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1 CORPORATION TAX AND BUSINESS TAX CHANGES

Lecture B611 (15.27 Minutes)

1.1 Corporation tax rates

Section 2 of FA 2010 and S 1 of F(No 2)A 2010 both deal with corporation tax rates. The main rate of corporation tax was set by FA 2010 as 28% for the 2011 financial year, but F(No 2)A 2010 reduces this to 27%.

The small profits rate (renamed from the small company rate) is given by S3 FA 2010 and is 21% for the 2010 financial year, with a rate of 19% applying to ring fence profits. The standard marginal relief fraction is 7/400 for the 2010 financial year, producing an effective marginal rate of 29.75% on profits between £300,000 and £1.5 million for the 2010 financial year.

The Government also announced an intention to reduce the small profits rate to 20% for the 2011 financial year – this change will be included in Finance Bill 2011 [ref BN03 dated 22 June 2010].

1.2 Annual Investment allowance

Section 5 of FA 2010 implements changes to the Annual Investment Allowance. Subsequent changes were announced in the Budget of 22 June 2010, but these will not be implemented until April 2012.

The annual investment allowance (AIA) has been doubled to an annual spend of £100,000 per annum. Businesses which have a year end other than 31 March (or 5 April for income tax businesses) will have an allowance for the current period of an amount calculated by time apportioning the old and the new limits.

1.2.1 Example

A Limited has capital expenditure of £150,000 in the year ended 31 December 2010. The following computations will be needed :

- Calculate the annual investment allowance for the period; this is arrived at by time apportioning the £50,000 limit by 3 months and the new £100,000 limit by 9 months, arriving at £87,500.
- The timing of the expenditure must now be examined :
    - No more than £50,000 of the total of £87,500 can be awarded against expenditure in the period 1 January 2010 to 31 March 2010.
    - The balance of any expenditure in that period will potentially qualify for first year allowances of 40% (subject to the conditions being met)
    - The remaining expenditure can qualify for AIA in the period 1 April 2010 to 31 December 2010, subject to the overall limit.

So if all of the expenditure fell in the first three months of the year the allowances would be :

- AIA of £50,000
- FYA of 40% x £100,000 = £40,000 (assuming qualifying expenditure)
- Total £90,000

If the expenditure feel in the last 9 months of the year, the allowances would be :

- AIA of £87,500, and
- Writing down allowance of either 10% or 20% - assume 20% = £12,500
- Total £100,000

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1.3 Reduction in capital allowances

Legislation will be introduced in a future Finance Bill to reduce capital allowances on plant and machinery as follows :

- The annual investment allowance will be reduced to £25,000
- The rate of WDA on the main pool will reduce from 20% to 18%;
- The rate of WDA on the special rate pool will reduce from 10% to 8%

The changes will take effect from 1 April 2012 for companies and 6 April 2012 for income tax businesses. Businesses with accounting periods spanning the date of change will have to calculate a hybrid rate, under which the two applicable rates will be apportioned on a daily basis. [Ref BN04 dated 22 June 2010]

1.4 First year allowances : zero emission goods vehicles

Zero emissions is the new term for what were previously termed "wholly electric" vehicles. 100% first year allowances will be available on the purchase of new and unused zero emissions goods vehicles. This change will be included in the Finance (No 3) Bill 2010. A vehicle will qualify if :

- the vehicle cannot under any circumstances produce CO_2 emissions when driven;
- it is of a design primarily suited to the conveyance of goods or burden; and
- the expenditure is incurred on or after 1 April 2010 (CT) or 6 April 2010 (income tax) and before 1 April 2015 (CT) or 6 April 2015 (income tax).

However, there are some complex restrictions related to State Aid rules, as follows; the FYA will not be available to a business:

- in difficulty for the purposes of the *Community Guidelines on State Aid for Rescuing and Restructuring Firms in Difficulty (2004/C 244/02)*;
- subject to an outstanding recovery order following a European Commission decision declaring an aid illegal;
- engaged in the fisheries and aquaculture sectors, as covered by Council Regulation (EC) No 104/2000; or
- managing waste for other undertakings for the purposes of Directive 2008/98/EC (for example, a waste collector contracting with a local authority, or large retail business, to provide an integrated waste management service).

Finally there will be a cap on the total amount of relief given as FYA's over the whole 5 year period of €85 million. [Ref BN05 dated 22 June 2010]
[BN42]

1.5 Writing off loans to participators in close companies

The tax treatment of the write off of loans to participators in close companies is as follows :

1.5.1 The tax implications - director

The write off of the loan is taxed on the recipient as if it were a distribution under S416 ITTOIA 2005, so that it is deemed to be a payment net of the normal dividend tax credit. A tax liability will only arise to the extent that the director concerned has a higher rate liability in respect of the income. Naturally the amount of the loan should be grossed up for the tax credit to determine the tax liability. This tax treatment is statutorily required and takes precedence over any liability under ITEPA 2003 as earnings.

1.5.2 The NIC implications – director and company

HMRC's view is that when the loan is written off it becomes earnings liable to NIC. There is no clear guidance on how the NIC is to be accounted for as the payment of earnings was made sometime in the past when the loan was advanced, but here we assume that the director accepts liability for his portion and makes the relevant payment back to the company (or indeed this forms a new debit to the loan account. For these purposes we assume that the director has no other earnings from the company and that both employer and employee liabilities are settled.

1.5.3 Tax implications – the company – S455 CTA 2010 (previously s 419 ICTA 1988)

The write off of the loan is treated as if it were a repayment of the loan for the purposes of S 455 tax. If the loan is written off before the tax falls due at the 9 month point, the tax credit under section 458 arises on the same date, and no tax is payable. If the 9 month date is passed without repayment or write off, the credit under section 458 is timed at 9 months after the end of the period in which the repayment or write off occurred.

It is worth noting that there is no automatic mechanism for repayment of section 419 tax liabilities, which needs to be done by writing to the relevant corporation tax district. This can be the cause of significant delay in practice.

1.5.4 Tax implications – the company – loan write off

The write off of the loan to the director is a loan relationship debit. The debit would be allowable under the loan relationship rules as a loss on a non trading loan relationship. In order to do so, it would need to satisfy the unallowable purpose test (but see below for the change in FA 2010). This presents some challenges, as the purpose of the loan would need to be examined in some detail. There is quite a common belief that a tax deduction would be available for the write off, but this view is open to challenge for the following reasons:

- The loan must not have been made with the intention of writing it off, otherwise the unallowable purpose test would apply and no deduction would be available. This tax treatment would therefore only apply to loans in existence rather than a loan made as a result of delivering this advice as the separation of the making of the loan from the subsequent writing off would be difficult to demonstrate otherwise.

- If the loan is not made on a commercial basis with a suitable interest charge it has been common for HMRC to challenge such loans when made by pension schemes and charities to other related parties.

- The HMRC guidance on the subject of unallowable purpose hints at this approach (see below, although directed at loans made prior to 2002, this principle is likely to be persuasive). This is further borne out by the description of when the test would not be in point, referred to in the previous paragraph of guidance, which covers loans not on a commercial basis made by exempt bodies.

- If the loan is made as an advance of salary it is likely that the write off would be viewed as payment of the salary and therefore not a loan write off but a payment taxable under ITEPA.

- If the loan was made in anticipation of future dividends (as "drawings") and arose as a build up of various withdrawals it is my view that the unallowable purposes test would also apply, as the lending of the money does not arise in connection with the company's trade or business.

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HMRC guidance on unallowable purpose

CTM56780 – situations where para 13 (unallowable purposes test) would apply

a. that, subject to the comments at CTM56770(d) and (e), relate to the write-off of loans where the purpose of the loans was not amongst the business or other commercial purposes of a company. An example of a loan of this nature would be an interest-free loan made by a company, whose business consists in operating a widgets retail outlet, which had lent the money to a football club supported by one of the directors of the company for the purpose of providing financial support to the football club. Furthermore, if the company borrowed to make the loan to the football club, then paragraph 13 would normally also apply to disallow the loan relationship debits relating to the interest or other finance costs on that borrowing. If, however, the purpose of the loan included a commercial or other business purpose such as advertising, then this would be taken into account in arriving at the amount attributable to the unallowable purpose on a just and reasonable basis (Paragraph 13(1));

b. that, subject to the comments at CTM56770(d) and (e), relate to a borrowing the proceeds of which are used in such a way that the company cannot or does not expect to make an overall pre-tax profit. An example would be where a company borrows at interest and on-lends at a rate of interest that is less than the rate of interest on the borrowings; or

CTM56780 – situations where para 13 (unallowable purposes test) would not apply

b. that relate to a borrowing from an exempt body (such as a pension fund), even if that exempt body is connected with the borrower, provided the arrangements are commercial;

Note : Para 13 is the reference to the legislation as originally written in FA 2006 – the appropriate statutory reference is now CTA 2009 S441

1.5.5 Other tax implications

The liability to income tax on the benefit in kind if the loan is made interest free should not be overlooked, and indeed arrangements made if necessary to draw up the loan account as at the end of the fiscal year for the purpose of computing the benefit in kind charge and the related Class 1A NIC which must be returned and the liability paid in July following the end of the tax year. There are fixed penalties for failure to file the P11D(b) which could add considerably to the costs if this is overlooked.

1.5.6 Finance Act 2010 change

Section 43 of FA 2010 introduces a new section 321A into CTA 2009 to deny corporation tax relief on all loans written off on or after 24 March 2010.

Practice point

Rather than claim a corporation tax deduction under the loan relationship rules (which has now been stopped) the waiver could be treated as part of the company's employment costs. However, this will be subject to the normal requirement that the amount waived could not be excessive in relation to the services provided by the director to the company (with a close company, this is usually easier to justify).

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The new S321A CTA 2009 prohibits a tax deduction in the company for the cost of writing off a loan or advance under S455 CTA 2010. However, this only appears to apply for the purposes of the loan relationship rules! The key words of the new anti-avoidance legislation are:

'No debit is to be brought into account for the purposes of this Part in respect of the release or writing off'

It will therefore continue to be possible to obtain corporation tax relief via the 'wholly and exclusively' provisions of S54 CTA 2009.

Despite these difficulties, a loan waiver is anyway a useful tax planning device. The disadvantage of paying a dividend as a means of remuneration is that it must be paid to all shareholders of that class, irrespective of their contribution to the company's success. If it is desired to direct a payment to only one individual, it may be worth considering making a loan to that individual and subsequently writing it off. To all intents and purposes, the individual is treated as though he had received a dividend, even though the other shareholders have received nothing. However, in this situation, the need for correct documentation, including a formal deed of waiver, cannot be stressed too highly.

Contributed by Robert Jamieson

1.6 Sideways loss relief

Section 24 and Schedule 3 of FA 2010 make changes to the existing anti avoidance legislation dealing with sideways relief for trading losses. The schedule deleted s 74B ITA 2007 which deals with non active individuals carrying on a trade and replaces it with new section 74ZA which precedes existing s 74A. The new section provides that where a person carries on alone or in partnership a trade profession or vocation, and makes a loss from that activity in the year, and the loss arises directly or indirectly in consequence of or in connection with relevant tax avoidance arrangements, no sideways loss relief or capital gains relief is available in respect of the loss.

Relevant tax avoidance arrangements are arrangements to which the person is a party and the main purpose or one of the main purposes of which is the obtaining a reduction in tax liability by sideways relief for capital gains relief. The restriction does not apply to qualifying film expenditure.

