in

its accounts. M then established a company (E), which at the time was non-UK resident. Shares in E were issued to M nominees and, in January 2000, E became UK-resident, with the result that its dividends fell within Sch F, rather than Sch D, to the legislation in force at the material time, namely, the Income and Corporation Taxes Act 1988 (the ICTA) (since repealed). In February, M transferred almost all of the £24m it had received from the taxpayer into E as a capital contribution, subscribed 24 million 1p preference shares at par and issued them to its nominee. M then granted individual awards of beneficial interests in almost all the preference shares to particular employees who had been identified by the taxpayer and the nominee was instructed to hold those shares for those employees. In March, E declared a dividend of 99p on each 1p preference share from the profits represented by the capital contribution. The dividend was paid to the nominee as the registered owner and thence, after the deduction of 25% income tax, to the selected employees. Essentially the same steps were repeated in the years 2000 and 2001. An issue arose between the taxpayer and the Revenue and Customs Commissioners (the Revenue) as to how the payments were to be treated for tax purposes, and a hearing took place before the first tier tribunal (the tribunal). The tribunal held that: (i) the payments were to be treated as emoluments from employment within s 19 of and Sch E to the ICTA; (ii) the payments also constituted dividends or distributions within s 20 of and Sch F to the ICTA; (iii) pursuant to s 20(2) of the ICTA, the payments were accordingly not chargeable to income tax pursuant to Sch E under Reg 80 of the Income Tax (Pay as You Earn) Regulations 2003; and (iv) the payments were earnings within the terms of ss 3 and 6 of the Social Security Contributions and Benefits Act 1992 (the SSCBA) and thus subject to liability for Class 1 National Insurance contributions. The Revenue appealed against the second and third of those conclusions, and the taxpayer cross-appealed against the first and fourth.

Relying on the line of authority derived from the decision in *Ramsay (W T) Ltd v IRC, Eilbeck (Inspector of Taxes) v Rawling*[1981] 1 All ER 865 (*Ramsay*), the Revenue contended that the payments were properly characterised as emoluments from the employees' employment under s 19 ICTA and it was wrong to apply a different characterisation for the purpose of s 20 ICTA. The taxpayer challenged the tribunal's finding that the dividends were to be treated as emoluments within s 19 of and Sch E to the ICTA essentially on the basis that the tribunal had failed correctly to apply the relevant case law. It further submitted, inter alia, that if a payment came from two sources, then it could not be a 'profit from employment' for the purpose of Sch E to the ICTA so that, in the instant case, if the payments received by the employees had come from the shares in E, they could not be emoluments from the employees' employment (the 'double source' proposition). The taxpayer also challenged the fourth conclusion on a similar basis.

The appeal and cross-appeal would be dismissed.

Upper Tribunal (Tax and Chancery Chamber)

7 July 2010

Closure of sub-post office – termination payment

The issue

This appeal related to the tax treatment of a compensation payment of £74,647.21 ("the Termination Payment") paid by Post Office Limited to the Appellant under the Urban Post Office Closure Scheme (part of the Post Office's Network Reinvention Programme) on 31 March 2005.

The Appellant argued that £30,000 of the Termination Payment should be treated as tax-exempt compensation for loss of office of sub-postmaster and the remainder should be treated as a capital payment to his wife and himself in equal shares in respect of their disposal of the goodwill of their partnership business upon closure of their sub-post office and shop.

HMRC argued that the whole amount should be taxed subject to the usual £30,000 exemption as employment income of the Appellant under s 403 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA").

Background and Facts

The Tribunal accepted that from the outset and at all relevant times, the shop (including the sub-post office) was run by the Appellant and his wife in a 50:50 partnership ("the Partnership").

The post of sub-postmaster was a personal appointment and could not be transferred. The Tribunal found as a fact that the Appellant was the sole holder of the sub-postmaster appointment at all material times; however it also found that the appointment (and the rights under it) was partnership property of the Partnership under s 20 Partnership Act 1890.

The Tribunal accepted that the business of the Partnership (including the operation of the Post Office counter) was carried on by both the Appellant and his wife. In doing so, they were interchangeable.

In a letter dated 16 March 2004 ("the Offer Letter"), Post Office Limited made a conditional offer, addressed to the Appellant personally, to pay what was described in the heading of that letter as a "compensation payment" totalling £70,046.04 if a decision was made, as part of the Urban Post Office Closure Scheme, to close the Post Office branch at the Woodsetton Post Office. The Offer Letter included the following sections:

"Subject to each of the conditions listed in paragraph 1 above being satisfied, Post Office Ltd offers to pay to you on or about your last day of service the sum of £70,046.04, if a final decision is taken to close your branch. This sum represents compensation for loss of office, and all Post Office® business must cease upon your last day of service...."

"We have sought the views of the Inland Revenue on the treatment of the compensation received under the Closure Scheme. The Inland Revenue has confirmed that that part of the total payment which relates to compensation for loss of office will be chargeable to tax under Section 401 Income Tax (Earnings and Pensions) Act 2003 and will attract exemption, up to a maximum £30,000 contained in Sections 403 and 404 of the same Act...."

"The Inland Revenue has also confirmed that that part of the total payment which relates to compensation for loss of office will not fall within the definition of 'earnings' in S3(1)(a) Social Security Contributions and Benefits Act 1992 and will not attract a Class 1 NICs liability."

Decision

The Tribunal found that the Termination Payment was received by the Appellant in his capacity as a partner with his wife in the Partnership. It was partnership property, to which he and his wife were entitled in equal shares. As such, for the purposes of s 401 ITEPA, the Tribunal considers that the Appellant can only be regarded as having "received" one half of the payment. The other half must, in the Tribunal's view, be regarded as having been "received" by the Appellant's wife.

Nonetheless, both halves of the Termination Payment were received "directly in consideration or in consequence of, or otherwise in connection with" the termination of the Appellant's office as sub-postmaster of the Woodsetton Post Office, and accordingly the part of the payment "received" by the Appellant's wife must, since she was his spouse (see s 401(1)), be counted as employment income of the Appellant under s 403.

Since s 401 on its face applies to any payment, irrespective of whether it is revenue or capital in nature in the hands of the recipient, questions of apportionment of the Termination Payment between compensation for loss of office and other compensation are, in the Tribunal's view, simply irrelevant. The whole payment falls within s 401 and 403 regardless of any such apportionment.

TC00516: Lakbir Singh Uppal

UK charity tax reliefs

A package of changes involving charities and Community Amateur Sports Clubs (CASCs) has been announced by the Government. They fall into two main categories:

- the tax reliefs available to UK charities are being extended to organisations equivalent to charities and CASCs located in the EU and in the EEA countries of Norway and Iceland; and
- the anti-avoidance legislation for charities has been strengthened.

Extending the charity tax reliefs

Following an ECJ judgment in January 2009, a new statutory definition of a charity entitled to charity tax reliefs has been introduced by S30 and Sch 6 FA 2010. The legislation brings in a four-stage test in order to determine whether an organisation is eligible for charity tax reliefs in the UK.

Firstly, under Para 1 Sch 6 FA 2010, the organisation must be established for charitable purposes only. The definition of what constitutes charitable purposes follows the law of England and Wales and is found in S2 Charities Act 2006.

Secondly, under Para 2 Sch 6 FA 2010, the organisation must meet a so-called jurisdiction condition. This states that it must be located either in the UK or a member state of the EU or in another specified country. The Commissioners for HMRC have the power to specify countries outside the EU by statutory instrument. Norway and Iceland will be duly designated as soon as practicable.

Thirdly, under Para 3 Sch 6 FA 2010, the organisation must satisfy a registration condition. Where an overseas organisation is required under the law of its home jurisdiction to be registered with a charity regulator similar to the Charity Commission for England and Wales, it must be so registered. The purpose of this condition is to ensure that only organisations which comply with the relevant charity obligations in their home country are eligible for UK charity tax reliefs.

Finally, under Para 4 Sch 6 FA 2010, the organisation must comply with a management condition. That is to say, all persons within the organisation having control and management responsibilities must be ‘fit and proper’ persons. It should be noted that the description ‘fit and proper’ is not defined in FA 2010 and so must be given its ordinary English meaning. While a properly run charity should seek to appoint persons of integrity to key management positions, there is always a chance that a charity may unknowingly appoint a person who is not ‘fit and proper’. In such a case, the charity would normally cease to meet the management condition described above and would no longer be eligible for the various tax reliefs.

Fortunately, Para 5 Sch 6 FA 2010 relaxes this stringent requirement in two sets of circumstances:

1. where the manager is not in a position to prejudice the administration of the charity, for example, if an ex-offender is appointed to a position of trust within the charity – provided that this person is not involved in the charity’s financial affairs, the charity will be treated as still meeting the management condition (Para 5(2)(a) Sch 6 FA 2010); and
2. where someone has been appointed to a responsible management position within the charity but he or she is later found not to be a ‘fit and proper’ person – as long as the charity has not colluded with the manager and subsequently works with HMRC to rectify the position, the Commissioners for HMRC are likely to consider that the let-out in Para 5(2)(b) Sch 6 FA 2010 should be in point.

In relation to donations by individuals under Gift Aid, the new definitions are treated as taking effect from 6 April 2010. Thus it is already possible to make donations to foreign charities and claim Gift Aid relief. For other purposes, the new definitions will only come into operation when the Treasury make a commencement order.

Anti-avoidance legislation

S31 and Sch 7 FA 2010 have introduced a new measure to block avoidance schemes which seek to exploit the rules for tax relief on gifts to charities of qualifying investments (eg. listed shares and interests in land). These provisions do not affect the charities themselves – they simply operate to restrict the tax deduction available to donors.

HMRC explain the background to the restriction and the effect of the anti-avoidance legislation as follows:

'The avoidance depends on the donor receiving tax relief at their highest marginal rate of tax on the full market value of the qualifying investments at the date of the gift where:

- the donor acquired investments at below market value as part of a scheme or arrangement; or
- the market value of the investment is artificially inflated at the date of the gift to charity.

The new rules adjust the amount of relief to the donor to the economic cost of acquisition of the gift where:

- the qualifying investment gifted to the charity (or anything from which the investment derives) was acquired within four years of the date of disposal; and
- the main purpose, or one of the main purposes, of acquiring the qualifying investment was to dispose of it to a charity and claim the tax relief.'

The legislation in Sch 7 FA 2010 applies to both individual and corporate donors. In the case of individuals, it amends S437 ITA 2007 and inserts a new S438A ITA 2007. For companies, it amends S209 CTA 2010 and inserts a new S210A CTA 2010.

Illustration

Wood, a top rate taxpayer, enters into an agreement to buy shares worth £200,000 in a FTSE 100 company from Company A for £30,000. These shares come with an option attached which allows Company A to buy them back after three years for £1.

Two days after buying the FTSE 100 shares, Wood donates them to his favourite charity and claims under S431 ITA 2007 that there is a donation of £200,000 (ie. the market value of the shares). The fact that there is an option to buy the shares back for £1 is not taken into account because the option is a contingent liability which is ignored by virtue of S440(2)(b) ITA 2007.

However, new S437(1A) – (1C) ITA 2007 will now apply given that the shares were acquired within four years of the date of their disposal and the reason why Wood bought them was so that he could donate them to the charity and claim tax relief.

As the cost of buying the shares was £30,000 (compared to their market value of £200,000), Wood is only entitled to claim relief of £30,000 under S431 ITA 2007.

This anti-avoidance legislation has effect for disposals to charities on or after 15 December 2009.

Contributed by Robert Jamieson

Lecture P609 (14.31 Minutes)

Capital Gains Tax

Practical implications of the CGT changes

Rates of CGT

The Finance Bill 2010 includes provision to change the rates of CGT for gains arising on or after 23 June 2010.

- For individuals, where their total taxable income and gains after all allowable deductions are less than the upper limit of the basic rate income tax band, the rate of CGT will be 18 per cent.
- For gains (and any parts of gains) above that limit the rate will be 28 per cent.
- For trustees and personal representatives of deceased persons, the rate will be 28 per cent.

Gains arising in 2010-11, but before 23 June 2010, will continue to be liable to CGT at 18 per cent and will not be taken into account in determining the rate (or rates) at which gains of individuals arising on or after 23 June 2010 should be charged.

Deferred gains crystallising

Certain CGT reliefs allow gains on disposal of an asset to be deferred until some time after the disposal. For instance, a gain can be reinvested in shares under the Enterprise Investment Scheme (EIS) and, subject to conditions, can be deferred until the EIS shares are disposed of. The CGT rate(s) on a gain deferred in this way will be the rate(s) at the time the deferral ends and the gain becomes liable to tax. Gains on disposals before 23 June 2010 which are deferred until 23 June 2010 or later will therefore be liable to CGT at the 18 or 28 per cent rates, in the same way as gains arising on disposals on or after that date.

In working out the CGT payable, taxpayers will be able to deduct losses and the AEA in the way which minimises the tax due.

Example 1

In 2010-11 X's taxable income, after all allowable deductions and the personal allowance, is £27,400. The upper limit of the income tax basic rate band is £37,400. X sells an asset in May 2010 and realises a chargeable gain of £17,000. In November 2010 X sells another asset, realising a chargeable gain £25,100. X has no allowable losses to set against these gains, and the AEA for 2010-11 is £10,100. Neither of the gains qualifies for entrepreneurs' relief.

X's taxable income is £10,000 less than the upper limit of the basic rate band (£37,400 - £27,400). X sets the AEA against the later gain (because part of that gain is liable to tax at the higher CGT rate), leaving £15,000 taxable (£25,100 – £10,100). The first £10,000 of the £15,000 is taxed at 18 per cent and the remaining £5,000 is taxed at 28 per cent. The £17,000 chargeable gain X realised in May 2010 before the change of rates on 23 June 2010 is taxable at the old 18 per cent rate.

For trustees and personal representatives of deceased persons, the CGT rate will be 28 per cent for gains arising on or after 23 June 2010, except where entrepreneurs' relief applies (see below).

Entrepreneurs' relief – rate of CGT and lifetime limit on relief

Subject to satisfying certain conditions, including the lifetime limit of £2 million, gains on disposals of entrepreneurial businesses by individuals and certain trustees qualify for entrepreneurs' relief (Chapter 3 of Part 5 of TCGA). Currently entrepreneurs' relief reduces qualifying gains by 4/9 and the remaining 5/9 are then charged at the single 18 per cent rate. This results in qualifying gains being taxed at an effective rate of 10 per cent.

The changes to CGT rates from 23 June 2010 would mean the 4/9 reduction no longer achieved an effective rate of 10 per cent. Finance Bill 2010 will therefore include provision to charge gains on disposals that qualify for entrepreneurs' relief on or after 23 June 2010 at a 10 per cent rate. The previous 4/9 reduction will cease to apply from that date.

The amount of an individual's gains that can qualify for entrepreneurs' relief is subject to a lifetime limit of £2 million (£1 million for disposals before 6 April 2010). For trustees, the £2 million limit is that of the beneficiary of the settlement who meets the conditions for the trustees to claim the relief.

Finance Bill 2010 will include provision to increase that limit to £5 million from 23 June 2010.

Where individuals or trustees make qualifying gains above the previous £2 million limit before 23 June 2010 (£1 million limit before 6 April 2010), no additional relief will be allowed for the excess above the old limit. But if they make further qualifying gains on or after 23 June 2010, they will be able to claim relief on up to a further £3 million of those additional gains (or up to £4 million where the earlier £1 million limit applied), giving relief on accumulated qualifying gains up to the new limit of £5 million. In determining at what rate(s) an individual should be charged to CGT on any other gains, those gains qualifying for entrepreneurs' relief are set against any unused basic rate band before non-qualifying gains.

Example 2

Y has previously used £1 million of their lifetime entrepreneurs' relief limit. In 2010-11 Y's taxable income, after all allowable deductions and the personal allowance, is £17,400. The upper limit of the income tax basic rate band is £37,400. In May 2010 Y realises a chargeable gain of £3 million on the disposal of a business. In December 2010 Y sells another business, realising further chargeable gains of £7 million. Both disposals qualify for entrepreneurs' relief (subject to the lifetime limits). Y has no allowable losses to set against these gains, and the AEA for 2010-11 is £10,100.

The £3 million gain realised in May 2010 is subject to the £2 million lifetime limit for entrepreneurs' relief (for qualifying disposals from 6 April 2010), of which Y has previously used £1 million. The gain is reduced by 4/9 of £1 million and the remainder charged to CGT at the single rate of 18 per cent. The increase in the lifetime limit from 23 June 2010 means that £3 million of the £7 million gain from December is chargeable at the 10 per cent rate of CGT. Y's taxable income is £20,000 below the basic rate band (£37,400 – £17,400). But the £3 million of the gain charged at 10 per cent is taken into account in priority to other gains in determining whether total income and gains exceed the basic rate band. So the remaining £4 million gains, less the AEA, are charged at the higher rate of 28 per cent.

Lecture P608 (12.01 Minutes)

Coll and another v Commissioners for Her Majesty's Revenue and Customs

Section 135 of the Tax on Chargeable Gains Act 1992, so far as material, provides: '(1) Subsection (3) below has effect where a company ("company A") issues share or debentures to a person in exchange for shares in or debentures of another company ("company B") and - (a) company A holds, or in consequence of the exchange will hold, more than one-quarter of the ordinary share capital (as defined in section 832(1) of the Taxes Act) of company B, or (b) company A issues the shares or debentures in exchange for shares as a result of a general offer - (i) which is made to members of company B or any class of them (with or without exceptions for persons connected with company A), and (ii) which is made in the first instance on a condition such that if it were satisfied company A would have control of company B, or(c) company A holds, or in consequence of the exchange, will hold the greater part of the voting power in company B... (3) Subject to sections 137 and 138, sections 127 to 131 shall apply with any necessary adaptations as if the 2 companies mentioned in subsection (1) above or, as the case may be, in section 136 were the same company and the exchange were a reorganisation of its share capital.'

Section 137 of the Tax on Chargeable Gains Act 1992, so far as material, provides: '(1) Subject to subsection (2) below, and section 138, neither section 135 nor section 136 shall apply to any issue by a company of shares in or debentures of that company in exchange for or in respect of shares in or debentures of another company unless the exchange, reconstruction or amalgamation in question is effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose or one of the main purposes, is avoidance of liability to capital gains tax or corporation tax. (2) Subsection (1) above shall not affect the operation of section 135 or 136 in any case where the person to whom the shares or debentures are issued does not hold more than 5 per

cent of, or, of any class of, the shares in or debentures of the second company mentioned in subsection (1) above.'

The taxpayers, JC and MC, were a married couple who separated but were subsequently reconciled. Each owned half the shares in a nursing agency. Their shares were exchanged for loan notes in a company and were redeemed in 1998-99 (the transaction), while the taxpayers were deemed to be resident in Belgium for the purposes of the double taxation agreement between the UK and Belgium. Sections 135 and 137 of the Tax on Chargeable Gains Act 1992 provided, inter alia, that an exchange of shares for debentures would be treated as a reorganisation of the share capital of a single company with the result that there was no disposal of the original shares by the shareholders, unless (i) the exchange was effected for bona fide commercial reasons, and (ii) that it did not form part of a scheme or arrangements of which one of the main purposes was avoidance of capital gains tax (CGT). The revenue charged teh taxpayers CGT on the transaction, and teh taxpayers appealed to the Special Commissioner. The Special Commissioner found, inter alia, that the taxpayers' plan to make the exchange while in Belgium was not a chance occurrence but a fulfilment of their intention to redeem the loan notes at a time when they were not resident in the UK. He found that they did not have an intention of residing specifically in Belgium, but rather they had an intention of living outside the UK so as to avoid CGT on the redemption of loan notes. The Special Commissioner found that s 137 of the 1992 Act prevented s 135 from applying, with the result that there had been a disposal of the shares in 1997-98 when the taxpayers were still resident in the UK. He also found their separation to have been a sham, and that the purpose of the arrangement was the avoidance of CGT. Consequently, he held that JC and MC were liable for CGT. The taxpayers appealed.

The taxpayers submitted that: (i) their circumstances should have been considered separately by the Revenue; and (ii) there had been no intention to avoid CGT. The Revenue contended that if s 137 applied to JC it applied to all the shareholders including MC and so there had been no need to consider her circumstances separately.

The appeal would be dismissed.

(1) For the purposes of s 137 of the Act, there was no obligation on the Revenue to identify the 'scheme or arrangements' and it was for the appellant to prove that there was no scheme or arrangements (see [8] of the judgment).

It was obvious in the instant case that the scheme was the issue of loan notes with the purpose of JC becoming non-resident and redeeming them while non-resident (see [8] of the judgment).

(2) On the plain words of the Act, s 137 was an all-or-nothing provision applying to all the shareholders (other than unconnected shareholders holding 5% or less). Accordingly, if there were such a scheme or arrangement as was mentioned in s 137 of the Act, then none of the shareholders qualified for treatment under s 135 of the Act, other than unconnected shareholders holding 5% or less (see [10] of the judgment).

If there were a reorganisation of a company share capital within s 126 of the Act then, by s 127, the original shares and the new holding would be treated as a single asset. Either there was a reorganisation of the share capital of a company or there was not; if there was, the same treatment had to apply to all the shares. Section 135(3) of the Act applied the same approach to a share exchange by treating both companies involved as a single company and the exchange as a reorganisation of the share capital of that deemed single company. That treatment likewise had to apply to all the shares if it applied to any of them. Section 137 of the Act provided that s 135 did not apply to any issue in the exchange unless the conditions there set out were satisfied, except that an unconnected shareholder holding 5% or less would in any event qualify under s 135 of the Act. That also pointed to all the shareholders being treated in the same way. Further, s 138 provided for the ability of either company to apply for a clearance which was a further indication that the provisions related to all the shares involved in the exchange. If s 137 of the Act applied to each shareholder separately, a clearance application by one of the companies on behalf of all the shareholders in s 138 of the Act would make no sense (see [10]-[12] of the judgment).

On the evidence, the finding that JC's continuing intention was to become non resident had not been unreasonable. There had been a finding of fact that, for the purpose of s 137, the exchange had been

part of a scheme, and that a main purpose of the scheme was avoidance of CGT. In those circumstances, the appeal would be dismissed (see [37]-[39] of the judgment).

Snell v Revenue and Customs Comrs [2006] All ER (D) 336 (Dec) distinguished; *Edwards (Inspector of Taxes) v Bairstow and Harrison* 36 TC 207 considered.

Upper Tribunal (Tax and Chancery Chamber)
30/06/2010

Inheritance Tax and Trusts

Hatton v Revenue and Customs Commissioners

This is an appeal against the determination by the Commissioners of HM Revenue and Customs, under section 221 of the Inheritance Tax 1984, that the value of the freehold interest held by Mrs Ilona Hatton deceased in a house known as 22 First Avenue, London, W3 7JR (the appeal property) on 27 September 2005, the date of death, was £475,000.

The appellant is Ms Lesley Susan Hatton, the executor of Mrs Hatton's will. She contends that the value was £400,000.

The appeal was conducted in accordance with the Tribunal's simplified procedure. Mr David Sharron FNAEA, principal of Ravenscourt Residential, estate agents and valuers of London, W12 appeared for the appellant with permission of the Tribunal and gave evidence. Mr Colin Ryder of HMRC Inheritance Tax Appeals Team appeared for the respondent, again with the Tribunal's permission. He called expert evidence from Mr Brian Timmis MRICS, a senior valuer attached to the London Strategy Team of the Valuation Office Agency. I inspected the exterior of the appeal property and certain comparable properties in the vicinity, accompanied by representatives of the parties, on the afternoon of the hearing.

From the evidence and my inspection I find the following facts. First Avenue is a quiet residential road of Edwardian terraced houses, situated just off and to the north of The Vale, Uxbridge Road (A4020) in East Acton in the London Borough of Ealing. It is a predominantly residential area with good access along Uxbridge Road, east towards Shepherd Bush and Central London and west towards the A40 and the national motorway network. There are local shops within a short walking distance and Uxbridge Road is well served by local buses. Shepherds Bush Market (Hammersmith and City line) and Shepherds Bush (Central line) underground stations are approximately seven-eighths of a mile and one and a quarter miles to the east respectively.

The appeal property is a two storey mid-terrace Edwardian house, constructed of solid brick walls and a pitched plain tiled roof. It has a projecting front gable, providing bay windows to both floors. There is a small front forecourt and a rear garden, approximately 20 feet deep. There is no garage and there is on-street parking only, but a service road provides vehicular access to the rear. The appeal property is one of many similar houses in this and neighbouring roads, although a number have been converted to flats.

At the valuation date the accommodation comprised an entrance hall, sitting room, dining room, kitchen and breakfast room on the ground floor and two double bedrooms, one single bedroom, kitchen, bathroom and separate wc on the first floor. (The first floor kitchen was subsequently converted to a single bedroom). There was also an external wc and a small external store. The property was in reasonable condition but in need of improvement. The roof was covered with original plain tiles which would require replacing shortly.

The appeal property was placed on the market by the appellant in the summer of 2007 at £650,000. An offer to purchase at the asking price was made on 31 August 2007 and the sale at £650,000 completed on 12 November 2007. The condition of the appeal property in November 2007 was similar to that at the valuation date. In a letter to the appellant dated 7 April 2008, the new owner stated that, following the sale, £41,350 was spent on works "which were necessary to bring the house to a habitable condition for a young family."

Mr Sharron said that the market value of the appeal property at the valuation date was £400,000. This figure was based on his "hands on local knowledge of property in the area", and on 25 years experience. The main comparable sale upon which he relied was that of 5 Agnes Road, which his firm had sold very close to the valuation date for £390,000. He also obtained support for his valuation from the sale of 10 Second Avenue, which had had two bedrooms created in the roof space and which sold for £500,000 in May 2006 when, said Mr Sharron, values were very much higher than at the valuation date. Mr Timmis's valuation of £475,000 was based on sales of six broadly similar houses, all of which were located in either First Avenue or Second Avenue. They included the appeal property itself and 10 Second Avenue. Second Avenue runs immediately parallel to and to the west of First Avenue. The six sales took place between April 2004 and October 2007. Mr

Timmis adjusted the sale prices to reflect movements in the residential property market generally between the dates when he assumed contracts were exchanged and the valuation date. For this purpose Mr Timmis used the Nationwide House Price Index for Greater London and the Land Registry Index for the London Borough of Ealing.

Mr Timmis made further adjustments to the sale prices to reflect condition, where it was apparent from the available sales particulars that a property had been improved. He said that it was difficult to know how well refurbished the properties had been when sold, but for the sake of consistency he had used a figure of £40,000 in each case, being the approximate amount spent on the appeal property following its sale in 2007. Where necessary he had also made adjustments to reflect the presence of additional accommodation to bring a comparable into line with the appeal property.

Having seen and heard the two experts giving evidence, I have no doubt that the opinion of Mr Timmis is to be preferred. This is because, on two occasions, Mr Sharron's evidence was misleading. Firstly, he said in oral evidence that he had inspected the appeal property in 2005, shortly after the date of death. The appellant had asked him to advise on its value with a view to a possible sale. Mr Ryder pointed out that Mr Sharron had not referred to such an inspection in his written report and it became apparent that there was no reference to 2005 in Mr Sharron's file. I therefore asked Mr Sharron to provide the Tribunal and Mr Timmis with copies of an extract from his diary entry for 2005, showing the precise date of his first inspection. The following day Mr Sharron wrote to the Tribunal. He said that, after checking through his records, it was clear that he had first inspected the appeal property in May 2007.

Secondly, in his written submission to the Tribunal Mr Sharron referred to 5 Agnes Road - one of his two principal comparables - in the following terms:

"5 Agnes Road also needed refurbishment and offered scope for enlargement, subject to consents. This semi-detached property was wider and also had the benefit of a larger 60 ft rear garden."

These observations gave the clear impression that 5 Agnes Road was, if anything, more valuable than the appeal property. Mr Sharron failed to mention that 5 Agnes Road is a much smaller house. Mr Timmis pointed this out in his supplementary report. Mr Sharron agreed that the sales particulars prepared by his firm showed that the net internal area of the appeal property was 28% greater than that of 5 Agnes Road, but he made no attempt to revise his valuation to take the difference in size into account. He merely observed, after I had raised the matter with him, that values per square foot were always higher for smaller properties and that "I don't get involved with areas in second hand buildings". I regret that I have concluded that Mr Sharron's presentation of this evidence was intended, not to assist the Tribunal in arriving at the correct value of the appeal property, but to justify a figure of £400,000.

Mr Timmis does not have first hand local knowledge to assist with the valuation exercise. He was, however, a straightforward witness. He frankly acknowledged the deficiencies of using indices to arrive at accurate valuations, and the absence of full information about certain of his comparables. I am satisfied that he has done the best he can with the information available. In appeals of this nature the onus is on the appellant to prove that the determination of HMRC is wrong. That onus has not been discharged and the appeal is therefore dismissed.

In appeals conducted in accordance with the Tribunal's simplified procedure, costs are not awarded except in limited circumstances (Lands Tribunal Rules 1996, rule 28(11)). If either party wishes to apply for costs they must do so in writing within 14 days of the date of this decision, giving full reasons for their request. Copies of any such application must be sent simultaneously to the other party, who may make written counter-submissions within the following 14 days. In the absence of any costs submission being received within 14 days of the date of this decision, the decision will become final.

Upper Tribunal (Finance and Tax)

Dated 23 June 2010

Administration

Liechtenstein Disclosure Facility – what is it and how can using it save money?

John Cassidy, tax investigations partner at PKF (UK) LLP, explains the ground-breaking agreement between HM Revenue & Customs (HMRC) and Liechtenstein and explains why using it to come clean on tax arrears can be beneficial even for those with no current connection to Liechtenstein.

Introduction

There have been various tax amnesties in recent years, those relating to offshore issues being the Offshore Disclosure Facility in 2007, followed by the New Disclosure Opportunity, which finished in 2010. The underlying principles were that a voluntary disclosure of up to 20 years of undeclared tax on offshore assets and payment of the arrears would bring the person's tax affairs fully up to date with only a relatively low tax penalty.

A separate facility currently exists for those with accounts or other assets held in Liechtenstein. While it also involves a disclosure that brings the person's tax affairs up to date, its generous terms provide a huge opportunity for legitimate tax savings in certain circumstances. The reason for this different approach is that the bespoke terms of the facility were negotiated directly between Liechtenstein and HMRC with a Memorandum of Understanding (MOU) signed in August 2009; this created the Liechtenstein Disclosure Facility (LDF). HMRC is well aware of the potential tax savings that LDF users can make but is keen to reap additional tax receipts that it could not otherwise obtain.

Key principles of the LDF

Liechtenstein banks and other financial intermediaries (for example, fiduciary and trust businesses) must identify 'relevant persons'. Any of the bank's clients who may have a tax liability in the UK, for example, if a UK address is somehow linked to the account in question, is a relevant person. Those financial institutions will be audited to verify their compliance with this requirement.

The financial institutions must then write to all relevant persons (starting in autumn 2010) and ask them to provide a certificate to confirm that they are fully UK tax compliant. If they cannot provide such a certificate, the account holder must register for the LDF to resolve any UK tax issues, which again results in the issuing of a certificate. If the financial institution is not provided with the certificate for either route, they are obliged to close that individual's account and cease acting entirely.

If there is a UK tax problem

The account holders identified must register for the LDF and provide to the Liechtenstein bank the original of the registration certificate received from HMRC. The individual then has up to 10 months to make a full disclosure and settle the outstanding tax, interest and penalties. But there is no need for account holders to wait until they are contacted by their bank; the LDF can be used immediately if a disclosure is appropriate.

If there is no UK tax problem

Some relevant account holders might argue that no action is required if he or she is fully UK tax compliant. However, if an LDF registration certificate is not provided, the relevant person must provide to the Liechtenstein institutions an accountant's certificate that he or she is in fact fully UK tax compliant or be forced to close their account.

Provision of such certificates will not necessarily be a straightforward exercise. For example, many people with accounts in Liechtenstein will not be domiciled in the UK hence their accountant will need to prove a negative, i.e. that the relevant person has ***not*** remitted taxable income or gains to the UK. So a thorough review will have to be undertaken by a tax adviser who has the individual's best interests at heart – perhaps a better alternative than being exposed to detailed scrutiny by an HMRC officer (which will inevitably happen at a later date) who is seeking additional tax.

Offshore assets outside Liechtenstein

There is no need to have had a link with Liechtenstein before. Anyone who now moves offshore funds into Liechtenstein by 2015, or obtains an interest in an appropriate Liechtenstein asset, can use the LDF. There are various complexities to consider before ascertaining if the beneficial terms of the LDF will be available, but, in principle, a Liechtenstein presence can be validly created in order to make a disclosure under the LDF. This is envisaged in the MOU and I am already facilitating such arrangements with Liechtenstein institutions for a number of clients.

Potential benefits of the LDF

The terms of the LDF offer some interesting options and outcomes for users and mean that significant savings can be made compared to settlements under normal disclosure routes or previous offshore amnesties – as illustrated below:

A limited period

Firstly, an LDF disclosure needs to cover only ten years from 6 April 1999 rather than up to twenty years under normal routes or the other general amnesties. Clearly this could cut the tax bill drastically. Interest on the tax liabilities could have an even more marked effect as interest rates in the early 1990s were extremely high compared to today (at well over 10% for several years). For example:

£1m deposited twenty years ago, earning 5% interest.