The new restriction applies to arrangements or a transaction entered into on or after 21 October 2009, subject to unconditional obligations entered into before that date.

The practical effect of this change is to widen the scope of anti avoidance arrangements involving trading losses from those where the individual is "inactive" (as defined) to all situations where losses are contrived for tax purposes.

1.7 Restriction on property loss relief

Section 120 of ITA 2007 permits losses on a property business to be deducted from general income rather than carried forwards if the loss relates to a capital allowances claim. Section 25 of FA 2010 inserts new section 127A into ITA 2007 to prevent sideways loss relief if the loss arises from a claim to annual investment allowance where the loss arises directly or indirectly in consequence of or in connection with relevant tax avoidance arrangements.

Relevant tax avoidance arrangements here means arrangements to which the person is a party, the main purpose , or one of the main purposes of which is being in a position to make use of the annual investment allowance in the obtaining of a reduction in tax liability by means of property loss relief against general income.

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The restriction on the sideways relief extends only to the element of the loss that arises through the annual investment allowance claim, and any other element of the loss may still be offset against general income – to the extent that it relates to capital allowances. Property losses which do not relate to capital allowances can only be offset against future property income arising from the same property business.

The change applies to arrangements or transactions entered into on or after 24 March 2010, subject to unconditional obligations arising before that date.

1.8 Enhanced capital allowances

The ECA scheme under which 100% first year allowances are available on expenditure which is designated energy efficient or environmentally beneficial is reviewed annually, and changes made by Statutory Instrument. The current review will result in two additional technologies being granted designated status :

- Permanent Magnet Synchronous Motors, and
- Biomass fired warn air heaters.

There will also be some changes to other criteria, including the removal of some equipment from the list. Practitioners would be well advised to remain aware of this important allowance. [Ref BN11 dated 24 March 2010]

1.9 Research and development tax relief

A change will be made by Finance (No 3) Bill 2010 to permit SME's to participate in the R & D tax relief scheme where the company incurring the expenditure on R & D does not own the intellectual property that derives from it. Currently the SME scheme has this as a requirement to claim. The change will take effect for expenditure incurred on R & D on or after 9 December 2009. [Ref BN08 dated 22 June 2010].

1.10 Interest harmonisation

Interest on late paid corporation tax and interest paid by HMRC on overpayments or early payments of corporation tax is to be brought within the new harmonised regime for interest on tax by changes to be introduced in Finance (No 3) Bill 2010. Interest on Petroleum Revenue Tax will also be aligned at the same time.

However the changes will not affect interest in relation to the Quarterly Instalment Payment regime for larger companies (QUIPs) and this will remain separate. The changes will be implemented over a period of time as changes will be needed to HMRC computer systems. [Ref BN36 dated 22 June 2010].

1.11 Changes in accounting standards

There have been some changes to the accounting treatments of financial instruments and derivative products. As Corporation tax is based very closely on the accounting profit of a company, these changes leave the corporation tax rules adrift. Enabling powers are included in Section 62 and Schedule 19 to Finance Act 2010 to allow changes to the relevant corporation tax rules by secondary legislation.

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The enabling powers are be quite widely drawn, allowing regulations to be made amending the tax rules in Parts 5 (new s 465A) and 7 (new s 701A) of CTA 2009 (affecting loan relationships and derivative contracts respectively), where, as a consequence of a "change in accounting standards" there is a "relevant accounting change". A "change in accounting standards" refers to the issue, revocation or amendment of an accounting standard by an accounting body – defined as the IASB or the UK Accounting Standards Board or a successor body to either of them. A "relevant accounting change" is a change in the way a company recognises in its accounts the amounts that are brought into charge for tax purposes. This leaves sufficient scope to amend again if the accounting rules vary in the future.

1.12 Venture capital schemes

Some changes of detail to the rules on VCT and EIS are to be made to allow the schemes to obtain full EU State Aid status. These will be included in the Finance (No 3) Bill 2010. The changes are as follows:

- The requirement that the schemes are not used by "companies in difficulty", which is generally taken to mean companies which are no longer a going concern according to their last set of filed accounts;
- For VCT's the requirement that at least 30% of the VCT's qualifying holdings is represented by holdings of relevant shares is to be increased to 70%, but the definition of eligible shares will also change to allow shares with preferential rights to dividends to qualify.
- The requirement that the company trades wholly or mainly in the UK is to be replaced by the requirement that it has its permanent establishment in the UK. This requirement is also now to apply to the EMI scheme.

[Ref BN10 dated 22 June 2010].

1.13 Capital distributions received by companies

Since the exemption for income distributions from Corporation Tax was introduced in Finance Act 2009, there has been some doubt about certain capital distributions, and some debate about which side of the line certain payments fall.

Legislation will now be made in Finance (No 3) Bill 2010 to clarify that all distributions received by companies will be treated as income unless they are specifically excluded. This legislates for a practice which was technically unsustainable but which HMRC broadly continued to apply, and will apply to distributions arising both in the UK and abroad in accordance with the changes in Finance Act 2009.

The new legislation will also make clear that distributions made out of reserves arising from a capital reduction are also within Part 23 of CTA 2010 and accordingly can be treated as made out of income. [Ref BN06 dated 22 June 2010].

1.14 Bank payroll tax

The bank payroll tax was announced at the Pre Budget Report 2009 and was confirmed in the Budget statement, and has been implemented by Section 22 and Schedule 1 of Finance Act 2010. The yield from this tax had reached £2 billion (gross) by 22 March 2010, which would give a net yield of £1.3 billion, more than double the £550 million forecast made in December 2009.

In view of the limited application of this tax to wider business, only a brief review of the structure of the legislation is included here.

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1.14.1 Overview

The tax affects UK banking groups, and effectively makes a levy on the bonus pool which a banking group intends to distribute. The levy is 50% and applies to non contractual bonuses of more than £25,000 paid between 12.30pm on 9 December 2009 and 5 April 2010. The charge is not deductible for corporation tax.

Para 1(2) of Schedule 1 sets out the structure of the tax as follows :

"…tax is chargeable on the aggregate amounts of chargeable relevant remuneration awarded during the chargeable period to or in respect of relevant banking employees of a taxable company by reason of their employment as relevant banking employees."

Para 1(3) sets a floor on the chargeable remuneration of £25,000. Bank payroll tax does not apply to amounts of less than or equal to this sum.

1.14.2 Taxable company

Para 3 defines a taxable company as a UK resident bank or a relevant foreign bank or a building society, or a company which is a member of a banking group and is either a UK resident investment or financial trading company, or a relevant foreign financial trading company. Also included are companies which are UK resident investment or financial trading companies which are members of a group of companies which includes a building society. Most of the terms used are defined in Part 3 of the Schedule; these definitions are extensive and quite complex, and beyond the scope of a basic overview of the tax.

1.14.3 Relevant remuneration

This definition (in para 4 of Sch 1) extends to all earnings within s 62 of ITEPA 2003 and benefits which do not constitute earnings. This obviously encompasses all remuneration, but the legislation is then limited by defining and excluding "excluded remuneration". The definition of excluded remuneration is extensive and given by para 5. The de minimis of £25,000 is divided by the number of employments held in associated taxable companies where payments of relevant remuneration are made by more than one of them.

1.14.4 Chargeable period

The chargeable period commenced at 12.30pm on 9 December 2009 (when the Pre Budget speech commenced) and ended on 5 April 2010.

1.14.5 Other provisions

Various other definitions follow, and the collection and administration of the tax, which is self assessed, is dealt with by Part 2 of the Schedule. The tax is payable on 31 August 2010, and is self assessed by completing a bank payroll tax return which is due for submission on 31 August 2010. Enquiry into the return is possible for 12 months after the return is due or filed (if filed late), and there are also provisions to allow returns to be amended by the company. The penalty legislation in FA 2007 applying to inaccuracies on returns has been extended to apply to bank payroll tax.

1.15 Worldwide debt cap

This legislation commenced on 1 January 2010 and is the "cost" of the exemption of foreign dividends from corporation tax. Interest charges in international groups are capped under certain circumstances by being disallowed in the corporation tax computation.

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Several technical changes are being made to the legislation – some of which were announced at the Pre Budget Report 2009, and some additional changes which are new. The changes will be included in the Finance (No 3) Bill 2010. They affect only large groups of companies with subsidiaries outside the UK. [Ref BN07 dated 22 June 2010].

1.16 UK REITS

To retain tax exemption, a UK REIT must distribute at least 90% of its income each year. The legislation will be amended so that UK REITs can distribute by way of stock dividends and retain the exemption. The legislation will fall into the Finance (No 3) Bill 2010. [Ref BN18 dated 22 June 2010].

1.17 Definition of a charity for tax purposes

Section 30 and Schedule 6 of FA 2010 introduce a new definition of a charity for tax purposes, covering both unincorporated charities and charitable companies. There are similar changes to the definition of a Community Amateur Sports Club (CASC). The change largely takes effect from 6 April 2010.

The definition has been expanded to include charities in the EEA as well as those in the UK, and replaces the definitions previously in use. The definition is based on a company or body of persons meeting various conditions, which are :

- It is established for charitable purposes only – as described by the Charities Act 2006, irrespective of where the charity is established
- It meets the jurisdiction condition – that is the UK or any other member state, and is subject to the control of the relevant Courts in that jurisdiction
- It meets the registration condition – it has met any requirements applicable to it in section 3 of the Charities Act 1993 or equivalent legislation in other member states, and
- It meets the management condition – the managers (the persons having general control and administration of the body or trust) are fit and proper persons. Where the management condition is not met, HMRC has the power to treat is as being met if they consider that the failure to meet the condition has not prejudiced the charitable purposes and it is just and reasonable in all the circumstances to treat the condition as met. (para 5 Sch 6).

HMRC are given power to publish the names and addresses of bodies meeting the requirements for tax purposes, and the definition is effective for the following taxes :

- Income tax
- Capital gains tax
- Corporation tax
- VAT
- Inheritance tax
- SDLT, stamp duty and stamp duty reserve tax

1.17.1 CASC's

Part 3 of Schedule 6 deals with CASC's, introducing a location condition and a management condition into the existing definition now in Chapter 9 of Part 13 of CTA 2010 (at section 658).

The location condition is defined by new S661A, which requires that the club is established in a member State or relevant territory (as specified in Regulations issued under FA 2010), and that the facilities it provides for eligible sports are all located in a single member State or relevant territory.

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The management condition is defined in new section 661B, which mimics the provision for charities, requiring the managers to be fit and proper persons, including the power for HMRC to treat the condition as being met.

These provisions also commence on 6 April 2010.

1.18 Gifts of shares and land to charities

Section 31 and Schedule 7 to FA 2010 make changes to the rules regarding the donation of listed investments to charity in response to a number of schemes which have been intended to exploit this legislation. Frequently shares are issued at a low cost to investors, which shares then acquire a significant value on overseas stock markets. The shares are then donated to charity, with the loss against market value then claimed for relief by the donor. The shares are ultimately sold by the charity for no more than their issue price.

The changes to the relief prevent this from working by requiring that where the relevant shares have been held for less than 4 years and were acquired as part of a tax avoidance scheme, the shares are valued at the lower of market value and acquisition cost – the cost being reduced by any monies paid to the taxpayer under the terms of the scheme. The change affects both donations be individuals (changes to ITA 2007, including new section 438A) and companies (changes to CTA 2010 including new section 210A).