LDF

From 6 April 1999 to April 2009

tax at 40% is approx.	£410,000
interest is approx.	£99,000
Total	£509,000

Others

From c. April 1989 to April 2009

tax at 40% is approx.		£660,000
interest is approx.		£344,000
Total		£1,004,000
Tax saved	=	£250,000
Interest saved	=	£245,000
Penalty saved	=	£157,000*

(*Comparing 10% and 30% penalties. Note that the penalty advantage of the LDF will be much greater when the FA 2010 penalty regime – with penalties of up to 200% – takes effect).

Undeclared business profits

£1m was siphoned off the profits of a UK self employment into a Swiss bank account opened in Geneva in the 1970s. This went on for many years until 1998; between 1989 and that date the amount of undeclared business profits deposited was £600,000.

Under other disclosure routes, the tax due is 40% of everything deposited in the Swiss account in the 20 years to 5 April 2009, i.e. tax due of £240,000 plus interest (again including high interest from the early 1990's) and a penalty (30% minimum).

Under the LDF the tax due is nothing. **All of the undeclared business profits escape tax forever**. Interest and penalties on that tax are also saved.

I should add, the Swiss account also earned interest, which is taxable under the LDF post 1999 – for simplicity, I have not referred to the liability this triggered.

Undeclared inheritance tax 1

There is no limit on how far back HMRC can look for inheritance tax (IHT). Hence, HMRC can still collect undeclared IHT if the death occurred in, say, 1986. In one case, the taxable estate included a Swiss account with £1m in it; no IHT was paid on that asset.

Normally, £400,000 of IHT would be due plus interest (which will be huge since 1986) and penalties. Under the LDF the tax due is again nil. The MOU with Liechtenstein removes everything, even IHT, pre- April 1999 so £400,000 plus interest and penalties is saved forever.

Undeclared inheritance tax 2

Assuming the same facts but with a death post April 1999, say in 2008, on the face of it IHT due under the LDF is just the same as under any other route, i.e. £400,000.

Under the LDF, however, the person making the disclosure can opt to use the "composite rate". This means that there is no need to calculate the accurate amount due in respect of specific taxes in the normal way. Instead, a flat rate of 40% is used to work out a figure that is then deemed to stand in the shoes of all taxes that are theoretically due. This composite rate is applied only to **income and gains** – i.e. not to the estate assets - in the six years prior to death, so clearly this is another potentially sizeable saving.

Diverted company profits

The composite rate can also be useful in cases concerning a participator in a close company who has diverted profits into a personal bank account. In this common scenario, there is potentially corporation tax, VAT, tax on an overdrawn participator's loan account, a beneficial loan and national insurance contributions to account for. The total tax could easily be way over 40% as shown in the following example of £1m diverted from a VAT registered company to a director/shareholder. The tax due is:

- Corporation tax at 28% on the net of VAT amount — £238,000
- VAT at 17.5% — £149,000
- Tax on participator's loan account (assuming it started at nil) — £250,000
- Total tax due — £637,000

Under the composite rate arrangement the total tax due is 40% of undeclared income, i.e. £400,000, a saving of £237,000 before interest and penalties (and NIC) are considered.

Conclusion

The LDF is good for individuals, Liechtenstein financial institutions and HMRC. There are three possible scenarios:

- For anyone with assets in Liechtenstein, the LDF can be used if there is a UK tax problem.
- For anyone with offshore assets elsewhere, a link with Liechtenstein can now be created to use the LDF.
- For those with assets in Liechtenstein who have already declared all the relevant income and gains in the UK, action still needs to be taken by the individual to obtain an accountant's certification of the position.

Contributed by John Cassidy

Lecture P610 (13.26 Minutes)

Office of Tax Simplification

The Chancellor George Osborne and Exchequer Secretary David Gauke have established the Office of Tax Simplification (OTS).

The Chancellor has appointed a Board of tax experts who will be responsible for leading the work of the OTS over the next year. The Board Members are Michael Jack (Chairman) and John Whiting (Tax Director).

Their responsibilities will be to identify areas where complexities in the tax system for both businesses and individual taxpayers can be reduced and to publish their findings for the Chancellor to consider ahead of his Budget.

The OTS will undertake two initial reviews over the coming year. They will focus on tax reliefs and small business tax simplification (including IR35). The OTS will publish the initial findings from their work on reliefs in late autumn and on small business tax by the 2011 Budget.

The OTS will also draw on external expertise from the tax and legal profession over the coming months. These experts will focus on specific areas of complexity in the tax system and provide additional advice to the OTS.

The Government is committed to making the UK the most competitive country in the G20 and to reducing the complexity in the tax system. Over the past decade, the tax code doubled to more than 11,000 pages and the UK slipped from 7th to 13th in the World Economic Forum's Global Competitiveness Index between 1997 and 2009-10. This trend needs to be reversed, and the OTS is an important part of making the tax system work better for the taxpayer.

Chancellor George Osborne said:

"The previous Government took a complex tax system and made it even worse. A decade of meddling and intervening has made the tax affairs of millions of families and businesses across the UK extremely complicated. We need to sort out this mess.

"Two years ago I promised to create the Office of Tax Simplification. Today, we're delivering on that promise. With its independent, expert advice it will be a permanent force for a simpler tax system.

"Simpler, more competitive taxes will help us show the world that Britain is open for business."

The Rt Hon Michael Jack, the Chair of the OTS, said:

"Entrepreneurship should never be stifled because of an overly complex tax system. That's why I am delighted that the Government have committed themselves to looking at ways to simplify the tax system, with an initial focus on small businesses.

"Simplification in a complex world is a real challenge, but it's one that has to be addressed if the tax system is not to hinder the economy's ability to grow."

John Whiting, the Tax Director of the OTS, said:

"I've long argued that we need a simpler tax system in the UK, so I'm delighted to be given the opportunity to take forward the Government's commitment in that direction.

"In our complex world a truly simple tax system for all is probably impossible, but working towards a simpler system will help all who deal with it: taxpayers, especially the unrepresented, tax advisers and tax authorities."

XBRL - Four little letters

As of 1 April 2011, HMRC will no longer be accepting corporation tax returns on paper or in PDF format; the only method of submission will be electronic.

What is XBRL?

To make a document computer-readable, each individual item of financial data – say company turnover for example – is given what is known as a unique 'tag' in XBRL which, unlike a PDF file, a computer can read.

The unique XBRL 'tags' provide a way for HMRC's computer systems to instantly read and record each item of financial information, rather than needing manual input to do so.

Inline XBRL, or iXBRL, effectively enables the presentation of a financial report in normal, human-readable form. The XBRL tags will still be embedded within the document and will not normally be visible, although they can be displayed by the software if the user requires.

The use of iXBRL should therefore ensure that there is no change in the computations, accounts or tax return forms from what practitioners usually see on their screens, unless they choose otherwise.

These tags contain information such as: whether the item is text or a number; the year the information relates to; the currency it is in; the number of decimal places; and whether, if it is a number, it refers to thousands, millions, etc.

Initially, HMRC only require between 1,200 and around 1,600 unique items in an electronic document to be tagged, depending on whether the document is a corporation tax computation, accounts prepared under UK GAAP, or accounts prepared under IFRS.

Software solutions?

HMRC say that most practitioners will not need any knowledge about XBRL or what needs to be tagged; users of commercial software may not even realise the tags are there as they should be inserted automatically. This is good news for the majority of practitioners, but, unfortunately, not all.

There may be certain pieces of information that require you to type freeform text or data – that is specific to this company's return, for example explaining some of the regulations – into the software or the system.

The onus will therefore probably fall on the software houses to provide information and training.

The benefits

In addition to the removal of the need for manual inputting of results, it should make it easier for HMRC to:

- target the best candidates for an investigation or tax enquiry more effective
- compare financial data between companies as iXBRL tags collect every single important fact or figure

There is also the fact that Companies House will also be introducing iXBRL online filing for unaudited accounts this summer, with a view to introducing iXBRL-filing capability for other accounts types by summer 2011.

With other countries having already started to use XBRL as a means of electronically filing accounts some could argue that the introduction of XBRL benefits the UK on the global financial stage as well.

Accountants could also use it to compare clients' financial performances.

Penalties

While HMRC have been said to take a 'soft landing' approach to those who attempt to apply iXBRL tags, an HMRC spokesman warned that late filing penalties may be imposed on those without a 'reasonable excuse' for not e-filing on time – and 'reasonable excuse' would not include having non-compliant software or 'finding the online system too complicated'.

Client documents

There is also the issue of tax accountants receiving documents from clients which need converting to an iXBRL-friendly format which would be time consuming.

The big risk for many will be within their engagement letter. Accountants will need to update these to ensure it is clear who will be responsible for ensuring the tagging of data.

Smaller-scale practitioners?

Rather than investing in software, one option is to outsource the iXBRL tagging of a set of accounts.

Alternatively, for small companies or organisations with straightforward tax affairs, HMRC provide their own free online software service, which would also require practitioners to register and enrol for their corporation tax online service to submit the return.

Setting up the online account with HMRC would need to be done in plenty of time before the April mandation date.

A third way is to postpone the problem altogether: filing all clients' tax returns by 31 March 2011 in order not to worry about XBRL until April 2012 comes around.

Taken from an article in Taxation by Santhie Goundar

Failure to operate CIS

The case

Mr KG and Mrs HE Johnston had traded in partnership as Johnston Builders for 36 years submitting self-assessment income tax returns under the name of K Johnston. In their partnership self-assessment income tax returns, they had claimed deductions for "payments to sub-contractors in the construction industry", but had not made yearly returns as were required by the Construction Industry Scheme ("CIS").

HMRC

HMRC asserted that the Appellant partnership was engaged in construction operations as a builder and that during the period 2002 to 2007 workers were engaged to do work for the partnership. HMRC maintained that the CIS legislation should have been applied as these workers were sub-contractors and the Scheme should have been operated when payments were made to these workers, but was not so operated by the Appellants.

HMRC asserted that the statutory returns of payments made to sub-contractors, and of any deductions required to be made from such payments, were not submitted to HMRC, and that it was responsibility of the Contractor to be aware of and to operate the CIS scheme in accordance with the Regulations.

HMRC therefore were of the view that there had not been full compliance with this legislation, and sought to collect amounts which should have been deducted when making the relevant payment to subcontractors, as was required under the CIS.

The Appellants

The Appellants maintained that throughout the relevant periods they had promptly and accurately completed HMRC self-assessment tax returns, and had been unaware of the requirements of the CIS until September 2007, when HMRC started conducting their enquiries of the Appellants. The Appellants were upset that during so many years of trading HMRC had not queried their sub-contractor entries on their self-assessment return forms in the earlier years. The Appellants maintained that they had not received leaflets about the Scheme, had not seen newspaper advertising of the Scheme, and were not aware of any radio station announcements of the Scheme, nor had they been informed of the Scheme by their builder's merchants. They claimed that they had been seriously mislead by HMRC who had failed to inform them of the CIS scheme earlier.

The legislation

The legislation for the periods under appeal requires that a contractor registers with HMRC as a contractor, pays sub-contractors in the right way by making deductions where necessary, pays over-deductions to HMRC, gives sub-contractors deduction vouchers, sends a yearly return to HMRC, and keeps proper records. If a business in the construction industry fails to operate the scheme correctly, HMRC may make an assessment of the amount of tax that it believes should have been deducted from the amounts paid to sub-contractors under Regulation 13 of the Income Tax (Construction Industry Scheme) Regulations 2005 ("2005 Regs"), had the CIS scheme been operated correctly.

Regulation 9

If HMRC believe that the sub-contractor has made a return and paid the relevant duty, some relief against the amount payable on the Regulation 13 determination may be given under Regulation 9 of the 2005 Regs.

Under regulation 9 relief may be granted under condition A if the contractor satisfies HMRC that he took reasonable care to comply with the Acts and Regulations, and under condition B if HMRC are satisfied that the sub-contractor has paid to HMRC the tax on the amounts that should have been deducted when the contractor made payment to the sub-contractor.

The Appellants gave information to HMRC which enabled Regulation 9 (4) relief to be given for some payments made to some individuals who performed work for the Appellants, resulting in the only matters remaining unresolved by the date of the hearing of this appeal being the amounts in respect of Mr. N for the relevant years, totalling £834.84

In this appeal the enquiries of HMRC revealed that the sub-contractor Mr. N did not make payment to HMRC, and in respect of the Appellants HMRC take the view that the Appellants did not take reasonable care to comply with the Regulations, ignorance of the law being no excuse.

Findings of fact and decision

The tribunal was satisfied that HMRC's enquiries did show that Mr. N did not pay those amounts to HMRC.

The Appellants failed to operate the scheme by making the statutory returns of payments made to sub-contractors, and failed to make the deductions required to be made from such payments in respect of Mr. N.

The tribunal was satisfied that there was not full compliance with the legislation by the Appellants, and that HMRC exercised their statutory power to determine that these amounts should be paid by the Appellants as contractors.

Condition A - Regulation 9 (3)

The Appellants had not taken reasonable care to comply with Section 61 Finance Act 2004 and the CIS Regulations 2005. They agreed with the views of the Judge in *Peter Jackson (Jewellers) Ltd v the Commissioners for Her Majesty's Revenue and Customs* TC00195 at paragraph 15:

"However unaware the Appellant may have been of the new regime the requirement to register is nevertheless an absolute one for which ignorance of the law is not a defence".

Condition B – Regulation 9 (4)

The Appellants were not entitled to relief under condition B, which only applies where HMRC are satisfied that Mr. N has paid the income tax to HMRC. We find that HMRC are not so satisfied.

Accordingly we find that the Appellants are contractors for the purpose of the scheme, that Mr. N was a sub-contractor in the construction industry, that HMRC are entitled to recover the sums due from the Appellants, and that they do not qualify for the statutory relief. Accordingly we dismiss the Appellants' appeal.

Mr K G & Mrs H E Johnston (Johnston Builders)

Government publishes nine tax consultations!

On 27 July 2010 the Exchequer Secretary to the Treasury, David Gauke MP published nine documents for discussion and consultation relating to tax, following commitments made at the June Budget.

This will provide businesses, tax professionals and other interested parties with a more comprehensive view and the opportunity to comment on the Government's proposed tax reforms.

The Government set out its new and innovative approach to tax policy making at the Budget, designed to create a more predictable, stable and simple tax system in the UK

PAYE reform (HMRC))

The Government today is publishing a consultation on improving the operation of Pay As You Earn (PAYE), which seeks views on the collection of real time information to simplify taxation and reduce burdens on business. It also invites views on an option for longer-term reform to improve accuracy and further reduce administrative burdens, or alternative proposals to the same end. The Government seeks interested parties' views on these proposals;

Furnished holiday lettings (Joint HMT & HMRC) – **see page 38 below.**

The Government today is publishing a consultation document on a proposal to ensure that the tax rules for furnished holiday lettings meet EU legal requirements in a fiscally responsible way, by changing the eligibility thresholds and restricting the use of loss relief. The Government seeks interested parties' views on the proposal set out in the document;

Pensions tax relief (HMT)

The Government announced in the June Budget that it is considering the issue of pensions tax relief and the reduction of the annual allowance to £30,000 to £45,000. The Government today is publishing a discussion paper setting out the range of policy issues that would need to be decided in any new regime. The Government seeks interested parties' views on these issues;

Associated company rules (HMT) – **see page 48 below.**

The Government today is publishing a summary of responses to the recent consultation on simplifying the associated company rules as they apply to the small profits rate of corporation tax. As announced in the June Budget, the Government will introduce the proposed legislation in Finance Bill 2011 and it will take effect from 1 April 2011;

Inheritance tax avoidance schemes (HMRC)

The Government today is publishing a consultation on legislation designed to bring inheritance tax, as it applies to the transfer of property into trust, into the disclosure regime, with the objective of addressing the problem of identifying such schemes and users at an early stage. The Government seeks interested parties' views on the detail of implementation;

Taxation of foreign branches (HMT)

The Government today is publishing a discussion document on the scope of an exemption for foreign branch profits, aimed at delivering a more territorial approach to corporation tax to enhance the UK's competitiveness. The Government seeks interested parties' views on the likely impacts of the proposals set out in the document and on implementation of these proposals;

Controlled Foreign Companies interim improvements (HMT)

The Government today is publishing a short note setting out the aim and scope of CFC interim improvements, together with the framework for consultation over the summer. The Government seeks interested parties' views on the nature of these improvements, including possible options to achieve the aims set out here and potential other worthwhile improvements that should be considered;

Modernisation of Investment Trust Company rules (HMRC))

The Government is publishing a consultation document, which sets out proposals for modernising tax rules for Investment Trust Companies, together with consequential amendments to the Companies Act by the Department for Business Innovation and Skills. The Government seeks interested parties' views on the proposals for change;

National Minimum Wage: travel and subsistence schemes (Joint HMT, HMRC & BiS))
The Government today is publishing a summary of responses to the recent consultation on travel and subsistence schemes implemented for some temporary workers paid at or near the National Minimum Wage (NMW). The Government has carefully considered the responses and has concluded that, on balance, action should be taken. It will amend the NMW Regulations to take effect from 1 January 2011.

Full details of the consultation documents can be found on the HMRC website.

Extracts from HM Treasury Press Release, 27/07/2010

Business Tax

Reform and latest developments in the medical profession

The age profile of the UK will continue to rise until around 2040 when around 50% of the population will be over 60. This, combined with other factors including new technology, patient expectations and financial constraints, is big cause for concern.

Most doctors and dentists are self employed with contracts in place between their practice and the NHS. Increasingly doctors are moving away from being in sole practice, preferring multi-doctor organisations.

Interestingly, the number of GPs and registrars is fairly constant but there has been a significant rise in the number of salaried GPs which are significantly cheaper costing between £60,000 and £80,000 rather than £103,000 to £110,000 per principal.

The White Paper

This was published on 12 July 2010 and contains radical changes for both doctors and dentists.

Under the proposals:

- Strategic Health Authorities and Primary Care Trusts would be abolished
- All hospitals would be moved to Foundation Status
- All GP practices would have to enter into consortiums
- There would be a new GP contract with GPs measured on the performance of:
    - their practice
    - how they commission secondary care

The new structure

The aim of the reform is to save 45% of the cost of the current NHS management team, with annual savings estimated to be around £20 billion.

Under the new structure, patients would receive care through their GPs.

Funding would be passed down from Government, through the Department of Health to the new NHS Commissioning Board. In turn, they would pass funding on to the new GP Commissioning Consortia who would enter into contracts with secondary care providers including the provision of out-of-hours work.

It is proposed that practice boundaries are abolished

The GP contract would be fundamentally revised with:

- Completely new qualities and outcome framework
- Patient at centre of the monitoring process

Dentists

Dentists contracts are also to be completely revised focusing on:

- Improving quality
- Achieving good dental health
- Increasing access to good NHS dentistry
- Good oral health of school children

Timetable

There is a very tight time table planned which is summarised below:

July 2010	White paper published + consultation documents
Autumn 2010	Health Bill introduced into Parliament
April 2011	Shadow NHS Commissioning Board will be formed Run alongside Strategic Health Authorities Shadow GP consortium will start to be formed
April 2012	Commissioning Board formally established
Autumn 2012	Consortia formally established Budgets allocated for 2013 and 2014 Strategic Health Authorities will be abolished
April 2013	All contracts in place Primary Care Trusts abolished

Adapted from the seminar given by Bob Trunchion

Lecture B606 (15.06 Minutes)

Repair or capital? – New hope with this age old problem

Overview

It has long been the case that on the acquisition or refurbishment of a business property for own use or an investment property for letting, a distinction is necessary as to what constitutes capital expenditure as opposed to revenue expenditure. The former clearly attracts tax relief only if it comes within the entitlement to capital allowances of some type, whereas the latter is deducted in arriving at the net profit for tax purposes of the relevant source.

There is plenty of HMRC guidance on this – particularly in paragraph PIM2020 of the Property Income Manual. Further source material is now available following the decision for the taxpayer in C Wills v HMRC TC00479. As that is a decision only at tax tribunal level it may of course be changed in the event of a successful appeal, but essentially it is a question of fact and there is also the interesting comment by the tribunal that paragraph PIM2020 supports their decision.

Before looking at that case, we should consider the general position and what PIM2020 has to say.

HMRC's published views

Repair means the restoration of an asset by replacing subsidiary parts of the whole asset. An example is the cost of replacing roof tiles blown off by a storm. There is not a repair however, if the expenditure results in a significant improvement of the asset beyond its original condition. For instance, there will be a capital improvement if the taxpayer takes off the roof and builds on another storey.

Examples of repairs that are normally deductible in computing rental business profits include:

- exterior and interior painting and decorating,
- stone cleaning,
- damp and rot treatment,
- mending broken windows, doors, furniture and machines such as cookers or lifts,
- re-pointing, and
- replacing roof slates, flashing and gutters.

The cost of land and any buildings on it is capital expenditure. So is the cost of any new buildings erected after letting has started and any improvements. Other examples of capital expenses include:

- expenditure which adds to or improves the land or property; for example, converting a disused barn to a holiday home,
- the cost of refurbishing or repairing a property bought in a derelict or run-down state,
- expenditure on demolishing a derelict factory to clear space for a new office building, plus the cost of the new building,
- the cost of building a car park next to a property that is let,
- expenditure on a new access road to a property,
- the cost of a new piece of land next to a property that is let.

It is largely a question of fact and degree in each case whether expenditure on a property leads to an improvement. Sometimes the improvement may be so small as to count as incidental to a repair. In the absence of other capital indications, the entire cost is then revenue expenditure.

Problems can arise where the taxpayer does work on an old asset. A repair or replacement of a part of a building using modern materials may give an apparent element of improvement because of the greater durability, superior qualities and so forth of the new material. But the cost normally remains revenue expenditure where any improvement arises only because the taxpayer uses new materials that are broadly equivalent to the old materials. For example, the cost of replacing wooden beams with steel girders, and lead pipes with copper or plastic pipe is usually revenue expenditure in the absence of any other capital indications.

However, there is likely to be capital expenditure if, say, the steel girders were designed to take heavier loads so that the building could take larger machines after the work was done. The same is true if the new pipes are designed to take greater pressure or heat. But HMRC accepts that there is usually no improvement if trivial increases in performance or capacity arise solely from the replacement of old materials with newer but broadly equivalent materials. For example, the replacement of pipes or storage tanks of imperial measure with the closest metric equivalent may result in slightly increased diameter or capacity but the cost is still revenue expenditure.

Where a significant improvement arises from the change of materials, the whole of the cost is capital expenditure. This includes things like redecoration after the main work has been done (redecoration would ordinarily be a revenue expense). The entire cost is capital expenditure, including the expense of making good any damage to decorations.

Extensive alterations to a property – HMRC view

Alterations to a building may be so extensive as to amount to the reconstruction of the property. This will be capital expenditure. Rebuilding, whether forced on the taxpayer or voluntarily undertaken, is capital expenditure. Only the actual cost of normal revenue repairs to a part of the old building that is preserved in the rebuilt structure is allowable as an ordinary revenue business expense.

However, the whole of a payment is not necessarily either capital or revenue - it may be possible to split it between capital and revenue items as below.

Work commissioned on a property may include expenditure on capital works and also separate expenditure on repairs at the same time. Here the expenditure on repairs remains allowable. Expenditure may be apportioned on a reasonable basis to estimate the amount attributable to the

repair element. An apportionment in the contractor's bill may provide a sensible basis for splitting the total

Repairs etc after a property is acquired

Repairs to reinstate a worn or dilapidated asset are usually deductible as revenue expenditure. The mere fact that the taxpayer bought the asset not long before the repairs are made does not in itself make the repair a capital expense. This view follows the famous Odeon Associated Theatres case. But HMRC say that a change of ownership combined with one or more additional factors may mean the expenditure is capital. They give examples of such factors as follows:

A property acquired that was not in a fit state for use in the business until the repairs had been carried out or that could not continue to be let without repairs being made shortly after acquisition.

The price paid for the property was substantially reduced because of its dilapidated state. A deduction is not denied where the purchase price merely reflects the reduced value of the asset due to normal wear and tear (for example, between normal exterior painting cycles). This is so even if the taxpayer makes the repairs just after they acquire the asset.

The taxpayer makes an agreement that commits them to reinstate the property to a good state of repair. For example, Fred is granted a 21-year lease of a property in a poor state of repair by his landlord that he, in turn, sublets. When Fred's landlord grants him the lease Fred agrees that he will refurbish the property. Fred's expenditure on making good will be capital expenditure and not allowable. But Fred's landlord may be chargeable on the value of the work under the lease premium rules and Fred may then qualify for some relief.

Further views of HMRC on repairs

What they regard as a repair necessarily changes with the passage of time to reflect technological improvements. This issue was considered in the tax case Conn v Robins Brothers Ltd. As a result they accept that the replacement of a part of the 'entirety' with the nearest modern equivalent is allowable as a repair for tax purposes and not disallowable as improvement expenditure.

An example is double-glazing. In the past they took the view that replacing single-glazed windows with double-glazed windows was an improvement and therefore capital expenditure. But times have changed. Building standards have improved and the types of replacement windows available from retailers have changed. HMRC now accept that replacing single-glazed windows by double-glazed equivalents counts as allowable expenditure on repairs.

Generally, if the replacement of a part of the 'entirety' is like-for-like or the nearest modern equivalent, they accept the expenditure is allowable revenue expenditure.

The C Wills case

Christopher Wills had income from property lettings and he incurred costs of £106,707 on an outbuilding. He claimed tax relief against the letting income on £43,665 as repairs, with £63,042 allocated by him as capital expenditure. HMRC considered that the whole expenditure was capital because they had enhanced the living area available and the property could now be let for more.

The outbuilding was a listed building used in a variety of ways – storage, as a games room, and generally as additional living space. It had become extremely run down and in view of its state of disrepair was becoming dangerous.

In undertaking such extensive repair work as was necessary, it made sense to the owner to bring the interior a little more up to date at the same time including heating, electric power points and a water supply. After the repairs the outbuilding was used as a games room and studio as well as for storage - not hugely different to the previous use.

The tribunal found that the rent before and after the renovations had changed only in line with inflation and also that the use of the space before and after the work had not fundamentally changed. The work had to be performed to some extent to make the property safe and it seemed reasonable that the extra work was performed at the same time. The costs were therefore allowable as repairs.

Contributed by Gerry Hart

Lecture B607 (13.32 Minutes)

3 line accounts – yes or no?

The basic position

If a client is self-employed with annual turnover of less than £30,000, there has long been the opportunity to not have to divulge to HMRC the expenses under the normal separate headings. Instead, you have been able to simply tell them 3 things - income, total expenses and net profit. The same applies to property lettings income.

From 2009/10 that level for 3 line accounts was dramatically increased to £68,000, to tie in with the VAT registration level (so for 2010/11 it is £70,000). It is reckoned that 85% of the 3.8 million self-employment pages which have to be filed each year can now use the 3 line accounts facility. When it comes to income from property, the figure is 98% of the 1.4 million UK property pages.

The 3 line accounts facility is also available for the trading and professional income section and UK property pages of the partnership tax return. It cannot be used for any of the following:

- Income and expenditure from land and property abroad
- Employment income and expenses
- Any income shown on the trust and estate return

Determining the best policy

So is it sensible to take advantage of this facility? The client's view must be sought here, and in that connection he or she should be advised that the amount of work you will need to do is not reduced, as of course you still need to determine each expenditure item so as to then decide what 3 figures you do give to HMRC. There is also the requirement for records and documentation to exist and to be retained which support the information supplied in the 3 boxes.

In reality any saving is on HMRC's side, by way of less time taken in processing the tax return.

There a number of issues which need to be appreciated, including quite possibly the client still wanting a full set of accounts - for a variety of reasons.

The alternative

If 3 line accounts are not adopted for whatever reason, then naturally the full analysis of expenses has to be supplied to HMRC using the self-employment (short) pages unless one of the following applies in which case the full version has to be completed and that has far more headings of expense items:

- Accounting date has changed
- Basis period is not the same as the accounting period
- Business ceased in the year and accounting period does not start on the opening day of the tax year
- Taxpayer is a barrister (advocate in Scotland)
- Business is carried on abroad
- Claim being made for IBA or ABA
- Overlap relief claimed
- Averaging claim being made for farmer, market gardener, or creator of literary or artistic works
- Claim for adjustment to profits chargeable to Class 4 NICs

Using the expense headings in the self-employment (short) pages, rather than adopting 3 line accounts, can itself create difficulties in so far as at best the arbitrary headings are misleading and at worst they can be downright dangerous. As a result, further explanations may be advisable so as to reduce the chances of a tax enquiry.

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The headings are:

- Costs of goods for resale, or goods used
- Car, van and travel
- Wages, salaries and other staff costs
- Rent, rates, power and insurance
- Repairs and renewals of property and equipment
- Accountancy, legal and other professional fess
- Interest and credit card etc financial charges
- Telephone, fax, stationery and other office costs
- Other allowable business expenses

HMRC compliance checks

In the current situation, where HMRC resources are clearly stretched, one might feel that a client using 3 line accounts is less likely to face a tax compliance check. That could be felt to be especially so, given the apparent improvement to and greater level of sophistication of HMRC's risk-assessment procedures according to comments they have made in recent times. One could understandably consider that HMRC will be more selective in choosing which cases to look at, with an enquiry on a 3 line account case not likely to generate much extra tax, if any, and therefore on that basis alone being less likely to be selected.

That view is not valid, however, if one accepts at face value what they said as part of a release of information on their risk assessment procedures following a formal request under the Freedom of Information Act. 3 line accounts were mentioned as being a risk factor (amongst several others) which their Risk and Analysis Teams take into account when determining whether the taxpayer should be regarded as low risk or non-low risk.

That surely does not mean that using 3 line accounts will itself increase the likelihood of selection for a compliance check, but on the other hand it seemingly does not provide comfort of a lesser chance of selection.

The £68,000 level for 2009/10

This is an annual turnover amount, below which the 3 line account facility can be used. If the self-employment or UK property source existed for only 9 months in the year to 5 April 2010, the requirement is for turnover to be less than £51,000. On the other hand, if the accounting period is 18 months it means that the level increases to £102,000.

Contributed by Gerry Hart

Lecture B608 (11.11 Minutes)

Trading losses relieved against employment income

The Appellant's wife was an experienced manicurist, pedicurist and cosmetic make-up artist. In 1999, after having children, she returned to work part time, operating from home as a manicurist, pedicurist and beautician, typically providing between two and seven treatments a month .

The Appellant maintained that she was working as his employee in a self-employed trade which he started to carry on at that time and that the trade had incurred losses in every year of its operation. The Appellant himself devoted very little of his own time to the trade as his wife effectively ran it on her own.

Over the four years ended 5 April 2000, 2001, 2002 and 2003, the Appellant claimed losses.

2002 – 2003 enquiry

The Inland Revenue enquired into the 2003 return which culminated in a reduction to the Appellant's self-assessment for the year ended 5 April 2003 and an agreement for the basis of calculating his self-employed expenses for the purposes of his return for the year ended 5 April 2004.

The Inland Revenue raised the question of whether the Appellant was trading with a view to profit. He explained that he was ill during 2003-04, so the income was reduced because his wife spent more time looking after him. Mrs Foley warned that his trade would be "reviewed for profitability" in the year ended 5 April 2005.

The Appellant carried on as before, claiming relief for trading losses.

Later enquiries

On 14 January 2009, a different Inspector of Taxes, Mr M G Smith, wrote to the Appellant, notifying him of HMRC's intention to carry out a full enquiry into his returns for the years ended 5 April 2007 and 2008.

On 14 May 2009, Mr Smith wrote again, notifying the Appellant of HMRC's intention to carry out a full enquiry into his return for the year ended 5 April 2009.

Mr Smith formed the view that the wages paid to Mrs Agnew should be disallowed as expenses of the trade, as their payment was not made "for business purposes but due to the relationship between you", and they represented "merely a transfer of income" between the Appellant and his wife. He also expressed the view that "if the wages were paid to an independent person the business would have closed down many years ago as the income generated is insufficient to cover expenses."

HMRC then issued assessments to recover the tax underpaid as a result of disallowance of the loss relief claims in full for the years ended 5 April 2004, 2005 and 2006; they also issued closure notices setting out amendments to the Appellant's self-assessment returns in respect of the years ended 5 April 2007, 2008 and 2009 for the same purpose. All these assessments and notices were issued on 13 August 2009.

Was the Appellant carrying on a trade?

The Tribunal found that there was a trade, but on the facts it considers that the trade was carried on by Mrs Agnew and not the Appellant.

If the Appellant was carrying on a trade, was it carried on on a commercial basis?

The Tribunal considered that if the Appellant were found to be operating a trade, it would certainly not be on a commercial basis.

Can HMRC renege on 2004 agreement on how results are calculated and disallow later losses?

The Tribunal found that the Inland Revenue had made it clear to the Appellant in October 2004 that any agreement reached with him would apply specifically only to the years ended 5 April 2003 and 5 April 2004 The Inland Revenue had made it clear that they were concerned as to whether the Appellant was trading with a view to profit (and therefore on a commercial basis) in those years.