The changes take effect for donations made on or after 15 December 2009. The following examples of how the new rules work were included in the Explanatory notes to the Finance Bill (note that this was originally moved as Schedule 8)

Example 1

Mr Jones enters into an agreement with Company X to buy £200,000 of shares in a FTSE 100 company from Company X for £30,000. The shares come with an option attached for Company X to buy them back after three years for £1.

Two days after purchasing the shares Mr Jones donates them to Charity B and claims under section 431 of ITA that this is a donation of £200,000 – the market value of the shares. He claims that the fact that the option to buy the shares back for £1 exists is not taken into account in valuing the shares because the option is a contingent liability which is ignored under section 440(2)(b) of ITA.

However new section 437(1A), (1B) & (1C) of ITA will apply because the shares were acquired within four years of the date of disposal and the reason Mr Jones purchased them was so he could donate them to Charity B and claim tax relief. As the cost of buying the shares was only £30,000, compared to their market value of £200,000, Mr Jones is only entitled to relief of £30,000 under section 431 of ITA.

Example 2

Mr Blake is a successful IT entrepreneur who buys a controlling stake in a small listed IT company in 2009 for £5 million. He has seen an opportunity to turn the company round and make a significant profit on his investment. He is successful and by 2011 the company is thriving and his shares are now worth £25 million.

In 2012 Mr Blake visits a hospice to see an old friend and is so impressed by what he sees he decides to donate £1 million of those company shares to the charity that runs the hospice to pay for a new treatment room and some equipment they need.

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Although Mr Blake has donated shares to a charity less than four years after he purchased those shares, new section 437(1B) of ITA does not apply as when he purchased those shares in 2009 the main purpose, or one of the main purposes, of making that acquisition was not to obtain tax relief by donating the shares to a charity.

Example 3

Miss Smith inherited 10,000 shares in a listed company from her father in 1982.

In 2010 she decides to donate half the shares to a local animal shelter which is run by a charity. At the time of the donation the 10,000 shares are worth £80,000 so her donation is worth £40,000. Miss Smith is entitled to relief on £40,000 under section 431 of ITA. The shares were acquired by her over four years ago so the new provisions do not apply.

Even if Miss Smith had inherited the shares in 2008 the new provisions would not apply as although the gap between acquisition and donation is less than four years, the shares were not acquired by her in circumstances where the main purpose, or one of the main purposes, of that acquisition was to obtain tax relief by donating those shares to a charity.

Example 4

Mrs Jackson lives in a small village in Suffolk and farms a 1,000 acre arable farm around the local village. A fellow farmer decides to sell 10 acres of land on the edge of the village next to the village hall. The village hall (a charity) would like to acquire two acres for a sports field but don't have sufficient funds.

Mrs Jackson agrees to buy the 10 acres for £40,000 (market value) and then donates two acres of the land to the village hall and claims the tax relief available. She keeps the remaining eight acres and incorporates the land into her farm.

Mrs Jackson only purchased the land so she could donate the two acres to the village hall. She did not particularly need another eight acres for her farm, although she will use it to grow wheat.

Mrs Jackson can claim relief under section 431 of ITA for the two acres donated to the charity. New section 437(1B) of ITA will apply because the land has been purchased and donated within four years and was purchased so she could donate the two acres to the village hall and claim the tax relief available. Therefore the amount of relief is limited under new section 438A of ITA to a "just and reasonable" apportionment of the acquisition cost of £40,000. Given 2/10ths of the land has been donated then a similar proportion of the acquisition costs would qualify for relief - £8,000.

If the situation had been a little more complex, say half of the 10 acres had just been re-zoned by the local Council for housing and so the cost of the 10 acre parcel was £5 million, then in apportioning how much of the £5 million relates to the two acres given to the village hall would be more complex. For example if the two acres were not within the re-zoned area the cost would probably still be £8,000 as the vast majority of the £5 million cost will relate to the five acres which can now have housing built on it. Such a case may require valuations to be agreed with HM Revenue & Customs to determine the amount of relief due under section 431 of ITA.

1.19 Other amendments to charity tax law

Section 32 and Schedule 8 to FA 2010 make various amendments to charity tax law :

- Paragraph 1 implements a tax charge on charities which receive donations through the payroll giving scheme. The donations are then exempt from tax based on the application of the funds for charitable purposes only. It is likely that this was an omission in the existing legislation; the change inserts new section 521A in ITA 2007 for charities which are not liable to corporation tax and new section 472A in CTA 2010.

- A slight change to the rules on overseas donations provides that to qualify as charitable expenditure a charity must show that any claim that a payment overseas is supported by evidence sufficient to satisfy the Commissioners for HMRC that the charity's trustees took reasonable steps to ensure the money would be spent charitably. In practice that means charities will be required to maintain records of how charitable funds are spent overseas and be able to produce evidence of charitable works undertaken. The level of recordkeeping required will depend upon the circumstances relating to the expenditure. For example, it may not be possible for a charity providing aid during an emergency to maintain the same level of record-keeping as for routine overseas expenditure.

- Paragraph 3 aligns the treatment of UK and non UK donors who pay insufficient tax to cover the tax relief on their donation. Previously, gifts from non UK donors would not qualify as gift aid at all if the donor paid insufficient tax to cover the tax retained on the gift. The new legislation ensures that non UK donors assume the liability for the tax shortfall themselves, and not the charity recipient.

- Finally, paragraphs 4 to 7 make some administrative changes to the gift aid reclaim process.

1.20 Loan relationships – amounts "derecognised" in accounts

The loan relationship and derivatives rules for corporation tax are closely based on the accounting treatment of these items. However certain aspects of these transactions may not be reflected in the accounts under GAAP, and thus corporation tax law needs to be amended to ensure that these amounts to be brought into account for tax purposes even though they are not accounted for. Section 8 and Schedule 5 to the Finance (No 2) Act 2010 provide the conditions when this will occur and expand on the current provisions requiring loans and derivative transactions to be taken account of for tax purposes when not included in the accounts. Finance (No 3) Bill proposes further changes in this area.

The measure is essentially an anti avoidance measure as the most frequent situation when loans are derecognised is when matched with an equivalent transaction. When a loan relationship bearing interest (income) is matched with preference shares paying an equivalent dividend and derecognised, the company effectively pays no tax on the interest income, although the matching transaction – the payment of dividends – is not allowed for tax purposes.

1.21 Consortium relief

A change will be made by Finance (No 3) Bill 2010 to the rules on consortium loss relief. At present the "link company" – the member of the consortium which transfers losses from the consortium to its group – must be UK resident. This will be extended to allow any company established in the EEA to qualify.

In addition, a further test will be added to control the amount of losses which can be claimed form a consortium company. At present the lowest of the following can be transferred :

- The percentage of ordinary share capital held
- The percentage of profits to which the company is entitled, and
- The percentage of assets to which the company would be entitled on a winding up.

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To these three will be added a further test based on the proportion of voting rights and the extent of control the member holds in the consortium. [Ref BN14 dated 22 June 2010].

1.22 Proposals for amended rules for Furnished Holiday Lettings

This legislation is likely to be in Finance Bill 2011, but as details are available for consultation, they are set out here :

The proposals seek to tighten up the conditions under which the favourable tax regime can apply, and to modify the rules on loss relief.

- A qualifying property must presently be available for letting to the public for 140 days a year. It is proposed that this is increased to 210 days a year – 30 weeks.
- A qualifying property must actually be let to the public for 70 days a year – this will increase to 105 days or 15 weeks.
- Losses made in a UK or EEA FHL business will be restricted so that they can only be set against profits from the same FHL business. This ends the favourable loss relief available on FHL activities.

There are also aspects of the proposals which formalise the treatment of capital allowances. Strictly, when a property let under the FHL rules, in respect of which capital allowances have been claimed that would not be available to a normal rental activity does not qualify for one year there should be a disposal of the assets on which allowances have been claimed but which no longer qualify. HMRC has taken a concessionary approach when a property fails to qualify for what is anticipated to be a temporary period, but this approach needs formalising.

New capital allowance rules therefore propose that the plant which qualifies under FHL rules but not under normal letting rules is maintained in a separate pool or pools and no allowances granted in periods for which the property does not qualify, but additions to and disposals from the pool are dealt with in the period, the written down value being brought "on stream" again when the property once again qualifies.

1.23 Anti avoidance provisions

1.23.1 Capital allowance buying

Section 26 and Sch 4 introduce anti avoidance legislation to prevent capital allowance buying. Where a company has not claimed capital allowances, perhaps because the company has been incurring losses, a latent allowance will build up in the pool. Had the allowances been claimed, the unrelieved losses would be inflated. On the sale of the company or the underlying trade, the use of the losses would be restricted by existing anti avoidance legislation, but there are not restrictions on the claiming of capital allowances, which allows the loss buying legislation to be circumvented in some cases.

The new legislation prevents the use of capital allowances except against the profits of the business or company sold; they may not be surrendered as group relief. It is triggered when the tax written down value exceeds the balance sheet value of the same assets (which will be the case when allowances have not been claimed but the asset has been depreciated). The legislation is relevant when there is a "qualifying change" – essentially a sale of all or part of the company or trade. There is a tax avoidance (unallowable purpose) test to target the legislation better.

The change applies from 21 July 2009, and from 9 December 2009 in relation to allowances for ships.

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1.23.2 Leased assets

Section 27 and Sch 5 include targeted anti avoidance measures against two types of scheme which have been disclosed.

The first scheme involves arrangements intended to create a company that is taxed on very little income from the leasing of an asset, but which is potentially able to claim capital allowances on the full cost of the asset, creating tax losses where there is a commercial profit. The first scheme may, alternatively or additionally, rely on obtaining a deduction for a rebate of rentals to generate a tax loss where there is a commercial profit. This is countered by limiting the allowances to the present value of the amounts it would be reasonable to expect will be realised as income over the life of the scheme, eliminating the tax advantage.

The second scheme involves arrangements where a lessor that has claimed capital allowances in the initial loss-making phase of a lease of plant or machinery avoids tax on the income that arises once the lease moves into its tax-profitable phase. The intended effect is to turn a tax-timing advantage into a permanent loss of tax on a transaction that is commercially profitable. This is countered by amending the calculation of the disposal receipt at the termination of the arrangement to the amount that would apply if the arrangement had not been entered into.

1.23.3 Cushion Gas

Cushion gas is used in gas storage facilities. Section 28 FA 2010 makes changes to capital allowances available in respect of expenditure on cushion gas, allocating it to the special rate pool, and designating all leases in respect of cushion gas as long funding leases. Other planned anti avoidance legislation in connection with cushion gas has been deferred after discussions with the industry.

1.23.4 Sale of lessors

Existing anti avoidance legislation regarding the sale of lessor companies has been amended by section 29 FA 2010 to extend the legislation to companies which are an indirect 75% subsidiary of a company owned by a consortium, rather than a 90% direct subsidiary of a company owned by a consortium. This change is necessary to ensure that the legislation bites as intended.

1.23.5 Transfer of assets to non resident company

Where a gain has been postponed on the transfer of an overseas branch's assets to a non-resident company in exchange for securities consisting of shares and loan stock, the change made by Section 37 of FA 2010 will ensure that the disposal of any of these securities will create a deemed chargeable gain that is subject to corporation tax. Currently where the stock received in exchange comprises Qualifying Corporate Bonds, no tax charge arises, as the postponed gain is only brought back into charge on their disposal – QCB's being exempt from tax on chargeable gains.

1.23.6 Index linked gilts

Section 41 and schedule 14 to FA 2010 make changes to ensure that companies holding indexed linked gilts do not benefit from the tax exemption applying to the increase in value if the transaction is hedged.

1.23.7 Payments to Approved share incentive plans (SIPs)

Section 42 FA 2010 amends the rules on SIPs. To counter disclosed avoidance schemes, corporation tax deductions will no longer be available on payments to the trustees of an approved SIP which are part of tax avoidance arrangements, where the main purpose or one of the main purposes of the company making the payment is to obtain relief from corporation tax. There is also a change to rules allowing HMRC to

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withdraw approval of a SIP when there are no participants or where no shares have been awarded under the SIP to close potential loopholes. The changes take effect from 24 March 2010.

1.23.8 Corporate debt : release of debts between connected parties

Section 44 and Schedule 15 to FA 2010 make changes to the corporate debt legislation in CTA 2009. The change is intended to close schemes which exploit an exemption in the "debtor release" rules intended to apply to corporate rescues. The debtor release rules impose a tax charge on the debtor company when the debt has been impaired by an unconnected company which is then acquired by a connected company – and a tax charge is imposed on the deemed release of the debt. The exemption for corporate rescue allows a debtor in financial distress to be acquired without triggering the debt release rules. The schemes now closed allowed companies to buy back publicly issued debt which is traded at a discount to avoid the tax charge which would arise when the debt is redeemed for less than was paid for it. The new rules restrict the use of the exemption to genuine corporate rescues and to certain self rescue arrangements by groups issuing new debt or shares for old debt. The changes apply to transactions occurring on or after 14 October 2009, with one aspect applying from 9 November 2009.

1.23.9 Taxation of repos

As a result of a challenge to the repo legislation in CTA 2009, section 45 of FA 2010 makes clear that manufactured payments received by companies in the course of repo transactions must be included in profits chargeable to corporation tax if they are included in the accounting profits of the company.

1.23.10 Risk transfer schemes

Section 46 and Schedule 16 to FA 2010 restrict tax relief on losses from overhedging and underhedging structures ("risk transfer schemes") to the real economic loss from
those transactions. This is achieved by ensuring that any losses from these arrangements, other than the real economic loss at group level, are ring-fenced and can only be offset against profits from the same arrangements.

1.23.11 Authorised investment funds

A measure will be included in Finance (No 3) Bill 2010 to ensure that corporate investors cannot make use of an AIF to create a UK tax credit where no UK tax has been paid [Ref BN16 dated 22 June 2010].

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2 PERSONAL TAX CHANGES

Lecture P611 (23.20 Minutes)

2.1 Personal allowances

The rates of personal allowance for 2010/11 were announced at the Pre Budget Report 2009, with the exception of the Capital Gains Tax annual exempt amount – which is similarly unchanged from 2009/10. These items are dealt with by S1(3) FA 2010.

Personal allowances are withdrawn for those taxpayers with adjusted net income in excess of £100,000. This change has already been announced and legislated for in Section 4 Finance Act 2009. At this level, the personal allowance will be reduced by £1 for every £2 of income until the allowance is removed completely. The adjusted net income is calculated in the same way as for the abatement of the age allowance, by deducting losses from gross income and then deducting the grossed up pension premiums and gift aid payments. Pension contributions made gross are also deducted.

Where a taxpayer entitled to age related personal allowances has adjusted net income in excess of £100,000, the normal age related abatement will be made at the age allowance income limit, and the allowances will be further abated when income reaches £100,000, so those entitled to age related allowances are treated in the same way as other taxpayers.

The Budget announcements on 22 June 2010 also included details of future changes to personal allowances. For 2011-12 the personal allowance for the under 65's will increase by £1,000 to £7,475. [Ref BN01 dated 22 June 2010]

2.2 Tax rates and bands

S1 of FA 2010 also confirmed previous announcements (which have been legislated for) to introduce an additional rate of income tax of 50% applicable at £150,000 taxable income. The dividend rate within this band will be 42.5% which is an effective rate of 36.1%. The rate applicable to trusts will be 50% and the dividend trust rate will be 42.5%.

Table : income tax bands and rates 2008/09 and 2009/10

	Upper limit	
	2010/11	**2009/10**
Savings starting rate 10%*	£2,440	£2,440
Basic rate 20%	£37,400	£37,400
Higher rate 40%	£150,000	N/A

*Only applies if the taxable non savings income is below the limit shown.

In 2011-12 the following changes have already been announced : the basic rate limit will be reduced so that higher rate taxpayers do not benefit from the increase in personal allowances (see 2.1). No details of the exact amount are available, but the reduction to take account of the £1,000 increase in personal allowance would be £2,000. It is likely that some allowance will be made for inflation, so the reduction may be slightly less than the full £2,000. No mention has been made of the additional rate threshold. [Ref BN01 dated 22 June 2010 – para 2].

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Practice point - Top ten ideas for mitigating higher rates of income tax

Lecture P612 (15.57 Minutes)

With the top rate of income tax now 50% here are some thoughts about how this tax exposure could be mitigated.

1 Making investments which give rise to capital gains

Even with the top rate of capital gains tax (CGT) rising to 28%, this still can be a better result than paying income tax at 50%. This become even more stark if the 10% CGT rate is viable under entrepreneurs' relief. This could mean considering Enterprise Investment Schemes (EIS) or Venture Capital Trusts (VCTs) or using CGT structures.

2 Married couples - simple planning

They should consider transferring income producing assets to a non-working spouse to make sure that the spouse's personal allowance and lower tax bands are being fully utilised.

Where one spouse is a higher earner, income-producing assets be transferred outright to the lower earning spouse ie two incomes of £150,000 will suffer far less tax than one of £300,000.

This sort of planning is effective provided it is an unconditional gift of both the asset and the income arising from it. Otherwise the income is still taxed on the donor as an arrangement which is regarded as a settlement under s620, ITTOIA 2005 (the well known settlements legislation).

Section 624 then treats the income as assessable on the donor. Section 626 exempts the donor from tax where the gift is an outright gift between spouses or civil partners and the gift carries a right to the whole of the income. Section 626(4).states that a gift is not an outright gift 'if there are any circumstances in which the property or related property is payable to the giver; is applicable for the benefit of the giver; or will, or may become, so payable or applicable'. The key case here remains that of *Jones v Garnett*.

Following the case of *Glyn v IRC* 30 TC 321, which considered the meaning of 'any circumstances' HMRC accepts that where the donee spouse is free to do what he or she likes with the property given, any decision to return it to the donor will be a mere voluntary application of the property outside the terms of the settlement itself.

A measure of protection or benefit for the donor, if this is an issue, should be available if they are:

- placing funds into an account with joint beneficial ownership. This can provide a degree of protection by arranging for withdrawal only if the donor is a signatory; the income is then taxed 50:50. HMRC accepts this provided it is a straightforward gift.

- converting property from sole into joint ownership. This is a straightforward gift. The property could be owned 90:10 in favour of the donor but with the income taxed 50:50.

- crediting the income from the asset transferred into a joint account. This is not likely to be regarded as taxable on the donor even though receiving some benefit, provided it was not a condition of the gift being made.

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- using the income from the asset transferred to meet the family's household/ family/ holiday expenses.

For a partnership arrangement between spouses the issues are whether a profit share different from a capital share is an arrangement caught under the settlement anti-avoidance rules; or the share of the business transferred is excessive for the level of actual involvement.

3 Looking to extract profits from a business?

If the client does not want to keep large cash balances in the company given the current economic climate, then rather than considering the conventional options of bonuses, dividends or contributions to an approved pension scheme, perhaps an Employer Financed Retirement Benefits Scheme (EFRBS) might be the answer.

This is an unapproved pension arrangement and therefore it doesn't have the same tax treatment as an approved pension. Contributions into the pension pot are not taxable or subject to national insurance on the employee although corporation tax relief is not generally available on contributions and there may be inheritance tax implications as a result.

The fund itself does not enjoy the same tax privileges as an approved scheme, but there will be flexibility over how the fund is invested. An EFRBS also provides a pension pot, which is currently only taxable at 40% on death or when benefits are taken. This compares favourably to the combined 82% tax rate, which can apply to the fund on death with some approved pension schemes.

Note that HMRC has issued warnings about some more aggressive EFRBs planning and this can be viewed in its 'Spotlight' (number 6) which is a section on its website (see http://www.hmrc.gov.uk/avoidance/spotlights.htm).

4 Use available reliefs

Why wait until the end of the tax year to think about advising clients to use all available reliefs? It is highly likely that many will have losses (may be capital losses or business losses) and thinking about how best to use these now may be a valuable use of time.

5 Income shifting

Where a married couple are in business together it may be possible for partnership profits or dividends to be shared, keeping both below the £150,000 threshold. The Arctic Systems Ltd case (*Jones v Garnett*) highlighted the pros and cons of the settlements legislation (s660A, ICTA 1988 as was – now s619 et al, ITTOIA 2005) but providing the parameters of the case are adhered to most married couples should be able to structure effectively. The proposed income shifting rules which were floated after that case have been put on the shelf – at least for the moment.

Do watch out for aggressive dividend waivers though in favour of lower rate taxpayers that could be attacked and nullified by HMRC. For example, see the recent Special Commissioner decision in *Buck v HMRC* SpC 716, where a dividend was waived by the husband so that his wife could receive an enhanced dividend. This was held to be an arrangement caught by the anti-avoidance rules. Accordingly the wife's dividend was taxed on her husband.

The particular circumstances were that the company had a lack of reserves sufficient to meet the company's obligation in the absence of the waiver. The reserves position had to be looked at on each occasion of a dividend waiver. There was accordingly an element of bounty under an arrangement

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that Mr Buck would not have entered into with someone with whom he was dealing at arm's length. The exclusion for an outright gift to a spouse was not available as (unlike in Arctic Systems) there was no transfer of shares from husband to wife.

There are other areas where income shifting would not work. For example, in *Bird v HMRC* SpC 720, 60% of the issued shares of a family company were issued to the minor children, with their parents, Mr and Mrs Bird, owning 20% each. All the shares had normal dividend rights. It was held that the issuing of the shares and consequential payment of dividends amounted to the use of a corporate structure to provide an income stream to a minor child, and thereby reduce higher rates of tax. That was a typical situation where the taxation of settlors legislation did apply, and this was consistent with the decision in Jones v Garnett where the spouse exemption acted to exclude the settlement provisions which otherwise applied.

The children did not take part in any commercial transaction. What actually happened is that the grandfather of the minors died and a loan was supposedly made by the minors to the company from monies prospectively owned by them from the estate. The shares were then issued to them.

In this case HMRC were held not to be entitled to make a discovery for the years outside the enquiry window. This was because there was no negligent conduct. The relevant section of the tax return was headed 'Income and Capital from which you have provided funds'. The parents had not made any entry in respect of their minor children. They would have considered HMRC's side notes on this topic, which drew attention to certain extensions, but the assumed reasonable compliant taxpayer would not be expected to enter the children's dividends in the box even after reading the notes and interpreting them at face value. They had not obviously 'provided funds for a settlement'.

The taxpayers made a last minute decision not to attend the appeal, and HMRC applied for costs on the grounds that Mr and Mrs Bird had acted wholly unreasonably by not attending. The application was refused as it was not wholly unreasonable for them to make that decision. In any event, the decision against HMRC on the extended time limits issue made an award of costs inappropriate.

6 Trusts

With increasing tax rates for trusts, they have lost some of their allure for basic rate taxpayers. Taxpayers did consider converting existing discretionary trusts into trusts with a revocable life interest before 2010/11. This was to deal with the high tax rate suffered by discretionary trusts in receipt of dividend income but it also remove dthe need for beneficiaries with taxable income under £150,000 to claim tax repayments. There were no CGT or Inheritance Tax (IHT) drawbacks. Even now it is worth looking closely at whether trusts are the answer.