2006-07, 2007-08 and 2008-09 assessments

HMRC commenced the enquiry into the Appellant's tax returns for the years ended 5 April 2007 and 2008 by letter dated 14 January 2009, within the time limits set out in sub-s 9A(2) TMA. They commenced the enquiry into his return for the year ended 5 April 2009 by letter dated 14 May 2009, also within the normal time limit. No question of breach of time limits therefore arises in relation to any of these three years.

The amendments to the Appellant's self-assessments for the years 2006-07, 2007-08 and 2008-09 are therefore upheld

Discovery assessments for earlier assessments?

The key question was whether, given the information that had been made available to the Inland Revenue during the 2004 enquiry, it could be said that HMRC had made a sufficient "discovery" to entitle them to raise assessments based on s 29 TMA.

2002 -03 return

In the context of the enquiry into the Appellant's 2002-03 return, he provided detailed information about the manner in which his alleged trade was carried on, including the basis for calculation of his wife's "wages" and the other expenses he claimed, and the loss-making nature of the business (at least up to 5 April 2004).

2003-04 assessment

The Tribunal found that all relevant information was contained in the particulars which the Appellant had supplied at his meeting with the Inland Revenue on 4 October 2004 in connection with the 2002-03 enquiry.

Based on that information, all of which was available before the normal s 9A TMA enquiry window closed for the 2003-04 return on 31 January 2005, any officer of HMRC could have reasonably been expected to be aware at that time of the insufficiency of the 2003-04 assessment.

The Tribunal found that the raising of the 2003-04 assessment was not permitted by s 29 TMA and it must therefore be discharged.

The 2004-05 and 2005-06 assessment

During the 2003-04 enquiry, the Inland Revenue warned that the 2004-05 and subsequent results would be "reviewed for profitability".

The Tribunal was satisfied that no officer of HMRC could have been reasonably expected, on the basis of the information made available to him before 31 January 2006, to be aware of the insufficiency in the Appellant's self-assessment for the year 2004-05.

The same principle applied to 2005-06

Accordingly both assessments were properly issued under s 29 TMA and should be upheld.

John Cree Locke Agnew

First-tier Tribunal (Tax), 14 June 2010

Furnished Holiday Lettings - Consultation

Introduction

The Chancellor confirmed in the June Budget that the Government would not repeal the special tax rules for furnished holiday lettings. Instead, the Budget announced a public consultation on a proposal to change the existing rules in a way that both meets our obligations under EU law and does so in a fiscally responsible way.

This consultation document sets out the Government's proposal for achieving that aim by changing the qualifying conditions for businesses to be taxed as furnished holiday lettings and changing the way loss relief is given. Any changes will take effect from 1 April 2011 for companies or from 6 April 2011 for individuals. For the current tax year 2010-2011, the existing rules will continue to apply.

Background

The special tax rules for furnished holiday lettings allow property businesses that meet certain conditions to be treated as a trade for some specific tax purposes. These are:

- loss relief;
- capital allowances;
- Landlords' Energy Saving Allowance (LESA);
- certain capital gains reliefs (including business asset roll-over relief, entrepreneurs' relief, relief for gifts of business assets, relief for loans to traders and exemptions for disposals of shares by companies with a substantial shareholding); and

- relevant UK earnings when calculating the maximum relief due for an individual's pension contributions.

To qualify for this tax treatment, the following conditions must be met:

- the property must be situated in the UK or the European Economic Area (EEA);
- the business must be carried on commercially, and with a view to a profit;
- the total periods of "longer term occupation" must not exceed 155 days during the relevant period. A period of "longer term occupation" is a letting to the same person for longer than 31 continuous days. The relevant period is normally the tax year.
- the property must be available for commercial letting as holiday accommodation to the public for at least 140 days during the relevant period; and
- the property must be commercially let as holiday accommodation to members of the public for at least 70 days during the relevant period. A letting for a period of "longer term occupation" is not a letting as holiday accommodation for the purposes of this condition.

Historically, the tax rules were only available for lettings of UK properties.

However, recognising that the UK rules may not have been compliant with EU law, HM Revenue and Customs has applied these rules to properties situated elsewhere in the EEA from 22 April 2009, the date of the 2009 Budget.

At Budget 2009, the previous Government announced the repeal of the special tax rules for furnished holiday lettings from April 2010 for UK and EEA lettings. This would have meant that the income and losses would have been taxed and relieved under the tax rules applying to property businesses.

The Government has listened to the views of businesses and the tourism industry and has decided not to proceed with the previous Government's proposal to repeal the special rules for furnished holiday lettings.

The Government has rejected a repeal of the special tax rules for furnished holiday lettings rules because of the adverse affect this would have on UK businesses and the tourism industry. However, the Government has also decided that it would not be fiscally responsible simply to extend the current tax rules to properties situated elsewhere in the EEA, without other changes. That is why it proposes to introduce changes to the qualifying conditions to ensure that properties that are let as a commercial or full-time furnished holiday lettings business will continue to benefit from the favourable tax treatment.

This consultation looks at proposals to change the special tax rules for furnished holiday lettings. The proposals balance the need to:

- make sure the rules meet our obligations under EU law;
- continue to provide support to commercial businesses; and
- ensure that the changes are affordable.

The Government's Proposal

The Government proposes to change the current rules so that:

- Furnished holiday lettings in both the UK and EEA are eligible to qualify as qualifying furnished holiday lettings within the special tax rules;
- The minimum period over which a qualifying property must be available for letting to the public in the relevant period is increased from 140 days to 210 days in a year;
- The minimum period over which a qualifying property is actually let to the public in the relevant period is increased from 70 days to 105 days in a year;
- Losses made in a qualifying UK or EEA furnished holiday lettings business may only be set against income from the same furnished holiday lettings business.

For companies, the proposed changes would take effect for accounting periods beginning on or after 1 April 2011. For individuals, the rules would apply for the 2011-12 tax year onwards.

Throughout this proposal the term 'business' refers to a business carried on by any person , whether individual, company or other.

Taxation of EEA and UK furnished holiday lettings businesses

Property businesses in the UK and the EEA are treated as separate businesses. A UK property business consists of every business a person carries on that produces income from land in the UK. Every business a person carries on that produces income from land outside the UK is treated as part of a person's overseas property business.

Profits or losses of an overseas property business are not combined with the profits or losses of a UK property business. A UK property business can include commercial lettings of furnished holiday accommodation and, if so, separate calculations are made of the profits from the furnished holiday lettings.

The same applies to furnished holiday lettings in the EEA. A person's UK furnished holiday lettings business will comprise every commercial letting of furnished holiday accommodation in the UK and a person's EEA furnished holiday lettings business will comprise every commercial letting of furnished holiday accommodation in the EEA. The special rules for a qualifying furnished holiday lettings business will apply to both a UK and an EEA qualifying furnished holiday lettings business.

Changes in qualifying conditions

The proposed changes would reduce the cost of extending the special tax rules to EEA properties.

The increase in the minimum period over which a property must be available for letting to the public aims to balance the need not to penalise UK businesses with the need to ensure that the rules are better targeted at those who run furnished holiday lettings as commercial businesses.

The increase in the minimum periods over which the property is both available for letting and actually let to the public, from 140 days to 210 days and from 70 days to 105 days respectively, reflects the changes in the tourism industry since the furnished holiday lettings rules were introduced in 1984. The letting season has widened and allows for commercial letting throughout more of the year, with variation in school holiday periods, the peak summer season alone has expanded and more letting is seen over the Christmas and Easter periods. The existing 70 day limit is no longer in line with the modern tourist industry.

The other qualifying conditions would not change.

Capital allowances

A qualifying furnished holiday lettings business is eligible for capital allowances on assets for use within that furnished holiday lettings business in accordance with the special tax rules. A furnished holiday lettings business that does not qualify for the special rules is only eligible for capital allowances on any plant or machinery that is not for use in the dwelling house.

Under the existing rules, where a furnished holiday lettings business qualifies in one year but not in the next, then strictly a disposal event should arise. This would mean that the disposal value of the plant and machinery on which allowances were being claimed would have to be brought into account to arrive at a balancing adjustment.

In practice, where the failure to meet the rules appeared likely to be temporary, HMRC has in the past accepted, on a concessionary basis, that capital allowances could continue for the year in which the qualifying conditions are not met. However following the *Wilkinson* case this concession cannot be continued.

The Government wishes to avoid imposing additional administrative burdens on business, which could happen under the current law in cases where a person may qualify for the special tax rules in one year but not the next. It therefore proposes to introduce new rules to address this point.

Proposed new capital allowances rules

One option would be to keep expenditure on plant and machinery for use in a dwelling house in separate capital allowances pools from any other plant or machinery used in the business and to maintain that expenditure as a notional pool or notional pools until the property once again satisfied the qualifying conditions.

The notional pool would maintain a record of unrelieved expenditure, additions and any disposal receipts. However, if there were disposals that exceeded the balance in the pool (including any additions), a balancing charge would arise in that year. Any unrelieved balance in the notional pool could be brought into account in the next year the property satisfied the qualifying conditions.

This could require complex legislation. However, allowing businesses to maintain a notional pool may be potentially less burdensome than a strict application of the existing rules. These would impose a valuation requirement and balancing adjustment on each occasion that the business qualified or failed to qualify for treatment as a furnished holiday lettings business.

The Government welcomes comments on the proposed new capital allowances rules above, and suggestions on any changes that might overcome the potential difficulties, or more generally provide a simpler approach.

Summary

Following the proposed changes, a qualifying furnished holiday lettings business could:

- claim capital allowances on expenditure on assets for use within the holiday property;
- continue to be treated under the existing furnished holiday lettings rules for capital gains and calculating relevant UK earnings for pension purposes; and
- set losses from a qualifying furnished holiday lettings business against income from the same qualifying furnished holiday lettings business.

Next Steps

The Government invites interested parties to respond to the consultation by the closing date of 22 October. Any responses should be e-mailed to Jacqueline Latter (Personal Tax Team, HM Treasury) at holiday-lettings-consultation@hmtreasury.gsi.gov.uk by 22 October 2010.

The intention is to publish the Government response and draft legislation by the end of the year, alongside a more detailed technical paper setting out exactly how the changes will be implemented. This will include details of any transitional rules.

The changes will be implemented in the 2011 Finance Act, to take effect from 1 April 2011 for companies and 6 April 2011 for individuals.

Extracts of HM Treasury Press Release, 27/07/2010

Corporation Tax

Company share option plans – anti-avoidance

A company share option plan is a discretionary share scheme which allows companies to award share options to selected directors and employees. The granting of an option allows the director or employee to buy shares from a date in the future at a price set at the time of the grant.

Under the company share option plan legislation, companies can grant directors or employees options over shares with a market value of up to £30,000 at the time of the grant. Provided that the requirements of the scheme are met, there are no income tax or NIC charges on the exercise of such options (although CGT may of course be due on a subsequent disposal of the shares).

Until 1980, shares in unlisted companies were not permitted to be used in approved share schemes. However, this rule was changed to allow shares in subsidiaries to feature in approved schemes, provided that the parent company was listed on a recognised stock exchange and was not a close company (or a company which would be close if it were UK-resident).

Unfortunately, this relaxation has given rise to a problem, as HMRC explain:

> ‘Avoidance arrangements have been used recently in which company share option plan options are granted over shares which are subject to “geared growth” arrangements. Under these arrangements, the shares which are subject to the option have no rights, or limited rights, over the value of the company at the time the options are granted but have rights over all subsequent growth from that time onwards. This allows a large number of low value shares to be issued within the £30,000 limit, with potentially high growth in the future, which can thereby circumvent that limit.’

The arrangements described by HMRC above typically involve share options being granted over shares in an unlisted company which is under the control of a listed company (eg. a subsidiary of a plc). S39 FA 2010 counters this ploy. It does so by amending Para 17 Sch 4 ITEPA 2003 so that options can no longer be granted over shares in an unlisted company controlled by a listed company. This will ensure that, in HMRC’s words, ‘the effectiveness of the £30,000 limit is not weakened’.

Where the rules of an approved scheme provide that a company may grant options over shares in an unlisted company which is under the control of a listed company, the scheme will no longer meet the requirements of Sch 4 ITEPA 2003. S39 FA 2010 provides for a transitional period of six months during which the rules of any such scheme can be changed to meet the newly amended requirements of Para 17 Sch 4 ITEPA 2003. If schemes are not amended by the end of this period, it is likely that HMRC will withdraw approval of the scheme.

These changes take effect for all options granted on or after 24 March 2010. Notice that no options granted during the six-month transitional period over shares in an unlisted company controlled by a listed company will qualify for the exemption from income tax and NICs on the exercise of the option. Options granted prior to 24 March 2010 are unaffected by S39 FA 2010 and will continue to enjoy the usual income tax and NIC breaks as long as the other requirements of the company share option plan code are met.

Contributed by Robert Jamieson

Lecture B609 (9.43 Minutes)

Gripple Ltd v Revenue and Customs Commissioners

Paragraph 5 of Schedule 20 to the Finance Act 2000 provides so far as material: '(1) For the purposes of this Schedule the staffing costs of a company are (a) the emoluments paid by the company to directors or employees of the company, including all salaries, wages, perquisites and profits whatsoever other than benefits in kind; (b) the secondary Class 1 national insurance contributions paid by the company; and (c) the contributions paid by the company to any pension fund (within the meaning of section 231A(4) of the Taxes Act 1988) operated for the benefit of directors or employees of the company. (2) The staffing costs of a company attributable to relevant research and development are those paid to, or in respect of, directors or employees directly and actively engaged in such research and development.'

The claimant company (the taxpayer) was an engineering company. At all material times, H was the director of the taxpayer. He was also the director of an associated company, LH, a former wholly owned subsidiary of the taxpayer. H carried out research and development work for the taxpayer on behalf of LH. His salary had at the relevant time been paid by LH. LH sent an invoice to the taxpayer by way of recharge in respect of the work carried out and the taxpayer made payments to LH. Subsequently, the taxpayer paid corporation tax under the corporate self assessment regime on the footing that it was entitled, as a small or medium sized enterprise, to claim tax relief, pursuant to Sch 20 to the Finance Act 2000 (the Act), as amended by the Corporation Tax Act 2009, for the research and development work carried out by H. The Revenue and Customs Commissioners (the Revenue) found that the taxpayer was not entitled to claim relief for the work carried out by H when his salary had been paid by LH. The taxpayer appealed to the General Commissioners of Income Tax (the commissioners), who dismissed the appeal having found that the sums paid by the taxpayer were not 'staffing costs' within the meaning of para 5 of Sch 20 to the Act. The taxpayer appealed to the High Court.

The issue for consideration was whether the Revenue and the commissioners had misdirected themselves as to the application of Sch 20 of the Act in respect of the expenditure of the taxpayer relating to the cost of the services provided by H. The taxpayer submitted that the commissioners had interpreted para 5(1)(a) of Sch 20 to the Act too narrowly and that they had failed to interpret it in the light of the wording in Para 5(2) of the Act. Paragraph 5, it submitted, should be construed so as to include emoluments paid indirectly by a company to a relevant director or employee, and that the recharge arrangement in the instant case, between two closely related companies, should be characterised as an indirect payment of emoluments by the taxpayer to H. It essentially argued that the taxpayer had paid half of H's remuneration by channelling it to him through LH. Alternatively, the taxpayer submitted that it was an appropriate case for the court to lift the veil of incorporation and to treat the taxpayer and LH as a single commercial entity that had undertaken research and development.

The appeal would be dismissed.

(1) The purpose of para 5(2) of the Act was not to expand the meaning of 'staffing costs', which had already been exhaustively defined in para 5(1), but rather to explain which staffing costs were to be treated as 'attributable to relevant research and development'. Paragraph 5(2) set out the circumstances in which expenditure attributable to research and development was to be treated as attributable to staffing costs, namely when it was 'paid to, or in respect of, directors or employees directly and actively engaged in such research and development' (see [25] of the judgment).

In the instant case, the sums recharged by LH to the taxpayer in respect of H's services could not be treated as staffing costs within the meaning of para 5(1)(a) as they were not emoluments paid by the taxpayer to H. The taxpayer could not gain assistance from the wording of para 5(2) of the Act. All emoluments paid to H over the relevant period had been paid to him by LH. (see [24] of the judgment).

(2) It was settled law that, in respect of taxes, companies in a group, however closely related, were normally to be treated as separate entities. There was no authority which provided any support for the notion that the court should somehow coalesce separate corporate entities in construing fiscal legislation, unless the legislation properly construed permitted such an approach. In the absence of express provision in the Act, the general principle had to be to respect the separate corporate identity of the group members, and the question whether the preconditions for grant of relief had been satisfied had to be answered accordingly (see [23] of the judgment).

It followed that the taxpayer's submission about lifting the corporate veil could not be accepted (see [23] of the judgment).