7 For companies about to go into liquidation

A pre-liquidation distribution is always subject to income tax but a distribution made after the winding-up process is a capital transaction (s122, TCGA 1992) subject to the lower CGT tax rates.

8 Create a general trading partnership?

Can you create an income tax or CGT loss in this way? The partnerships are unincorporated bodies and carry on a commercial business. It is a requirement that the individual partners make identifiable contributions to the partnership business. It used to be possible for a loss created for tax purposes to be set against income or capital gains. However, sideways loss relief has seemingly been stopped under this type of scheme following the publication of draft legislation applying from 21 October 2009.

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9 **Convert income to capital?**

It may be advantageous to hold investments within a personal company, if the income is not required to be distributed. Corporation tax is at 28% on interest, with net income retained in the company, but if the investment is in property the small companies rate of 21% is available. You could consider closing the company down at a later stage and pay CGT at 28% or lower. The recent uplift in CGT rates may make this option less attractive.

Also watch the notorious anti-avoidance legislation on transactions in securities in ss682 to 713, ITA2007. This serves to tax a profit as income where the person has obtained an income tax advantage in respect of the transaction or series of transactions. The exception to this is in s685 which applies if Conditions A and B below are both met. Condition A states that for the transaction to be effected it must be (a) for genuine commercial reasons, or (b) in the ordinary course of making or managing investments. Condition B states that enabling an income tax advantages to be obtained should not be the main object or one of the main objects of the transaction.

10 **Temporary or longer term, emigration**

A rather drastic option but it may also be a useful planning tool, especially if an individual is likely to be working outside the UK for a period of time.

Contributed by Francesca Lagerberg, Head of Tax at Grant Thornton UK LLP

2.3 National Insurance contributions

There are no changes to the rates and limits for National Insurance contributions for 2010-11. The Lower Earnings Limit has, however been increased from £95 to 97 per week – this change was legislated for separately.

Budget on June 2010 made some announcements regarding the National Insurance Contributions rates and thresholds for 2011-12. The previous Government had announced an increase in Class 1 and 4 NIC rates from 6 April 2011; the change was announced in two stages and totals a 1% increase in both primary and secondary liability for Class 1 contributions and a 1% increase in Class 4 contributions.

The following further changes will also be implemented :

- The Upper Profits Limit and Upper Earnings Limit will both be reduced to reflect the change in the basic rate limit for income tax (see 2.2). It is intended to retain the parity between these measures.
- The secondary threshold for Class 1 contributions will be increased by £21 per week above any inflationary increase. The effect of this is to shelter employers from additional NIC on earnings of up to around £20,000 per annum.

So although the 1% increases will be carried through, employers will be sheltered by the increase in the threshold – which will now differ substantially from the primary threshold – the point at which employees pay NIC – and employees will be somewhat sheltered by the increase in the tax allowance – which will also differ from the NIC thresholds. [Ref BN01 dated 22 June 2010; details of rate changes in PBRN01 dated 9 December 2009]

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2.4 Pension contributions – extension of special annual allowance charge

This legislation, which was in Finance Act 2009, was extended by an announcement in the 2009 Pre Budget report to those with "relevant income" (as defined) of £130,000, rather than the £150,000 as originally included in the legislation. The change is implemented by Section 48 of FA 2010. The new income limit applies to both 2009-10 and 2010-11, but additional transitional rules apply to protected pension inputs and pre change contributions to prevent the legislation biting before 9 December 2009.

2.5 Pensions Tax relief – high income individuals

The rules due to commence in April 2011 which will see the restriction of tax relief on pension contributions by individuals with income of more than £150,000 were reconfirmed in the Budget announcements, and implemented by Section 23 and Schedule 2 to FA 2010. However, proposals made by the newly elected Government mean that this legislation is likely to be repealed before it commences, so a brief outline only is provided here. The key elements of the new rules will be :

- The new legislation is known as the "high income excess relief charge", and is a charge to income tax on the individual making contributions or in respect of whom contributions are made.
- The income test – gross income (as defined) - for this purpose will apply to total annual income **before** deduction for gift aid payments and pension contributions; other deductions such as relief for losses are permitted; payroll giving donations and expenses of employment are added back where a deduction has been made. Gross income also includes the amount of increase in pension savings for the year less any relievable contributions made by the individual (this therefore includes contributions made by others on behalf of the individual).
- The high income limit is £150,000 of gross income as defined, but an individual is only caught by the legislation if his relevant income for the year is not less than £130,000. Relevant income is found as for gross income, but the addition of pension saving s increases is not applied, and instead sums relating to either salary sacrifice or flexible benefits arrangements made after 22 April 2009 in relation to pension contributions are added back.
- The tax charge is 0% if the charge when added to the individual's reduced net income for the year does not exceed the basic rate band, 20% if this exceeds the basic rate band but not the higher rate band and 30% otherwise. However for gross income (as defined, so including pension savings by the employer) of less than £180,000, the charges (except the 0%) are reduced by 1% for each £1,000 by which it is less than £180,000. Reduced net income is after step 3 in s23 ITA 2007.

The legislation then needs to prescribe quite complex and detailed provisions to describe the total pension savings amount for the year; this is complex as in the case of defined benefit schemes it needs to recognise the additional value of benefits provided each year – and this is the area where commentators believe that the legislation would not work in practice.

2.6 Pensions tax relief – an alternative approach

The current Government announced an intention to repeal the rules in FA 2010, and to replace the complex legislation with a simple reduction in the Annual Allowance in the pensions legislation. A discussion document has now been issued to consider the proposals in more depth, and Section 5 of Finance (No 2) Act 2010 is enabling legislation to permit section 23 of and Schedule 2 to the Finance Act 2010 to be repealed by statutory instrument. Such an instrument must be made by 31 December 2010.

In outline the constraints of the proposals are :

- That any new legislation raises broadly the same amount of revenue as the high income excess relief charge. This is shown in the Red Book dated March 2010 as £2.9bn in 2012-13 on an indexed basis.

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- That the new annual allowance will act to restrict pensions savings rather than the lifetime allowance as now. It is however also likely that the lifetime allowance would be reduced at the same time, with transitional protection for those in excess of the new limit when it is introduced (as there was in 2006 when the lifetime limit was introduced for the first time);
- That the change is simple to operate in respect of defined benefit members as the impact of the reduced allowance is likely to be much wider than the current annual allowance;
- That there is fairness of treatment between members in defined contribution schemes and defined benefit schemes;
- That there is the opportunity for members in occupational schemes to "opt out" of the legislation by reducing their employer provided pension savings in return for more remuneration (or similar arrangements).

The suggested new limit would be of the order of £30,000 to £45,000; valuation methods for defined benefit schemes will probably be using a fixed multiplier rather than an age related multiplier for simplicity's sake. The multiplier may, however, be different to that currently used for the annual allowance computations.

The legislation will be developed over the autumn of 2010 for inclusion in the 2011 Finance Bill, for commencement on 6 April 2011.

2.7 Pensions – requirement to purchase an annuity

It is the current Government's intention to repeal the requirement to purchase an annuity by age 75 thus permitting pensions savings to be used more creatively at maturity. As a temporary measure, section 6 and Schedule 3 to Finance (No 2) Act 2010 defer the current requirement to purchase an annuity at age 75 by two years for those reaching the age of 75 on or after 22 June 2010. This provides a window of two years for the relevant legislation abolishing the requirement completely to be drawn up.

2.8 Taxation of company cars

2.8.1 Already announced

Budget 2009 and PBR 2009 included a number of changes affecting the taxation of company cars and vans, some of which came into effect from April 2010. Those which have been previously announced and legislated for, but have yet to take effect are as follows :

- Electric cars will attract a zero benefit in kind for five years from 2010/11.

- Electric vans will similarly be taxed at £0 for five years from 2010/11.

- From 6 April 2011 the base figure on the Table will reduce to 125g/km.

- From 6 April 2011 the cap of £80,000 on list price will be abolished.

- From 6 April 2011 all of the alternative fuel "discounts" will be abolished. Cars will either be taxed at the Table rate, or Table + 3% for diesel. Electric cars are dealt with separately.

- From 6 April 2012 the Table will be restructured so that it starts at 10%, which will equate to 99g/km and below. From there, 100g/km (up to 104g/km) will be taxed at 11%, 105g/km at 12% and so on. This has the effect of reducing the base figure (at which 15% benefit is applicable) further to 120g/km. The legislation to achieve this is included in Finance Act 2010 at section 59.

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2.8.2 New changes

Finance Act 2010 makes the following changes :

- Section 58 introduces a new 5% rate of benefit in kind on cars emitting strictly no more than 75 g/km (this special rate will still be subject to the 3% addition for diesel vehicles). Currently, cars emitting no more than 100g/km are taxed at 10% of list price (or 13% for a diesel model). This new rate commenced on 6 April 2010 and runs for five years.
- Section 58 also restructures the legislation on electric cars to describe them as "zero emissions", defined as a car which cannot under any circumstances emit CO_2 by being driven. Similar changes have been made to the terminology in relation to vans.

2.9 Subsidised meals for employees – salary sacrifice arrangements

Where a subsidised meal or canteen arrangement is available to employees but the cost of the meals taken is adjusted against the employee's salary through either a salary sacrifice arrangement or a flexible benefit package, the provision will no longer be tax free with effect from 6 April 2011.

This is implemented by section 60 FA 2010 which makes changes to s 317 of ITEPA 2003, by introducing a further condition on the tax free status of such arrangements. They must not be provided pursuant to either relevant salary sacrifice arrangements, or relevant flexible benefit arrangements. Both terms are defined, and such arrangements are caught whenever they were made.

2.10 ISA limits

The ISA limit is £10,200 for all savers for the tax year 2010/11. The limit was raised during 2009/10 but only for savers over 50. Half of the available limit can be saved in cash.

The Government further announced that the ISA limit would in future be subject to statutory indexation in line with RPI – with a rounding to a multiple of £120 to ease the computation for monthly savers. The reference point will be RPI in the September before the start of the tax year. The cash limit will remain 50% of the overall limit. This change will be made by secondary legislation. [Ref BN21 dated 22 June 2010].

2.11 Remittance basis : "relevant person"

The definition of a relevant person is key to the new remittance basis rules, as it constrains the identification of remittances. The definition is subject to a minor amendment by s 33 FA 2010 to extend the definition to include subsidiaries of non UK resident companies which would be close companies if they were resident in the UK. The change takes effect from 6 April 2010.

2.12 Remittance basis – foreign currency bank accounts

The existence of foreign currency bank accounts is a particular challenge under the remittance basis, as gains and losses will arise on the accounts depending on exchange rate movements unless the currency is held for personal use; however, the CGT rules can interact with the income tax rules to give rise to losses where no loss has actually been incurred. Section 34 and Schedule 9 introduce legislation intended to cope with the complexities of the calculations required, and in particular prevent an allowable capital loss from arising when there is no economic loss. The change commences on 16 December 2009.

Essentially, when an amount is withdrawn from a foreign currency bank account and remitted to the UK, it may be taxable under the remittance basis as income. As a result, the computation of the CGT gain or loss on the bank account (due to exchange movements) would exclude the amount remitted because the amount has already been included for income tax purposes. (S37 TCGA 1992). However, as the cost of the asset

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(the original amount invested) includes the cost of the amount withdrawn, this would always produce a capital loss. The new legislation excludes the cost of the amount withdrawn from the calculation, thereby eliminating the artificial loss.

2.13 Transactions in securities legislation

Modernisation of this anti avoidance legislation has been planned for some time and the changes in section 38 and Schedule 12 to the Finance Act 2010 finalise these plans.

Schedule 12 introduces a replacement for Chapter 1 of Part 13 of ITA 2007, substituting for the existing sections 682 to 694 with new sections 682 to 687. Existing sections 695 to 713 are retained – so sections 688 to 694 no longer exist.

The focus of the legislation is set out in section 684 which is to counter an income tax advantage which is the main purpose (or one of the main purposes) of a transaction or transactions in securities.

A transaction in securities is defined as:

- The purchase, sale or exchange of securities;
- Issuing or securing the issue of new securities;
- Applying or subscribing for new securities; and
- Altering or securing the alteration of rights attached to securities.

An income tax advantage is defined by new s 687 – it is more narrowly defined than before. A person obtains an income tax advantage if:

- The amount of income tax which would be payable by the person in respect of the relevant consideration if it constituted a qualifying distribution exceeds the amount of any capital gains tax payable in respect of it, or
- Income tax would be payable by the person in respect of the relevant consideration if it constituted a qualifying distribution and no capital gains tax is payable in respect of it.

So much of the relevant consideration as exceeds the maximum amount of qualifying distribution that could have been paid at the time is excluded from this calculation. The income tax advantage is the amount of the additional income tax payable (or the amount payable in the case where no CGT would be payable).

However, to focus the legislation on close companies, section 685 provides the following (note that this section merges old sections 689 and 690, and the only real change is that it now refers to close companies rather than a "relevant company"). Entitled "Receipt of consideration in connection with distribution by or assets of close company", it is triggered when condition A or B is met :

- Condition A – as a result of the transaction in securities (or any one or more of the transactions in securities) the person receives relevant consideration in connection with :
    - The distribution, transfer or realisation of the assets of a close company;
    - The application of assets of a close company in discharge of liabilities, or
    - The direct or indirect transfer of assets on one close company to another close company

  and does not bear or pay income tax on the consideration (apart from this chapter).
- Condition B –
    - The person receives relevant consideration in connection with the transaction in securities or any one or more of the transactions in securities
    - Two or more close companies are concerned in the transaction in securities or the transactions in securities concerned, and
    - The person does not bear or pay income tax on the consideration.

However, where there is a fundamental change of ownership of a close company, new section 686 excludes the counteraction measures from applying. This is a new exemption. Where, immediately before the transaction in securities a person (P) has an interest in the shares of the close company and there is a change of ownership so that as a result of the transaction the shares in the company are controlled at least 75% by a person or persons who are not connected to P, and have not been so connected within the pervious two years, these shares carrying a right to at least 75% of the voting rights and a right to at least 75% of the distributions. This change of control must persist for at least 2 years after the date of the transaction.

The new legislation commences in relation to income tax advantages obtained on or after 24 March 2010.

2.14 Employer supported childcare

There are already moves under way to restrict the tax relief on employer supported childcare to basic rate for new entrants from April 2011 onwards. However, this measure will correct a potential anomaly and resolve a tax problem which some employees are exposed to.

Employer supported childcare is tax exempt if it is available to employee generally, in common with most tax exempt benefits in kind. However, where a salary sacrifice scheme has been implemented for staff taking up childcare vouchers, those staff at or just above the minimum wage have been excluded form the scheme as if they were to accept a salary sacrifice they would be paid below minimum wage. Their employers therefore exclude them from the scheme.

This means, in fact that the scheme is not an exempt benefit, and that any employees who have participated in the scheme have a tax liability on the benefits they have received under the scheme. HMRC now intends to ease the conditions to allow the exclusion of staff at or near to minimum wage without prejudicing the tax status of the benefit provided to other staff. The change will be backdated to 2005/06 when the scheme was introduced.

2.15 Trust income

Finance (No 3) Bill 2010 will provide that where a settlor of a trust receives a tax refund on income accruing to the trust on which the trustees have been taxed at 50%, he is required to pay the refund to the trustees. The payment will be ignored for inheritance tax purposes. [Ref BN25 dated 22 June 2010].

2.16 Tax in relation to carers

A number of tax changes are proposed for Finance (No 3) Bill 2010 which make changes in relation to carers.

2.16.1 Special guardianship and residence orders

Individuals who care for a child paced with them under either a special guardianship order or a residence order (where the carer is not a parent or step parent) will not be liable to tax on payments they receive either from the child's parent or the local authority in relation to the order. This change will take effect from 6 April 2010; prior to that the simplified arrangements for adult placement carers applied for income tax purposes.

2.16.2 Shared lives carers

This change will allow shared lives carers, including adult placement carers, staying put carers and certain kinship carers (who care for a child not subject to a residence order) to apply the same treatment as foster carers to their income from caring. The new tax treatment will apply from 2010-11, but as an option,

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shared lives carers can alternatively apply the current simplified arrangements for adult placement carers for that year only.

The foster carer's allowance which will apply to shared lives carers will be :

- A £10,000 fixed allowance for the tax year, plus
- £200 per week or part week per placement aged under 11, and
- £240 per week or part week per placement aged 11 or over.

A carer is entitled to pay tax either on the excess of the payments they receive over the tax allowances set out above, or on the normal profits as computed for tax purposes. Where a carer provides both foster care and shared lives care there will only be one amount of £10,000 available, and the pooled foster care and shared lives care income will be compared to the allowances – opting for a normal profits basis is only possible in relation to **all** caring income.

Example
For the tax year 2011-12, Sarah is paid £35,000 to foster three children aged 7, 10 and 13. She is also paid £15,000 to provide shared lives care to one young adult. Sarah's total tax free allowance for the year will be £56,800, which is made up of:

- £10,000 fixed annual amount for the tax year;
- £10,400 = £200 x 52 for fostering the 7 year old child;
- £10,400 = £200 x 52 for fostering the 10 year old child;
- £13,000 = £250 x 52 for fostering the 13 year old child; and
- £13,000 = £250 x 52 for caring for the young adult.

Sarah's total caring income is £50,000, this is less than her total tax free allowance and so she will not pay income tax on her caring income. [Ref BN27 dated 22 June 2010]

2.16.3 Private residence relief for adult placement carers

A further change will protect PPR status of a carer's home when they use part of it exclusively for their business as a carer. [Ref BN28 dated 22 June 2010]

2.16.4 Capital allowances for carers

When a foster carer moves from computing profits as a normal business to using the foster care relief rules set out above, there is a potential anomaly with the capital allowances pool. Changes will be made to ensure that the rules operate as intended, and when a foster carer commences computing profits on a normal basis again, they are treated as acquiring the relevant assets at the lower of current market value and the tax written down value of the pool the last time they claimed capital allowances. [Ref BN29 dated 22 June 2010].

2.17 Tax exemption in relation to the Champions League Final 2011

This football final is to be held in England 2011. Section 63 and Schedule 20 make provision for certain persons to be exempt from income tax in respect of certain income arising in connection with the final.

The exemption applies if an employee or contractor of an overseas team which competes in the final is neither UK resident nor ordinarily UK resident at the time of the final. The person concerned is not liable to income tax in respect of any income arising to the person which is related to the duties or services performed by the person in relation to the final, but income which relates to a contract entered into or amended after the final is not subject to the exemption.

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There is also an anti avoidance provision which prevents the exemption applying to income which derives from arrangements (or form part of arrangements) made to secure the exemption which have the main purpose (or one of the main purposes) the obtaining of the exemption.

2.18 Expenses paid to MP's

Section 7 and Schedule 4 to Finance (No 2) Act 2010 introduce new tax exemptions for payments made to MP's under new parliamentary expenses allowance rules. Sch 7 introduces a replacement s 292 in ITEPA 2003 providing an exemption for accommodation expenses paid under the new rules. There is an exclusion for hotel expenses for late sittings in the House unless the House sits until at least 1am. Accommodation expenses are defined as those necessarily incurred on overnight accommodation that is required for the performance of the member's parliamentary duties in or about the Palace of Westminster.

Sch 7 further inserts a new section 293A into ITEPA to cover UK travel and subsistence expenses, defined as follows. Travelling expenses are those necessarily incurred on journeys made by a member that are necessary for the performance of the member's parliamentary duties and if the member shares caring responsibilities with a spouse or partner, journeys made by the spouse or partner between the member's London area residence and the member's constituency residence. Relevant subsistence expenses means expenses necessarily incurred on an evening meal (excluding alcoholic drinks) eaten on the Parliamentary estate where the member is required to be at the House of Commons because the House is sitting beyond 7.30pm.

The exemptions relate to payments made under the Parliamentary Standards Act 2009 on or after 7 May 2010. There is also an exemption for European travel expenses, which amends the existing exemption in s 294 ITEPA 2003.

2.19 Trusts formed to compensate certain asbestos victims

Finance (No 3) Bill 2010 will include legislation to exempt trustees of certain trusts from capital gains tax, inheritance tax and income tax. The trusts that will benefit are those set up on or before 23 March 2010 as part of an arrangement made by a company with its creditors and specifically to pay compensation to, or in respect of, individuals with asbestos related conditions. [Ref BN24 dated 22 June 2010].

2.20 Seafarers Earnings deduction

This deduction is currently only available to UK resident taxpayers. The deduction will be extended by Finance (No 3) Bill 2010 to EEA residents who are liable to UK tax on the seafaring earnings. [Ref BN31 dated 22 June 2010]

2.21 Anti avoidance

2.21.1 Double taxation relief

Section 36 and Schedule 11 to FA 2010 introduce further anti avoidance rules in relation to double taxation relief which prevent persons from sidestepping existing rules using manufactured overseas payments, and reaffirm the scope of existing anti avoidance legislation.

2.21.2 Approved company share option plans (CSOPs)

The definition of shares eligible for inclusion in an approved CSOP scheme has been amended by section 39 FA 2010 to counteract avoidance using "geared growth" schemes, which are intended to provide additional benefits to employees over and above that which is intended under the CSOP legislation. Accordingly, share options can no longer be granted under CSOP over shares in an unlisted company

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controlled by a listed company. The change affects options granted on or after 24 March 2010, after which options granted would be liable to income tax and National Insurance contributions. Schemes which have power in the rules to issue such options no longer meet the statutory requirements but now have six months to amend their rules. Failure to do so may result in HMRC withdrawing approval for the scheme.

2.21.3 Unauthorised unit trusts

Section 40 and Schedule 13 make changes to the unauthorised unit trust legislation to close disclosed schemes which allow them to convert foreign income subject to withholding tax into receipts of UK income with associated tax credit, and thus obtain either repayments of the foreign tax or to circumvent restrictions on the use of foreign tax credits.

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3 CAPITAL TAXES – CGT, IHT AND SDLT

3.1 Rate of capital gains tax

The rate of capital gains tax was amended by section 2 of and Schedule 1 to the Finance (No 2) Act 2010.

The rate of CGT is 18%, except as follows :

- The rate applying to trustees and personal representatives is 28%;
- If income is chargeable at the higher rate or the dividend upper rate, the rate is 28%;
- If no income is charged at the higher rate or dividend upper rate but the amount on which the individual is chargeable to capital gains tax exceeds his unused basic rate band, the rate applying to the excess is 28%; for this purpose, gains liable to entrepreneurs' relief are treated as the lowest part of the gains;
- In determining the available basic rate band, allowance is made for deficiency relief and for gains on life assurance policies (using the annual equivalent given by ss 536 or 537 of ITTOIA 2005, not the whole gain); allowance is also made for adjustments to the residuary income of the estate of a deceased individual by virtue of S669 of ITTOIA 2005.