Harmel v Wright (Inspector of Taxes) [1974] 1 All ER 945 considered; *DHN Food Distributors Ltd v Tower Hamlets London Borough Council* [1976] 3 All ER 462 considered.

Published Date 30/06/2010

Moneys mistakenly paid to trader

The issue

Pertemps is a UK incorporated and resident company.

The issue was whether sums of money mistakenly paid by customers to the Appellant, “Pertemps and not repaid, were liable to corporation tax under section 18(3) Income and Corporation Taxes Act 1988 ("ICTA").

Pertemps said that they were not.

The facts

Pertemps is a recruitment agency providing temporary and permanent workers to its customers. Where Pertemps provides a temporary worker, it pays the worker, and recharges the customer for the worker's costs plus a management fee. Where Pertemps provides help to enable a customer to engage a permanent worker, it charges the customer a recruitment fee. Pertemps invoices its customers in respect of these services.

Payments are received by Pertemps either by cheques in the post, or by direct credit to its bank account by BACS. Either way, all receipts (cheques and BACS direct credits) are made into the same single bank account from which business expenses incurred by the company are paid.

The sales accounts team posts all receipts to the sales ledger as quickly as possible on the day of receipt. Despite lengthy efforts made by Pertemps to unite payments with outstanding debts, some payments cannot be reconciled. The majority of unreconciled payments are either offset against another liability of the customer, or are repaid. Only in a minority of cases are payments neither offset against another liability nor returned to the customer.

Money received from unreconciled amounts remains in the same bank account as reconciled amounts.

Every six months Pertemps reviews unreconciled balances in the sales ledger. Those that are more than six months old are transferred to a balance sheet account. At the end of each financial year, this balance sheet account is released to Pertemps' profit and loss account as part of its year end procedures.

Pertemps keeps a full history of all payments received. If a customer can show that it has made an overpayment in error, Pertemps has and will refund the overpayment, even if the payment has been transferred to a balance sheet account or has been released to the profit and loss account under the procedures described above.

Findings

The Tribunal found that:

- each of the over payments was made by a customer under a mistaken belief that it owed money to Pertemps for services Pertemps had supplied to it. They emphasised that there was no suggestion that Pertemps conducted its business so as to encourage the receipt of the overpayments.
- the payments were derived from the business relationship that Pertemps had with its customers.
- Pertemps treated the overpayments as its own money. The overpayments were not segregated in any way from other receipts, and were paid into the same bank account. Money in this bank account being used to meet Pertemps' expenses.
- amounts paid by mistake to Pertemps by customers belong to Pertemps unless and until the customer makes a successful claim in restitution against Pertemps, or such a claim is settled by agreement. In practice as soon as a customer discovers its mistake, it will make a claim for a repayment. Pertemps therefore remains at risk of restitutionary claims irrespective of the length of time that has elapsed since the mistaken payment was received.

A mistaken payment for services has the same characteristic in the hands of the recipient trader as a payment made not in error – if the payment is made because the customer makes a mistake about owing something for services or for a trading transaction, the mistaken payment accrues from the trade of the recipient.

The Tribunal noted that Stamp LJ in *John Reynolds* (at 274-275) used as an example of a trading receipt a payment "... made to satisfy any legal liability, real or imagined, to which the customer was or believed itself to be subject."

HMRC submitted and the Tribunal agreed that the overpayments are a natural consequence of the efficient and lawful way in which Pertemps conducts its business, and that these processes will mean that sometimes it makes more money from the supply of its services than it had anticipated. In doing so, it has supplemented its trading profits, and the receipt is a trading receipt.

The appeal was dismissed.

Pertemps Recruitment Partnership Ltd

Deductibility of sponsorship payments

The issue

The issue in these three appeals is whether a number of very substantial payments made by Interfish Ltd to Plymouth Albion Rugby Football Club in the accounting periods to 31 January 2003, 2005 and 2006 are deductible in computing the company's profits for corporation tax.

The sums were described as 'sponsorship' payments and consisted of approximately £300,000 in 2003, nearly £400,000 in 2005 and over £500,000 in 2006. The company also made substantial loans to the Club at various times.

Were the payments wholly and exclusively laid out or expended for the purposes of the trade?

The case

Interfish was incorporated in 1977. It was founded and is controlled by Mr Jan Colam and is now the holding company of a successful group of companies involved in the fisheries industry, initially involved purchasing, freezing and exporting fish. In 2002 Interfish expanded into retailing, operating wet fish counters within Sainsbury supermarkets under the brand 'South West Seafoods'.

In 1999, Mr Colam was approached by the Club chairman and invited to join the board. It was in severe financial difficulties and the management hoped that Mr Colam might help out.

Mr Colam bought 300 shares and became a director of the new company.

Interfish's financial contributions to the Rugby Club

The Club sought sponsorship and to raise money through advertising and providing hospitality facilities at matches. There were advertising opportunities in the match day programme and on the perimeter of the pitch and to a range of sponsorship opportunities including shirt sponsorship and stand sponsorship.

Interfish advertised its South West Seafoods brand on a perimeter hoarding and on players' shirts, as did other local companies. Interfish also used the Club for business hospitality.

Interfish may have paid fees for some of the above but this was not clear.

Most significantly, Interfish lent money to the Club and made substantial payments to cover what would otherwise be a deficit in the Club's player budget.

Clubs needs

One of the Club's needs was to improve its squad of players. Interfish's first sponsorship payment enabled the Club to recruit a new director of rugby, Mr Dawe.

Mr Colam attended committee meetings with a view to giving him support in getting finance for a group of players that would make the Club more attractive to spectators. Mr Dawe would say how much he wanted by way of player budget; The Club's financial staff would say how much of the budget the Club could afford to bear itself, and there would be a negotiation between Mr Colam and the other board directors with a view to arriving at figure to be contributed by Interfish.

Benefit to Interfish

Mr Colam's view of his position as director and benefactor of the Rugby Club was that it 'opened doors' within NatWest, Intefish's bankers and the Plymouth business community.

Mr Colam used the Club for business entertaining and was able to have Club players, who understandably enjoy a degree of star status locally, visit the counters dressed in playing kit; this had been a very effective way of promoting the counters.

The decision

The starting point in considering the operation of section 74 is the summary of the effect of the authorities given by Millett LJ (as he then was) in *Vodafone*, on which both parties relied. It is convenient to set it out.

The leading modern cases on the application of the "exclusively" test are *Mallalieu v Drummond* [1983] AC 861 and *Mackinlay v Arthur Young McClelland Moores & Co. [1990] 2 AC 239* . From these cases the following propositions may be derived:

1. The words "for the purposes of the trade" mean "to serve the purposes of the trade". They do not mean "for the purposes of the taxpayer" but for "the purposes of the trade", which is a different concept. A fortiori they do not mean "for the benefit of the taxpayer."

2. To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his object in making the payment. Save in obvious cases which speak for themselves, this involves an inquiry into the taxpayer's subjective intentions at the time of the payment.

3. The object of the taxpayer in making the payment must be distinguished from the effect of the payment. A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment.

4. Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made.

Executive Network

Section 74 was applied by the Special Commissioners in *Executive Network* where the taxpayer company sponsored the equestrian activities of members of the family of one of the shareholders with a view to promoting the company through their participation in and equestrian events. Holding that the expenditure was not deductible, the Special Commissioners reasoned as follows:

The expression 'business sponsorship' has a wide significance. At one end of the spectrum is sponsorship of a charitable or philanthropic nature of, for example, the arts or sport. Expenditure on that will not normally be wholly, let alone exclusively, incurred for the purposes of the sponsor's trade. At the other end of the spectrum is sponsorship amounting to pure advertising or pure public relations. In that situation the quid pro quo for the sponsorship payment will be, for example, the advertising facility and no more. The fact that the sponsorship arrangement provides a commercial benefit to the 'spondee' will not disqualify the payment as a deduction of the sponsor's trade. Here the evidence shows the situation to lie somewhere in the middle. The sponsorship payments do not merely secure for EN the facilities of advertising and public relations, and they do more than provide Mrs Toms, the spondee, with an advertiser's or public relations consultant's profit. The 'sponsorship' payments in the relevant years provided at least four extra benefits. These were, additional working capital in Year 1 to build up Mrs Toms' stock of horses (which ... were to belong to Mrs Toms), a new horse box in Year 4, opportunities for the Toms children to build up their equestrian careers and a year-in-year-out revenue subvention which had the effect of underpinning and preserving the solvency of Mrs Toms' own trade.

Interfish's purpose

Interfish's purpose in making the payments can best be stated as being to improve the financial position of the Club, in particular by enabling it to enhance its squad of players without incurring a deficit, in order that those involved with the Club would thereby be induced to look favourably on Interfish in ways that would assist Interfish's trade.

The tribunal found that improving the financial position of the Club in this way was a conscious purpose in the mind of Mr Colam (and therefore the company); the amounts contributed were tailored to the Club's reasonable requirements for players and contributing them formed part of Mr Colam's plans for the Club which he did not want to see outvoted. The improvement of the Club's financial position was also an inevitable consequence of the payments.

The Tribunal also found that in Mr Colam's mind was a reasonably held expectation that those involved with the Club would in return look favourably upon Interfish in ways that would assist Interfish's trade, and that it was also his purpose was to achieve that.

However, it did not consider that Mr Colam could have been confident that the financial benefits to Interfish's business would necessarily be equal to the amounts the company was contributing. The influence and connections that Mr Colam established could only have been beneficial to Interfish, but could not be quantified financially.

Back to Lord Milett

Lord Millett's third proposition indicated that something which is 'merely a consequential and incidental effect' of making a payment is not to be regarded as part of the object of the taxpayer.

The Tribunal did not see how in this case the furtherance of the Club's trade can be dismissed as merely a consequential or incidental effect of the payments. Promotion of the business of the Club was not an unintended consequence of Interfish's payments; it was a consciously intended consequence and, necessary if Interfish were to derive benefit.

Purpose underlying s74

The requirement of 'wholly and exclusively ... for the purposes of the trade' is a restrictive one, and it would be surprising if the provision allowed the deduction of sums (and in this case substantial sums) laid out for the immediate purpose of promoting the trade of someone other than the taxpayer, in circumstances where the 'knock-on' benefits to the taxpayer's trade, whilst real, were intangible and hard to quantify.

Conclusion

The sums paid by Interfish for purposes such as increasing the Club's player budget are not deductible.

Within the sums at issue in the appeals there may be sums which fall on the right side of the line drawn by the Special Commissioners in *Executive Network* or are deductible for some other reason.

If Interfish and HMRC are unable to agree on the treatment of the deductions claimed by Interfish in the tax years in question in the light of this Decision, the case will return to the Tribunal.

TC00520: Interfish Limited

Simplification review of the associated company rules

Introduction

In October 2009 the previous Government published the consultation: *Simplification review: the associated company rules as they apply to the small companies' rate of corporation tax*. The Government confirmed in the emergency Budget on 22 June 2010 that it will introduce the proposed reform in Finance Bill 2011, with the legislation taking effect from 1 April 2011.

This document summarises the responses received to the consultation and also reflects further discussions with interested parties.

Background to the review and consultation

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

In the Finance Act 2008 the previous Government simplified the existing rules defining control of a company where a director or shareholder is separately in a partnership. However, this was only a first step in simplifying the rules, and discussions continued with representative bodies to identify how the rules could be further reformed. These discussions identified the main priority for reform as the rules governing control of a company through the attribution of rights held by one or more of their associates. A consultation document was published in October 2009 and can be found at http://www.hm-treasury.gov.uk/consult_simplification_review.htm.

Purpose of the consultation

Corporation tax was introduced in 1965 as an annual tax on the profits of companies. Initially, a single rate of corporation tax for a financial year applied to all companies irrespective of their level of taxable profits. Finance Act 1972 introduced a lower rate of corporation tax for companies with small profits. From 1 April 2010-11, the SPR is 21 per cent compared to the main rate of corporation tax of 28 per cent. The emergency Budget announced both rates will be reduced in future years: the SPR will fall to 20 per cent from 1 April 2011 and the main rate will be reduced to 24 per cent over 4 years from 1 April 2011.

The SPR applies to companies whose annual profit does not exceed £300,000 (the 'lower limit'). If a company's profits are above £300,000 but do not exceed £1 .5 million (the 'upper limit') the main rate of corporation tax is charged but marginal relief is due.

Where a company is associated with other companies the corporation tax thresholds (i.e. the lower and upper limits) are reduced accordingly. Broadly, the effect is to adjust the rate of tax to take account of the total profits of all associated companies, ensuring that each associated company's tax rate is reflective of it being part of a wider economic unit. The test for whether companies are associated are the rules governing 'control' of a company set out in section 450 of the Corporation Tax Act 2010.

As they apply to the SPR, most aspects of these rules are fully in accordance with the intended policy objective. For example, where companies are part of a group or controlled through rights held by the same person or persons they are associated for the purposes of access to the SPR. In discussions prior to the consultation there was broad recognition that it is right that companies within a group or controlled by the same person(s) should be regarded as associated.

However, some aspects of the rules work in an automatic, mechanical manner that serve to associate companies controlled by separate individuals regardless of the wider circumstances. For example, the rules governing the attribution to a person of rights held by another person linked to them can be unfair. The aim for reform of the existing rules is therefore to provide a test that retains those aspects of the current test that work well within a new test that attributes rights held between linked persons only in circumstances where actual links between the companies make it appropriate to do so. The consultation sought views on a new test that seeks to ensure that companies cannot be associated by an attribution of rights by mere 'accident of circumstance'.

The consultation questions

The consultation invited responses from interested parties on the consultation questions below:

1 Do you feel that the proposed new test ensures that companies would only be associated when their level of interdependence means that it would be appropriate to do so?

2 If not, what aspects of the proposed new test should be amended?

3 Are there any areas that you feel the draft guidance does not cover and would benefit from further examples?

4 Do you have any views on the draft Impact Assessment?

Responses to the consultation

A total of 17 responses to the consultation were received from individuals, businesses and representative bodies. A subsequent meeting was held with interested parties to discuss the specific concerns raised during the consultation about the clarity of the legislation and guidance. A summary of the responses and the Government's response is set out below.

Question 1: Do you feel that the proposed new test ensures that companies would only be associated when their level of interdependence means that it would be appropriate to do so?

There was wide support for the policy rationale behind the proposed new test. Responses highlighted it as a "sensible" change, "perfectly appropriate", "desirable", and "should result, in the vast majority of cases, with companies being treated as associated when it is appropriate to do so." At the same time, some concerns were raised that moving from a mechanical test to the proposed test might "increase uncertainty" because it would, by necessity, turn on matters of fact and degree. Another considered it might be "unlikely to constitute a simplification" as a result.

Two responses also suggested the new test did not go far enough because companies controlled through rights held by the same person would remain associated for the purposes of access to the SPR.

The Government's response

The Government has responded to the main priority identified by stakeholders in the simplification of the associated company rules and welcomes the broad support for the reform so that companies cannot be associated by an attribution of rights by mere 'accident of circumstance'. As set out in the emergency Budget 2010, it will proceed with this reform and introduce legislation in Finance Bill 2011 that takes effect from 1 April 2011.

The Government does acknowledge the concerns around the possibility of increased uncertainty. This was raised with stakeholders prior to the publication of the consultation when the proposed test was initially discussed. Interested parties considered it to be an inevitable consequence of their desire to move away from the existing automatic, mechanical test towards one based on the individual facts of each case. It was agreed that as a result some uncertainty would always exist but clear legislation, with supporting guidance, would mitigate this and the benefit of the reform would outweigh the potential for uncertainty.

As set out in the previous chapter, it was agreed with stakeholders prior to the consultation that it would focus solely on the attribution of rights between associates. The new test only amends the circumstances in which rights held by linked persons are attributed between them to establish control.

Question 2: If not, what aspects of the proposed new test should be amended?

Despite the broad support for the policy change there was concern that the draft legislation lacked clarity and was, in some respects, inconsistent with the draft guidance. Some felt the legislation to be too broad and difficult to interpret without making reference to the guidance. To tackle this, some commented that the principles on which attribution of rights would be based (i.e. economic, financial and organisational interdependence) should be made explicitly in the legislation.

Others considered a "significance test" or *de minimis* could be included within the legislation to eliminate minor links from creating an association, with s.51 G of the Capital Allowances Act 2001 cited as an example of an objective test to prevent the fragmentation of businesses.

The Government's response

The Government has revised the draft legislation to express more clearly the circumstances in which rights should be attributed between associated persons. The revised legislation explicitly sets out that rights are only attributed between associates where "substantial commercial interdependence" exists between the relevant companies. In considering where this exists, regard should be had for the level of economic, financial and organisational interdependence between the relevant companies. While lengthening the legislation, the change ensures the policy objective of companies only being associated through attribution of rights in circumstances where the links between them make it appropriate to do so and sets out the relevant circumstances.