The new rates of CGT apply with effect from 23 June 2010 to gains accruing on or after that date. 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.

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.

3.1.1 Treatment of losses

Because the new provisions regarding the rates of CGT apply mid way through the tax year, the legislation also needs to make provision about relief for capital losses. Para 3 of Schedule 1 allows for losses and the annual exempt amount to be set off in the most beneficial way to the taxpayer. The new Section 4B setting out this provision will apply whenever an individual suffers CGT at more than one rate.

HMRC Example

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.

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3.1.2 Transitional provisions

Paras 18 to 22 make transitional provisions.

- Gains attributed to temporary non residents for 2010-11 are to be treated as accruing before 23 June 2010;
- Gains accruing to an individual under the remittance basis are to be treated as accruing on the date the foreign chargeable gains are remitted;
- Foreign gains which are treated as remitted rather than actually being remitted (such a those nominated under the remittance basis charge) are treated as remitted before 23 June 2010;
- Where chargeable gains of an offshore trust are taxed on a UK settlor under s 86 TCGA 1992 they are treated as accruing before 23 June 2010;
- Where chargeable gains of an offshore trust are taxed on a UK beneficiary by virtue of receipt of capital payments, the gains are treated as accruing when the relevant capital payments are made.

3.2 Increase in Entrepreneurs' Relief maximum amount

S 4 FA 2010 makes the change to Entrepreneurs' Relief announced in the March 2009 Budget. The maximum gain that can benefit from Entrepreneurs' Relief (ER) will be £2 million after 5 April 2010; this new limit is, as before a "lifetime limit". Where a disposer has previously made gains which have attracted relief, a disposal in 2010/11 or later will attract further relief so that the total relief given is £2 million.

In relation to disposals occurring on or after 23 June 2010, the limit is further increased to £5 million by Section 2 and Schedule 1 of F(No 2)A 2010. The new limit is in para 5(4) of the Schedule.

Schedule 1 also modifies the way in which CGT works when Entrepreneurs' Relief is claimed. The scaling of the gain by deducting 4/9ths has been removed, and replaced with a provision that qualifying business disposals within the lifetime limit of £5 million will attract capital gains tax at a rate of 10%. This avoids the difficulty of adjusting the scaling fraction when the rate of 28% applies (see 3.1).

HMRC Example

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.

3.2.1 Entrepreneurs' Relief – disposals for QCB's

When shares qualifying for Entrepreneurs' relief (ER) are exchanged for Qualifying corporate bonds in a take over, it is unlikely that on subsequent disposal the QCB's would attract relief. The old legislation

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therefore scaled the deferred gain by 4/9 so that when the QCB's were disposed of, effect was given to ER in relation to the gain on the shares.

This has been replaced by a new section 169R (introduced by para 8 of Schedule 1) which allows the disposer of the shares to elect for the gain to be taxed on the date of the disposal, so that the lower 10% rate of CGT can apply if appropriate. However, it is key to note that this will bring forward the crystallisation of the gain and therefore the tax charge. Failure to elect will result in the loss of the ER available (assuming the QCB's do not qualify for ER).

Any election under this new legislation must be made by 31 January deadline for amending the tax return for the year concerned.

3.2.2 Entrepreneurs' relief – deferred gains under EIS

Where gains which would attract ER are deferred into an investment in EIS shares, once again the deferred gain is scaled by 4/9. Para 9 of the Schedule changes this arrangement so that an individual can essentially chose between :

- Crystallising the gain and paying 10% tax (assuming ER is fully available), or
- Deferring the gain and paying either 18% or 28% tax when the liability crystallises.

Again, it is essential to note this choice and advise clients accordingly. The change applies to disposals for which gains could be deferred on or after 23 June 2010.

3.2.3 Entrepreneurs' relief – change in mechanism for FA 2008 transitional relief

Finance Act 2008 provided transitional relief for gains deferred before 6 April 2008 into QCB's or EIS/VCT investments. Where a gains subsequently comes into charge, ER can be claimed if it would have applied to the previous disposal, had it been available at that time. Paras 10 and 11 of Schedule 1 provide that gains which have not come into charge between 6 April 2008 and 22 June 2010 can be subject to the new 10% rate when they crystallise. Gain which have partly crystallised between 6 April 2008 and 22 June 2010 will have been subject to the 4/9 multiplier, so will be taxed at 18% or 28% as appropriate when they eventually fully crystallise.

3.3 Inheritance tax nil rate band

The nil rate band for IHT for 2010-11 was set back to £325,000 by Section 8 FA 2010, reversing the increase to £350,000 made by s4 FA 2007. Section 8 also freezes the IHT nil rate band for the tax years 2011-12, 2012-13, 2013-14 and 2014-15 by eliminating the indexed rise in the preceding September of each tax year (up to September 2013, which would provide the indexed rise for 2014-15).

3.4 IHT on reversionary interests

Normally a reversionary interest in settled property is not part of someone's estate for IHT purposes. However, schemes have been designed to exploit this exemption so section 52 FA 2010 inserts new section 81A into IHTA 1984 which treats the end of a reversionary interest (and the assumption of actual interest in relevant property) as a transfer of value when either :

- The reversionary interest was purchased, or
- The person entitled to the reversionary interest is the settlor, or the spouse or civil partner of the settlor of the trust.

Section 52 also designates any transfer of a reversionary interest to which the above applies is not a potentially exempt transfer. The change applies to reversionary interests acquired under the above conditions on or after 9 December 2009.

3.5 IHT on interests in possession

When an individual purchases an interest in possession in a trust that interest will be treated for IHT purposes as part of their estate, and subject to the relevant property regime. This change (made by section 53 FA 2010) closes a scheme under which a person purchases an interest in an estate set up before the changes to trust taxation implemented in 2006, or which was otherwise outside the relevant property rules.

3.6 SDLT rates and thresholds

The main SDLT rates and thresholds are unchanged for the current financial year, but to finance the new first time buyers' relief (see 3.5), a new band of SDLT applying only to residential property has been created. The change is made by Section 7 FA 2010, and limits the current 4% band (which starts at £500,000 relevant consideration) to up to £1 million, and introduces a new 5% rate for properties with relevant consideration of more than £1 million.

The new 5% rate applies to land transactions with an effective date of 6 April 2011, unless contracts have been exchanged before 25 March 2010.

3.7 SDLT – first time buyers' relief

Section 6 of FA 2010 introduces the new first time buyers' relief for Stamp Duty Land Tax (SDLT). It inserts new Section 57AA into Finance Act 2003 (where the SDLT legislation was originally made).

This exempts certain transactions from SDLT charge on the following conditions :

- It is a relevant acquisition of a major interest in land;
- The land consists entirely of residential property;
- The relevant consideration for the transaction (other than rent) is more than £125,000 (the nil rate band for SDLT) but not more than £250,000; the purchaser, or all of the purchasers is a first time buyer who intends to occupy the property as their only or main residence, and
- The transaction is not one of a number of linked transactions, unless the linked transactions relates to the acquisition of a garage in a separate block, acquired with the property. (New Section 57AA(4))

3.7.1 Definitions

A ***relevant acquisition of a major interest in land*** is an acquisition of a major interest in land other than the grant of a lease with a term of less than 21 years, or the assignment of a lease with less than 21 years remaining.

The definition of ***residential property*** is the same as that used elsewhere in SDLT so no separate definition is needed.

A first time buyer is a person who :

- Has not previously been a purchaser in relation to a relevant acquisition of a major interest in land which consisted of or included residential property;
- Has not previously acquired an equivalent interest in land under the law of a territory outside the UK; and

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- Has not similarly acquired property under alternative finance arrangements (under which the property is normally purchased by a financial institution).

The relief is available on land transactions of which the effective date (normally the completion date) is on or after 25 March 2010 but before 25 March 2012. There are some exclusions from this rule to prevent contracts being varied or assigned after that date, or if the contract is purely an option or pre emption right.

3.8 SDLT and partnerships

Section 55 FA 2010 makes changes to SDLT to prevent to prevent certain land transactions involving partnerships being used in schemes to avoid SDLT. The change creates a notional land transaction on which SDLT is chargeable, removing the special rules governing chargeable consideration on notional transactions in Part 3 to Sch 15 FA 2003. The change applies to notional transactions with an effective date on or after 24 March 2010, subject to any scheme transactions entered into before that date.

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4 VAT CHANGES

Lecture B614 (17.51 Minutes)

4.1 Registration and deregistration limits

The threshold for mandatory registration increased from £68,000 to £70,000 with effect from 1 April 2010. The voluntary deregistration threshold was similarly increased to £68,000. These changes were achieved by secondary legislation. [Ref BN 45 dated 24 March 2010]

4.2 VAT fuel scale charges

New VAT fuel scale charges took effect for VAT accounting periods starting on or after 1 May 2010. They represent an increase of around 18%. [Ref BN44 dated 24 March 2010].

4.3 Standard rate of VAT

The standard rate of VAT will increase to 20 per cent on 4 January 2011, the change being implemented by section 3 of Finance (No 2) Act 2010. There are anti forestalling measures to prevent manipulation of the time of supply rules to secure a lower charge to VAT than would otherwise apply.

4.3.1 Anti avoidance – the supplementary charge to VAT

As was the case when the standard rate rose from 15% to 17.5%, there are provisions to prevent manipulation of the change by those who cannot recover all or any of the VAT they bear. These are in Schedule 2 to Finance (No 2) Act 2010.

The supplementary charge is made on the supplier of goods or services after 22 June 2010 if the supply spans the date of change (4 January 2011), is liable at the standard rate and is made to a recipient who cannot recover all of their VAT on the supply. The charge is triggered if a "relevant condition" is met.

For most supplies the relevant conditions are set out in para 2 of Schedule 2 :

- Condition A – the supplier and recipient are connected with each other at any time in the period staring with the date the supply is treated as made and ending on 4 January 2011.
- Condition B – the total consideration for the supply and all related supply of goods or services is more than £100,000.
- Condition C – any prepayment for the supply is financed by the supplier or a person connected with him.
- Condition D – full payment of the invoice issued in advance of the supply is not due before the date 6 months form the date on which the invoice was issued.

Slightly different relevant conditions apply to supplies which are a grant of a right to goods and services; these include A, B and C above, but C refers to payment, not prepayment.

Connected persons are defined by S 1122 of CTA 2010. There are various other definitions in Schedule 2. Part 2 of the Schedule sets out various exceptions as follows:

- The supplementary charge does not apply to letting or hiring of assets provided the invoice issued in advance is not for a period of more than 12 months and payment is in accordance with normal commercial practice;
- To condition B – where the only condition met is B, and the supply is made in accordance with normal commercial practice (as defined).

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- To condition D – where the supply is one under a hire purchase, conditional sale or credit sale of goods and the terms accord with normal commercial practice.

The supplementary charge is the difference between the VAT charged and that calculated at 20%. It is due on the date of the rate change – that is 4 January 2011. Certain supplies are given special rules for the basic time of supply by Schedule 2 – these are essentially "continuous supplies such as supplies of power, water, but also supplies of land and building services.