As stakeholders and respondents recognised, "substantial commercial interdependence" can exist in many ways and is thus difficult to define with absolute clarity. The revised legislation therefore takes the takes the form of:

- a high level statement in primary legislation that the rights of linked persons will only be attributed where "substantial commercial interdependence" exists between companies; and
- specific detail, in secondary legislation, of the factors that determine whether "substantial commercial interdependence" exists.

This approach provides the legislative clarity that respondents requested. The power to set out the factors indicating interdependence by way of Treasury Order has the virtue of giving legislative clarity in a manner that, if required, can be amended in line with changes in the business world without the timing restriction of the annual Finance Bill. Interested parties at a meeting subsequent to the consultation welcomed this revised approach.

The Government does not believe a significance test is appropriate. Each case under the revised legislation will be dependent on its own facts and tax legislation often turns on such questions of facts and degree. A statutory significance test would create a new "cliff-edge" test of the type this reform seeks to replace. Furthermore, HMRC Extra Statutory Concession C9, on which this reform is based, specifically uses the test of "substantial commercial interdependence". This test has been well understood and operated for many years without difficulties or the need for an additional significance test.

Question 3: Are there any areas that you feel the draft guidance does not cover and would benefit from further examples?

Responses on the guidance noted "the guidance is very good although, obviously, it cannot cater for every situation, and most situations will be more complicated than those presented". The examples were described as aiding "interpretation of the legislation and are transparent as to its intentions".

Some responses however suggested the examples in guidance did not provide sufficient clarity because, in some cases, they did not outline the specific interdependence leading to an association. Some also requested the guidance clearly set out the level of economic, financial or organisational interdependence required for companies to be considered associated.

Responses also made a number of suggestions for further examples that would be helpful to include in the guidance. These included circumstances where:

- spouses or civil partners owning different companies both work at home, while sharing childcare and household responsibilities;
- companies share premises;
- family businesses set up by one generation split into separate businesses when passing into ownership of next generation;
- there is financial assistance from a family member who is in another business;
- there are arms length transactions at commercial rates; and
- a private equity fund invests in a number of independent companies.

It was also suggested the guidance should include some practical advice about how to resolve any disagreements over interdependence and what additional information HMRC would seek in such instances.

The Government's response

The proposed revisions to the legislation explicitly set out the factors that must be taken into account when considering whether it is appropriate to attribute rights held by associated persons. While it is impractical for the guidance to cover every scenario, the guidance has been revised wherever possible to include the examples above and make the existing examples clearer. The revised draft guidance can be found at Chapter C and further comments are welcome. Further discussions will be held with relevant stakeholders in relation to private equity and the guidance will be updated to include appropriate examples if necessary.

The guidance provides practical advice on how HMRC will interpret the legislation in a range of scenarios. It is impractical to set out further what additional information may be required in the event of a dispute as it will depend on the facts of each individual case. Any disputes will be subject to the normal procedures and guidance can be found at www.hmrc.gov.uk/factsheets/hmrc1.pdf.

Question 4: Do you have any views on the draft Impact Assessment?

Only a small number of comments were received directly about the draft Impact Assessment. They suggested compliance costs could be more significant for some companies because a potentially complex judgement has to be made whether the interdependencies apply.

The Government's response

The Government acknowledges that the new test will, in some instances, involve a greater burden for the small number of companies that need to consider whether they are associated because of attribution rights. As set out above, this is the consequence of replacing the existing mechanical test in favour of delivering the priority reform requested by stakeholders during the course of the Review. In the majority of instances however, the attribution of rights play no part, or are only a very minor consideration, when deciding whether an association exists. Consequently, the Government believes the draft Impact Assessment represents a fair reflection of the average burden for companies considering matters of association but will make this clearer when producing the final Impact Assessment.

Other issues raised

The responses also highlighted a number of issues not directly related to the consultation questions.

One asked whether this meant HMRC Extra Statutory Concession C9 would be withdrawn as a result of these proposals. This states that where there is no substantial commercial interdependence between companies then, for the purpose of access to the SPR, they cannot be considered associated by virtue of an attribution of rights between relatives unless the attribution is between husband and wife or a child who is a minor.

One response suggested introducing a single rate of corporation tax to remove the need for the associated company rules as all profits would be taxed at the same rate no matter whether companies were associated or not.

Other responses commented on the scope of the consultation. Some suggested it should have also considered the case for removing the mechanical reduction of the thresholds by reference to the number of associated companies and replace this by applying the SPR to the total profits of all associated companies taken together. Others suggested the Simplification Review should consider the broader application of the associated company rules.

The Government's response

The Government confirms that HMRC Extra Statutory Concession C9 will be withdrawn when the new legislation is introduced.

The Government notes the suggested benefits of a single rate of corporation tax in terms of simplification. Tax rates are beyond the scope of this consultation.

The possibility of applying the SPR by reference to the total profits of all associated companies was discussed in detail with stakeholders prior to publication of the consultation. However, in those discussions there was collective agreement with the difficulties in a reform of this nature and so the published consultation did not focus on it. These difficulties include:

- problems arise when company A is associated with companies B and C but where there is no association between B and C. Company A may have no other associates apart from B and C, so for it thresholds are reduced by two-thirds, whereas company C may have many associates so that its thresholds are reduced to a small fraction. As a matter of policy it is highly difficult to decide the total amount of relief that company B should be allowed to share in and so there is no rational basis for resolving disputes between the companies as to what amount of relief each should get; and
- it would be particularly difficult where accounting periods do not coincide and also where the associated companies are not UK resident or trading within the UK and therefore not within the charge to corporation tax.

The Government has been unable to find a practical solution to these issues and neither stakeholders prior to the consultation nor those raising the issue again during the consultation have been able to find solutions to resolve these difficulties either. The Government does not therefore currently plan to act but remains open to further discussions if a practical solution can be found.

The Government also notes the suggestion there is interest in reviewing the associated company rules more broadly. Reforms have been introduced to tackle the specific issues identified as the main priorities identified by stakeholders during the Simplification Review process launched in 2007 and has now delivered on those areas. The associated company rules, as with all taxes, will be kept under review in the future.

Next steps

As announced in the emergency Budget 2010, legislation will be introduced in the Finance Bill 2011 to reform the associated company rules as they apply to the SPR. This will take effect from 1 April 2011.

The Government is currently consulting on improving the scrutiny of tax legislation.[1] It has proposed a minimum of 8 weeks for comments on draft Finance Bill legislation and 4 weeks for comments on draft secondary legislation where it makes a substantive change to the tax code.

The Government has delivered the priorities identified by stakeholders during the scoping stage of the Simplification Review in 2007 and discussions over the past three years. It will now formally close this strand of the Related Companies Simplification Review but will continue to keep the associated company rules under review should further reforms be necessary in the future.

Full details of the amended legislation and revised guidance can be found on the HMRC website.

Extracts of HMRC Technical Note, 27/07/2010

Should property be in or out of a company?

The increase in the rate of capital gains tax to 28% reopens the difficult question of whether it makes sense to hold property or other assets in a family company.

With an 18% rate of capital gains tax the answer was clear. It was normally sensible to keep the property outside the company. Provided no rent was charged, the property still attracted entrepreneurs' relief if the company was a trading company.

Tax at 10%, or even 18%, was cheaper than the small companies rate of 21% and a lot cheaper than at the 29.75% effective marginal rate or the 28% full corporation tax rate.

The only downside was that the property qualified for only 50% inheritance tax business property relief, whereas if it were in the company the increased value of the shares would qualify for 100% relief.

However, this was normally an acceptable price to pay to obtain flexibility in the event of a lifetime sale of the asset.

As the sale proceeds would be received personally the net after-tax amount could be freely spent, whereas if the property was owned by the company the after-tax proceeds either had to be reinvested in the company or extra tax had to be paid to take the money out of the company by way of dividend.

A change of strategy?

To what extent does a 28% capital gains tax rate point to a change in strategy?

First, it needs to be remembered that the strategy needs to be a long-term one. Once an asset has been put into a company it is very difficult to take it out again without triggering further tax charges, other than by way of loan repayment. Selling the property to the company will create a loan account, but will also trigger capital gains tax on the vendor.

That will, however, only cover the current value; there is still a problem with future increases in value. If it is a business asset it can be gifted to the company and an election can be made under TCGA 1992, s 165 to hold over the gain – but that still leaves the entire value locked in the company.

So the first need is to form a view of what is likely to happen to capital gains tax. How long will it remain at 28% with no recognition that much of the gain may be the product of inflation?

Is a 28% rate sustainable while the USA has a 15% rate and France has a very low effective rate where an asset is held for a long period?

It may be difficult to move a business to the USA, but it is not difficult for a wealthy individual to move to the USA, and the 28% rate is targeted primarily at such people rather than at owners of business assets of a UK business.

If you think that the rate could fall in five or ten years' time there is a lot to be said for leaving the property in the hands of a director/shareholder and hoping that it will not be sold in the interim.

Of course, capital gains tax could go higher, but that seems less likely as the Chancellor has said that the Treasury has calculated 28% as the level at which the law of diminishing returns comes into effect.

The long-term view

If you think that 28% (or higher) is likely to be a long-term rate, the next question is the long-term arithmetic. That may mean taking a view of corporation tax rates.

The Government has said that it will reduce the main corporation tax rate to 24% by 2014/15, but has given no indication that it will reduce the proposed 20% small companies rate. Let's look at both 20% and 24% and assume that when the property is sold the net gain will be extracted by way of dividend.

Example

A company owns a property that it intends to sell, making a gain of £100,000. The net gain, or increase in value of the company, will be paid to the shareholders as a dividend.

Below is a comparison of the potential liabilities depending on whether the company is liable at the small companies or main rate of corporation tax and the shareholders' marginal rates of income tax.

Corporate tax

	20%	**24%**
	£	**£**
Gain	100,000	100,000
Corporation tax	20,000	24,000
Net increase in value of company	80,000	76,000
Extract as dividend	80,000	76,000
Tax credit (1/9)	8,889	8,444
Total taxable income	88,889	84,444
Tax at personal level	**£**	**£**
Basic rate taxpayers	0.00	0.00
40% taxpayer (25% of dividend)	20,000	19,000
50% taxpayer (36.11%)	28,888	27,444
Net receipt		
Basic rate taxpayers	80,000	76,000
40% taxpayer	60,000	57,000
50% taxpayer	51,112	48,556

If the property had instead been held by an individual shareholder(s), then the worst case CGT liability would have been at 28%, meaning that the net gain – whether the usiness was carried on by a company liable at the small companies or main rate of corporation tax - would be as follows:

£100,000 x 72%	72,000	72,000

From a comparison of the figures it still seems to make sense to keep the property in personal hands unless the shareholders, or most of them, are basic rate taxpayers.

Even if they are basic rate taxpayers, unless there is a large spread of shareholdings a gain on disposal of a property could well be large enough of itself to bring the shareholders into the 40% tax bracket if it is 'dividended out'.

However, it might be possible to avoid this by paying dividends over a period to keep the shareholders' income within the basic rate tax band.

Company sale or liquidation

What if the shareholders do not need the money from the company's sale of the property and are content to leave the net gain in the company until it is ultimately sold or liquidated?

As in the example before, the company sells a property making a gross gain of £100,000. Instead of paying the net gain out as a dividend, the company retains it until the company is subsequently sold or liquidated. The shareholders disposal of their shares is then a capital gain and the potential CGT liability on that element of the gain relating to the property sale would then depend on their entitlement to entrereneurs' relief and the applicable marginal rate.

	£	£
Net increase in value of the company (as before)	80,000	76,000
CGT on net gain		
At 10%	8,000	7,600
At 18%	14,400	13,680
At 28%	22,400	21,280
Net receipt		
At 10%	72,000	68,400
At 18%	65,600	62,320

Caveat

There is an important caveat to the Sale or liquidation example. This is that if the company is sold, the full value of accumulated cash is unlikely to be reflected in the sale price.

The company will normally be valued on the basis of maintainable profits. In such circumstances, the net asset value may be irrelevant – although it might influence the multiple to be used in valuing the business.

But leaving that aside, there is still no advantage from the arithmetic in the property being held in the company.

However, if the shareholders are content to leave the gain within the company the inheritance tax position becomes more interesting, particularly bearing in mind that there is an uplift of the capital gains tax base cost on death.

One hunderd per cent inheritance tax business property relief (rather than only 50%) is likely to outweigh the long-term capital gains tax considerations.

Property investment

The 28% capital gains tax rate might also make property investment companies more attractive, but only if the intention is to create a family heirloom that will pass the shares from generation to generation.

Paying 20% corporation tax on gains rather than 28% capital gains tax increases the net amount available for reinvestment by 11%. Even with a 24% corporation tax rate the amount available for reinvestment increases by 5.55%.

However, this benefit is lost once it is wished to extract the gain from the company. The earlier arithmetic again applies, but entrepreneurs' relief does not apply so the ultimate tax charge is always increased.

Furthermore, there is a problem with a property company as a family heirloom. This is that while death uplifts the base cost at shareholder level, it does not uplift it at the corporate level.

This means that it will become increasingly expensive to liquidate the company, or even to sell individual properties when their investment value deteriorates.

Every taxpayer is different and detailed calculations should be prepared for each scenario.

However, the conclusion seems to be that in the majority of cases it is still sensible from a tax point of view to keep properties out of companies.

Robert Maas writing in Taxation, 28 July 2010

Value Added Tax

VAT penalties – recent developments

This article considers a number of recent appeals against penalties, which helpfully highlight how traders can get into trouble – and, sometimes, get out of it. It is better to learn from other people's mistakes than to make your own.

The article also describes two changes to the penalty rules themselves – the late notification penalty has already been replaced with effect from 1 April 2010, and default surcharge will be replaced from a date to be announced.

Late registration

A company was incorporated with the assistance of a firm of accountants which was then supposed to effect a VAT registration. It appears that they did not do so; some time later, a new accountant was appointed, and shortly afterwards the registration was completed. HMRC levied a penalty at 10%, mitigated by 25% for voluntary disclosure. The company appealed to the Tribunal to increase the mitigation.

The Tribunal noted that the reliance on the first accountant could not be a reasonable excuse. However, it could give rise to mitigation. Although the company could have been more diligent in following up its own accountants, the Tribunal was mindful that the 10% penalty had been triggered by just one day – if the notification had arrived one day earlier, the rate would only have been 5%. In these circumstances, the Tribunal added further mitigation of half the difference, reducing the assessed amount from £2,515 to £1,886.

First Tier Tribunal (TC00183): ALH Interiors Ltd

Misdeclaration

A trader claimed input tax on a number of invoices which HMRC decided were falsified. A misdeclaration penalty was raised. The trader's representative asked repeatedly for copies of invoices held by HMRC which they alleged showed that the trader's purchase invoices, purporting to be from a particular company, were "hijacked" forgeries. HMRC only produced these after many requests, including a direction from the Tribunal. When he saw the evidence, the representative advised that the appeals against those parts of the penalty should be dropped.

The hearing was then about whether the trader should be regarded as an innocent dupe who could not have known that the invoices were bogus. The transactions took place, and he believed that he was dealing with honest traders. The Tribunal disagreed: the discrepancies and inadequacies of the invoices were such that a conscientious trader would have carried out more checks, and those checks would have revealed the problem.

The representative also made a claim for some of the costs which were incurred as a result of HMRC's delay in providing the evidence which showed that part of the appeal could not succeed. The Tribunal rejected this argument. Although there was no excuse for HMRC's failure to provide the documents, the result of that production was that the representative carried out the checks that the trader should have done much earlier. Realising that the claim was ill-founded was not something that could justifiably be charged to HMRC.

First Tier Tribunal (TC00225): Sarwar & Sons Knitwear Ltd

Sales list penalty

A company started a new business with customers in the Netherlands and Belgium. It was repeatedly late filing EC Sales Lists. The penalty regime under s.66 VATA 1994 requires that the first late return triggers a penalty notice, which will lead to a penalty of £5 per day (to a maximum of 100 days or £500) if another return is late within the next 12 months. As with default surcharge, in practice HMRC usually send a "help letter" after the first sales list is late, so only the third late submission incurs the penalty.

The trader had submitted three successive sales lists in 2008 84, 84 and over 100 days late, and therefore received a penalty assessment of £500. On appeal, according to the Tribunal report, "The Respondents say that the Appellant had had more than adequate time, and warnings, to complete its

returns timorously [sic]". The Tribunal agreed that there was no reasonable excuse and confirmed the penalty. A reasonable trader would, on receiving repeated warnings, take steps to resolve the problem. This trader had not done so.

First Tier Tribunal (TC00365): Corriform Ltd

Default surcharge

HMRC have issued a revised version of the Notice on default surcharges. Changes include new information on deferring payments for the payment on account scheme, concessions for small businesses, late "nil" or repayment returns. There is also clearer advice on how to avoid a default when a due date falls on a weekend or bank holiday.

Unfortunately, most people who appear to plead reasonable excuse before the Tribunal do so because they have not yet read the Notice, rather than because the information in it was unclear.

Notice 700/50

The Steptoe argument

A company received about 99% of its income from a single customer, which was persistently slow in paying. The company was in default in most periods, and pleaded reasonable excuse on the grounds that its circumstances were similar to those considered by the Court of Appeal to constitute a reasonable excuse in the Steptoe case.

The Tribunal disagreed. It appeared that the company did have enough cash at most times to pay its outstanding VAT, and it had misunderstood the obligation to make payments on the basis of invoices rather than receipts. It is not clear why the company was not using cash accounting, which would surely have solved its problems.

It is interesting to note that the Tribunal discussed at length the difference of opinion between the appeal judges in Steptoe – the taxpayer only won on a majority decision, and the Tribunal appeared to regard this as indicating that the principle should be applied with caution.

First Tier Tribunal (TC00184): Pillars Property Cleaning and Maintenance Ltd

In a different case, the Tribunal appears to have been readier to accept and apply Steptoe. The company's argument appeared to be based on "the normal hazards of trade":

"…the decline in the Company's business as a result of the recession which was unexpected and unforeseen, the loss of a major customer, the effect that redundancies had on the business lowering staff morale and diverting attention from seeking new customers, the early payment of salaries before the Christmas 2008 shutdown, the late payment by customers and the necessity of the Company to pay its suppliers on time to remain in business…" all leading to an insufficiency of funds within Steptoe.

The Tribunal chairman commented:

"…we find that that the underlying cause of the default was a combination of the loss of a major client, the effect of the redundancies and the late payment by the Company's customers as a result of the current recession coupled with the necessity for prompt payment of its suppliers.

16. In deciding whether these reasons amount to a reasonable excuse we must consider what the reasonable competent businessman (taken for comparison purposes) exercising due diligence and a proper regard to his tax obligations, who must be taken to have exercised reasonable foresight, would have done in a similar situation.

17. We are of the view that such a businessman, in circumstances similar to that of the Company, would not have avoided the insufficiency of funds that led to the default."

Given the economic difficulties suffered by many traders at the moment, that is a relatively sympathetic interpretation.

First Tier Tribunal (TC00250): Mediaclash Ltd

Yet another Tribunal was less sympathetic. The company produced correspondence with a debtor (referred to as a "creditor" in the decision) which explained that it was late paying invoices because it was awaiting a VAT repayment from HMRC. The Tribunal considered that this was too remote from the late payment of VAT by the appellant. There was no evidence to show that it was this late payment that caused the default, or to show that the late receipt was such a high percentage of turnover that it could constitute a reasonable excuse. It appeared rather that the shortage of funds was part of the normal hazards of trade.

First Tier Tribunal (TC00251): YSL Video Wall Hire Ltd

Reliance on another

The employee responsible for a trader's VAT returns was dismissed on 3 November 2008. As a result, the managing director had to initiate a BACS payment for the October VAT return. He was aware that the company was in a surcharge period, but he was involved in business meetings in early December, and made a payment after close of business on 3 December which only arrived on 8 December. If he had made an "urgent" transfer the following day, it would have arrived in time.

The director argued first that the July 2008 return, which had led to an extension of the liability period, had been filed in time. The Tribunal found that there was insufficient evidence to support this assertion. In relation to the October return, the loss of the key employee occurred too long before the due date for it to constitute a reasonable excuse. The director said that a freelancer who was assisting with accounting had told him that receipt by 8 December would be acceptable, but even he admitted that he had doubts about the accuracy of that. If anything, it constituted "reliance on another", and that could not be a reasonable excuse.

The appeal was dismissed.

First Tier Tribunal (TC00182): J Z Machtech Ltd

A company had submitted its VAT returns for many years without experiencing any difficulty. When the chief accountant retired and was replaced, the new employee received training on the systems and worked alongside the retiring officer for some time, but still found it difficult to fulfil his responsibilities. Returns were not submitted. The management only discovered this when HMRC served a winding-up notice on one of the businesses in the group. When the full picture emerged, the company was subject to misdeclaration penalties for failing to correct inadequate central assessments, and default surcharges for late payment of VAT.

The only defence was reasonable excuse. The company director explained that the management had believed in the new accountant's references, experience and qualifications, and had given adequate training, support and a ten-week handover period. In the circumstances there was nothing more that they could have done to ensure that the VAT accounting would be properly carried through.

The Tribunal did not agree. The excessive reliance on the employee, without adequate control or supervision, had led to the problem; this was "reliance on another" and could not be a reasonable excuse. The directors were aware that the new accountant was late in preparing management accounts, and should have followed this through to the possibility that other parts of his duties were also in arrears.

First Tier Tribunal (TC00512): Pinnacle Office Equipment Ltd

A trader had a history of paying his VAT liability in two tranches, £10,000 and the balance. He entered the surcharge regime after a late payment, but the first surcharges were below the de minimis threshold and were not corrected. He then used a new book-keeper who was not aware of the rules, and both tranches were paid late. He appealed against a surcharge of £790.

The Tribunal found no reasonable excuse. If anything, the appeal was based on "reliance on another", which could not succeed.

First Tier Tribunal (TC00218): David Low t/a Low's Traditional Fish & Chips

Oops

A substantial company was subject to the payments on account regime. The balancing payment for June 2007 was paid late, triggering the surcharge regime. The instalment due on 30 June 2008 was paid late due to staff illness, extending the period to June 2009 and raising the rate to 5%. The December 2008 return was then submitted late, and the 5% surcharge based on the outstanding balance amounted to £91,393.60. The company argued that this was excessive, and offered interest of £7,358.29 instead.

The Tribunal examined the circumstances and could find no reasonable excuse in any of the late payments. There was no power to mitigate or reduce a surcharge, which was therefore confirmed as due.

First Tier Tribunal (TC00237): Beresford Blake Thomas Ltd

A company distributed video games. It was in default for four successive periods, culminating in surcharges at 10% (£200) and 15% (over £5,000). The very large surcharge appears to have alerted the company to the importance of submitting VAT returns on time, and it appealed against the surcharges on the grounds of insufficiency of funds. Like the trader in the case above, it offered to pay interest instead of surcharge in respect of the late payment.

The Tribunal could find no reason to cancel the penalty. There was no power to mitigate a surcharge or to replace it with interest.

First Tier Tribunal (TC00241): Click Distribution Ltd

Not this one, but the earlier one

A married couple ran a public house. They were under considerable financial pressure, and submitted several VAT payments late. On the returns which would have been penalised at 2% and 5% the end result would have been less than £400, which HMRC do not collect at the lower percentages. The first surcharge to be levied was therefore at the 10% rate in respect of the August 2008 return, amounting to £665.

The Tribunal agreed with HMRC that the financial difficulties in August 2008 did not and could not amount to a reasonable excuse. However, the Tribunal held that entering into (and complying with) a "time to pay" arrangement in February 2008 constituted a reasonable excuse for one of the earlier returns. Applying the Tribunal's decision in Aardvark Excavations Ltd (VTD 20,468), striking out an earlier default should be followed through to its consequences for later defaults. The rate in August 2008 should therefore be 5%, so the appeal was allowed to the extent of cutting the surcharge in half. The Tribunal did not instruct HMRC to follow their own policy and not collect the result because it was less than £400.

HMRC's counsel objected to the application of Aardvark, arguing that it had been wrongly decided (even though HMRC did not appeal it). The chairman disagreed: he considered that the analysis of the law in that case had been careful and detailed, and the result was right and was applicable to the present circumstances.

First Tier Tribunal (TC00521): RP Griffin and DM Griffin

A rare success

After many others have tried, finally a trader has succeeded with the argument that default surcharge can produce a result so unfair that it is "disproportionate" and therefore contrary to EU law. The company submitted a return one day late and was subjected to a surcharge at 5% of £131,881. This had been reduced from a 10% penalty after HMRC accepted that the company had a reasonable excuse for an earlier default.

The Tribunal did not consider that there was any excuse for the current default, but the chairman considered instead whether a Tribunal would impose such a high penalty if it was free to choose the amount. He concluded that this was "inconceivable". There was in general a public interest in the surcharge system which contributed to the prompt payment of taxes, but there were a number of features to the system that have "led to criticism":

It does not discriminate between the trader who, as in this case, has made a trivial slip and the trader who deliberately pays late; and the system equally does not cater for degrees of culpability in between those extremes. The potential hardship caused to the trader by the imposition of the penalty

is not a relevant factor. The penalty is the same no matter how long the delay. If a trader has a reasonable excuse for not sending in his payment on time, but the excuse then comes to an end, he suffers no penalty however much longer he delays. The correlation between the size of the trader and the size of the penalty is far from exact. For example, two manufacturers may have similar levels of turnover and profit, but if the major cost component of the products of one is attributable to standard-rated raw materials, he will have a smaller exposure than the other, whose product has a high labour content, since the former will, and the latter will not, have a large amount of input tax to set against his output tax, leaving a smaller net liability-the penalty being assessed by reference to the net liability. And a repayment trader (that is, one whose input tax consistently exceeds his output tax) is never exposed to a monetary penalty.

The chairman referred to the decision of the ECJ in Louloudakis v Greece (Case C-262/99), in which it observed that an essentially fixed (but high) penalty "is compatible with the principle of proportionality only in so far as it is made necessary by overriding requirements of enforcement and prevention, when gravity of the infringement is taken into account". As he could not impose a lesser penalty, he discharged the surcharge altogether.

First Tier Tribunal (TC00335): Enersys Holdings UK Ltd

Open goal

It is quite common for the trader to fail to appear at a Tribunal hearing. It is much rarer for HMRC not to be represented. In a recent case about default surcharge, the chairman decided to proceed in the absence of HMRC, and found for them anyway: the trader had clearly misunderstood the rules on the 7-day extended deadline for making electronic payments, and had no reasonable excuse for the failure to pay on time.

There were two "good" reasons for the trader's lack of understanding:

1. previous surcharges had not been collected, because they were below the level at which they would be enforced at the 2% or 5% rates, but they nevertheless increased the rate for the next surcharge to 10% – which would always be enforced;
2. previous liabilities had been settled in instalments using a "time to pay" agreement, but at that time this still counted as a default for surcharge purposes.

The Tribunal had some sympathy with the trader's situation and requested HMRC to consider whether the surcharge could be paid in affordable instalments, but the appeal against it was dismissed.

First Tier Tribunal (TC00372): E&M Pankhurst t/a Mays Terracotta

Long distance defaults

A trader was resident in Australia, making communications with HMRC difficult. He was regularly in default, and was liable to default surcharge at 15%. On the day before the extended due date for the return to 31 May 2006, 6 July 2006, he rang the National Advice Service to say that he was waiting for payment from his principal client. He was told that this might constitute a reasonable excuse for late payment, but that he should wait until he had received the surcharge assessment and appeal against it then. In due course, HMRC refused to accept that it was a reasonable excuse. He asked for a reconsideration, which confirmed the original decision, but the trader did not receive the letter telling him that he could appeal.

He only discovered that the surcharge was still outstanding when he incorporated the business and was told that he could not transfer the VAT registration because two amounts were owing - £612.02 in surcharge for 05/06 and £91.80 for the following period.

The Tribunal did not rule on whether the late payment constituted a reasonable excuse. Instead, the chairman focussed on the advice given by the Advice Service. He ruled that the failure to suggest a part payment on account rendered the advice misleading. The trader said that he would have done this to reduce the surcharge if the rules had been explained to him, and the chairman thought it possible that he might have borrowed enough to pay the whole liability.

No appeal had been lodged against the smaller penalty, but the chairman calculated that it was exactly 15% of the first one. So the payment for 08/06, which had been paid on time, had been allocated by HMRC's computer first to the disputed default surcharge, leaving £612.02 of the VAT liability outstanding to be surcharged again. The chairman ruled that the cancellation of the first

surcharge by the reasonable excuse of the NAS's misleading advice necessarily led to the cancellation of the second surcharge.

First Tier Tribunal (TC00388): Hipisol Ltd

Future penalties

The March Budget included the announcement that penalties for late filing and late payment are to be reformed across all the taxes so that they are more consistent. This is likely to mean that the regime for PAYE will become more stringent, but the proposals represent a considerable relaxation in comparison with default surcharge as it currently operates. The Budget Notice includes the following outline of what we can expect:

Under the new rules, there will be an escalating series of penalties depending on the number of failures within a set penalty period. Failure to file a quarterly return by the filing date will trigger a penalty period of one year and an immediate £100 penalty. Increased fixed penalties will then apply to subsequent failures within the period, and the period itself will be extended accordingly. Additional penalties of 5% of the tax on the return will be charged for continuing failure six and twelve months after the filing date. Penalties of up to 100% of the tax will be charged where the failure is intended deliberately to withhold information to prevent HMRC correctly assessing the tax.

Failure to pay tax due quarterly will also trigger a one-year penalty period although no immediate penalty will apply. A second failure in the period will attract a penalty of 2%, a third failure a 3% penalty and further failures a 4% penalty. Again, the penalty period is extended with each failure. Additional penalties of 5% of the tax will be charged for continuing failure six and twelve months after the due date.

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The June Budget repeated the announcement from the March Budget that default surcharge is to be replaced (by a lesser penalty for late payment, but including a new penalty purely for late filing). As stated earlier, the new system will not be introduced until HMRC's systems are ready for it, which may take several years. The new penalty regime already applies to other taxes under FA 2009 Sch.55, but will be applied to VAT, IPT, aggregates levy, climate change levy, landfill tax and excise duties in stages by Treasury Order.

BN 37

Penalties in force

HMRC have set out in a Brief the rules concerning the new "failure to notify" penalty under Sch.41 FA 2008. This applies to most taxes, including VAT, from 1 April 2010, and replaces the belated notification penalty under s.67 VATA 1994.

The penalty can be avoided altogether if there is a reasonable excuse for the failure. If there is not, the amount of penalty is tax-geared and will depend on similar principles to the error penalties which have applied since 1 April 2009. If the conduct leading to the failure was accidental, deliberate, or deliberate and concealed, and if the rectification was prompted or unprompted, together with the level of co-operation in putting matters right, produce the following table:

	Max %	Prompted, min %	Unprompted, min %
Non-deliberate	30	20	10
Deliberate	70	35	20
Concealed	100	50	30

One important difference between this penalty and error penalties is that full unprompted disclosure will not mitigate the penalty to zero. As with the old s.67 penalty, it is likely that there will be a charge simply for having failed to observe the rules at the right time.

R&C Brief 30/2010

Meanwhile, HMRC have updated their online Compliance Handbook to reflect the changes to penalties for inaccuracies, failure to notify and VAT and excise wrongdoing; and also penalties for failures to make payments on time, the publishing of details of deliberate tax defaulters and assessing time limit information.

http://www.hmrc.gov.uk/manuals/ch1manual/Index.htm

Contributed by Mike Thexton

Lecture B610 (23.25 Minutes)

Option to tax building used solely for relevant residential / charitable purpose

In Revenue & Customs Brief 39/09, HM Revenue & Customs (HMRC) announced changes to the application of the zero rate to new buildings and that, following a review, the phrase 'solely for a relevant residential or relevant charitable purpose' could incorporate a de minimis margin.

In order to avoid unnecessary disputes in marginal cases, HMRC accept that this statutory condition is satisfied for new buildings where the relevant use of the building by the charity or relevant residential user is 95 per cent or more. In light of this review, HMRC announced the withdrawal of Extra Statutory Concession (ESC) 3.29 and two related concessions as we considered them to be no longer necessary or appropriate.

However, ESC 3.29 also allowed charities to exclude the option to tax on supplies of buildings to them (other than parts used as an office) if they were solely used for a relevant charitable purpose. For consistency, HMRC accept that, where the customer and supplier agree, the option to tax can be excluded on supplies of a building or part of a building that is to be used 95 per cent or more for a relevant purpose in the following situations:

- where a building or part of a building (other than used as an office) will be used by a charity solely for a relevant charitable purpose (paragraph 7 of Schedule 10 to the VAT Act 1994 refers)
- where a grant is made in a building or part of a building designed solely for a relevant residential purpose (paragraph 5 of Schedule 10 to the VAT Act 1994 refers)
- where a grant in a building or part of a building is made to a person who intends to use the building solely for a relevant residential purpose (paragraph 6 of Schedule 10 to the VAT Act 1994 refers)

Revenue & Customs Brief 33/2010
Changes to exclusion of option to tax on buildings for relevant residential or charitable purpose