4.3.2 Flat rate scheme – consequential changes

The new flat rates applying from 4 January 2011 are given in BN45 dated 22 June 2010. There will be increases in two thresholds from 4 January 2011 to reflect the change in rate :

- The exit threshold is based on tax inclusive supplies, and is currently £225,000. This will be increased to £230,000.
- A business can remain within the scheme even if the above threshold is exceeded, if it believes that the tax inclusive turnover will be less than £187,500 in the next twelve months. This limit will increase to £191,500.

[Ref BN45 dated 22 June 2010]

4.4 Reverse charge – services

The reverse charge provisions introduced to combat carousel fraud have been extended by section 50 of FA 2010 to services, by the simple mechanism of introducing the words "or services" after "goods" in the existing legislation (which is in section 55 VATA 1994). This change is enabling legislation allowing emissions allowances to return to standard rated supplies; there is a temporary zero rating of allowances pending enactment of this change, and the designation of emissions allowances as a supply affected by S 55 VATA 1994.

4.5 Zero rating – qualifying aircraft

The supply of aircraft and parts for aircraft will be zero rated based only on the supply to an airline operating for reward chiefly on international routes. So aircraft which previously qualified by reference to size and weight will now be standard rated if supplied to private individuals. The change will be made by Finance (No 3) Bill 2010 and will apply to supplies made on or after 1 January 2011. [Ref BN39 dated 22 June 2010].

4.6 Place of supply rules : gas, heating and cooling

There are two strands to this measure which will be included in the Finance (No 3) Bill 2010. The place of supply rules for natural gas apply mainly to distributors who are based in the UK, or those who are based in the EU but supply customers in the UK. The current rules impose a reverse charge on the supply where the supply is natural gas imported through the natural gas distribution system, as the place of supply is where the wholesaler belongs or where the consumption takes place.

The current rules will be extended to apply to all categories of natural gas pipeline supplies where the pipelines are in the EU or linked to an EU pipeline, and extend VAT importation relief to all natural gas imported via a network including gas in liquid form imported by tanker.

The amended rules will also be extended to apply to supplies of heating and cooling supplied through networks. The change will apply to supplies on or after 1 January 2011. [Ref BN 40 dated 22 June 2010].

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4.7 Lennartz accounting

The purchase of an asset for both business and personal use is subject to a special VAT arrangement known as Lennartz accounting. This allows the VAT input tax to be recovered at the time of purchase, provided VAT is paid in respect of the private use during the life of the asset. There are to be some changes to the Lennartz rules, implementing a change in EU law, and HMRC also has a change of view about certain aspects of the Lennartz rules as they work in the UK, so this is a significant revision of the scheme. The changes will be made by Finance (No 3) Bill 2010.

The law will also ensure that it is clear that private use by employees of a company does not carry any input tax recovery, so the VAT charge must be paid when the article is used privately by staff of a company owner. [Ref BN42 dated 22 June 2010]

4.8 Penalties for late filing and late payment

The modernisation of the late filing and late payment penalty system continues, and Finance (No 3) Bill 2010 will include details of the new VAT penalties which will replace VAT default surcharge at some point – the changes are dependent on amendments to HMRC's computer systems and therefore will be implemented over the next few years. The new penalties dealt with here will also apply to insurance premium tax, aggregates levy, climate change levy, landfill tax and all excise duties.

4.8.1 Late filing penalty

The penalties will be very similar to the existing VAT default surcharge regime, but with separate penalties for late return and late payment. The penalties for late returns will be as follows :

- First late return – no penalty but penalty period starts; initial penalty period is one year
- Second late return (first late in penalty period) penalty £100;
- Third late return – penalty £200;
- Fourth late return – penalty £300
- Fifth and all subsequent late returns – penalty £400
- Each late return extends the penalty period to the anniversary of the most recent default
- Returns that are more than 6 months late attract a penalty of 5% of the amount due, with a further similar penalty at the 12 month point, and
- Those deliberately withholding returns to prevent HMRC from correctly assessing the tax due will be liable to a penalty of up to 100% of the tax due.
- Penalties for monthly returns are similar, except that the increases apply to every third late return in the penalty period

4.8.2 Late payment penalty

The late payment penalties are based on the VAT (or other tax) due on the return, as follows :

- First late payment – no penalty but penalty period starts; initial penalty period is one year
- Second late payment (first late in penalty period) penalty 2% of the tax due;
- Third late payment (second late in penalty period) – penalty 2%;
- Fourth late payment– penalty 3%
- Fifth and all subsequent late payments – penalty 4%
- Each late payment extends the penalty period to the anniversary of the most recent default

[Ref BN37 dated 22 June 2010]

5 OTHER CHANGES OF NOTE

5.1 Death bed planning

Lecture P614 (8.41 Minutes)

In an ideal world Inheritance Tax (IHT) mitigation happens long before the deathbed approaches. But we all know this isn't always practical, possible or has been overlooked. Nevertheless, where death is likely within the two year ownership period required for business property relief (BPR) there are still a few options.

BPR of course has a basic ownership qualification of the relevant business property for at least two years before the transfer of value (subject to the replacement property rules), but not generally that the property has been relevant business property throughout that period.

a) Conversion of investment company

The client may own shares in a company which are not eligible for BPR as being 'wholly or mainly' investment or dealing. Possibly they could convert an investment company into a trading company. This requires clear evidence of the change in character of the company's business ie it needs an actual conversion to trading status before death.

b) Asset incorporation in the business

Before death one could transfer assets to a trading partnership or company (subject to any CGT and stamp duty land tax (SDLT) implications).

It may be possible to avoid a CGT disposal when a partnership is used (which removes the need to consider hold-over relief) if the asset is held in a capital account owned solely by the transferor. With a gift (or indeed sale) to a company there will be a market value SDLT charge where the transferee company is controlled by the transferor.

Assets that remain used in the business of the company (or partnership) at the date of the transfer of value, should not be 'excepted assets' for IHT, as they will be required for future business use. It is essential to ensure that the relevant business as a whole remains wholly or mainly trading.

c) The claw-back

Matthew Hutton (writing in Private Client Business) has made the following excellent points about the BPR claw-back provisions:

'To maintain the benefit of BPR for a lifetime gift which the donor (or donee) fails to survive by seven years, the asset given away must (subject to reinvestment in replacement property) be retained by the donee for at least seven years or until the earlier death of the donor (or donee) and must continue to be relevant business property in his or her hands.

The claw-back provisions do not apply where the asset is unquoted shares in a qualifying trading company which cease to attract relief, eg by becoming an investment company.

There is a distinction in the operation of the claw-back between the case where there is a potentially exempt transfer (PET) on the one hand and an immediately chargeable transfer on the other. The result is that if the gross unrelieved value of the gift does not exceed the nil-rate band at death, no additional tax is chargeable. Indeed, whatever the value of the original gift, the estate, in effect gains an additional nil-rate band. This is accepted by HMRC.

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If the donee does not still hold qualifying business property on the donor's death within seven years after the gift, but this occurs within three years after the sale, then, to avoid the claw-back, the donee must reinvest the sale proceeds (net of any CGT and professional costs) in such property, within three years after the date of disposal.'

d) Dividend waiver

The legislation states that 'a person who waives any dividend on shares of a company within twelve months before any right to the dividend has accrued does not by reason of the waiver make a transfer of value'. It therefore will be better to retain cash within the company which would be used to pay a dividend than to pay it out only to attract IHT on the death of the shareholder. This assumes the money is not required for cash flow purposes and subject to it not being excepted assets in the company. The waiver needs to be by deed to be effective.

e) Rights issue

Cash could be injected into the company under a rights issue (again, provided that the company will remain wholly or mainly a trading company and that none of the cash will be excluded as excepted assets).

Where the unquoted shares owned by the transferor immediately before the transfer would under any of the share-for-share provisions be identified with other shares previously owned by him or her, the period of ownership of the original unquoted shares is treated for purposes of s106 as including the period of ownership of the other shares .

It is essential that the CGT reorganisation provisions do (or would) apply. For example, in a case there was a simple allotment of additional shares two days before the taxpayer's death, which did not satisfy the test (Vinton and Another (executors of Dugan-Chapman v HMRC).

f) Relief for successive transfers

The BPR two year condition is displaced by a rule which applies where there are two successive transfers of value one of which is a transfer on death. If the earlier transfer attracted BPR, the second transfer being made by the transferee (in this case on death) may also attract the relief, notwithstanding that the two-year test is not satisfied.

Even if the first transfer was spouse exempt, it will be protected as a 'successive transfer', because it is still a transfer of value which would have been eligible for relief if such relief had been capable of being given in respect of transfers of value made at that time. The advantage of using this rule for a transfer from a healthy to an ailing spouse could be to secure the CGT-free uplift to market value on death.

g) Borrowings

The general rule for IHT purposes is that a 'liability which is an encumbrance on any property shall, so far as possible, be taken to reduce the value of that property'. So to have a debt secured on property which attracts BPR (or indeed APR) is rather a waste. The rule is operated at the moment of the chargeable transfer. Hence, the (genuine) substitution of security before death with an asset which attracts no relief (or relief at just 50 per cent) is saving inheritance tax at 40 (or 20) per cent.

h) CGT: held-over gains within a trust – getting rid of them

CGT is generally not payable on death with its tax-free uplift to market value. However, where the beneficiary of an estate interest in possession dies and a gain was held over on entering the settlement,

that gain crystallises on the death. Any gain arising could be subject to further hold-over, whether as a business asset under s165, TCGA 1992 or on a chargeable transfer under s260. It is only where a UK-domiciled spouse becomes entitled to non-business assets that CGT will become payable.

However, it may be possible while the beneficiary with the estate interest in possession is still alive for the trustees to advance the asset out to him or her beneficially, under hold-over, and for him or her to die in possession of the asset, so that the held-over gain gets washed entirely.

Contributed by Francesca Lagerberg, Head of Tax at Grant Thornton UK LLP

5.2 IHT topical tax planning cases

Lecture P615 (11.35 Minutes)

RSPCA v Sharpe

You want to have a Will that is Inheritance Tax (IHT) efficient. You also want to benefit your family (or at least some of them!) and maybe a few close friends. You also believe there may be a little left over that could support one of your favourite charities. Thus are many Wills drawn up. A recent decision (*RSPCA v Sharpe* [2010] EWHC 268) has highlighted how important it is to get the wording exactly right to prevent court battles to resolve quite how such a Will should be interpreted. It also has led to strong criticism of a major charity's efforts to maximise its take from an estate.

The deceased wanted to make a tax efficient nil rate band (NRB) gift but the Will used a slightly non-standard form. The NRB was £300,000 at the relevant time. The Will gave the residuary estate to the well-known animal charity, the RSPCA, but subject to two gifts:

1 A nil rate band gift to two individuals in the form: 'I give the amount which at my death equals the maximum which I can give by this my Will without Inheritance Tax becoming payable in respect of this gift'.

2. A gift of land worth £169,000 to individuals.

The assets on death comprised of bank accounts (about £770,000), some cash (£12,832) and the land (£169,000). Mr and Mrs Sharp were administering the estate. They took £234,000 equally and the deceased's brother received the balance of the NRB gift (£66,000). The Sharps also took the property at the probate value of £169,000 and this left a residue of around £480,000 for the RSPCA. IHT had to be paid so in fact the charity was left with £370,000 approximately.

The RSPCA objected. It argued that the NRB gift only comprised of the balance once the gift of property had occurred. This would have meant the first £169,000 of the NRB would be applied against the gift of land with the balance available to the Sharps. The IHT payable would reduce and the upshot was that the residue available to the RSPCA would rocket up to around £650,000. This would be at the expense of Mr and Mrs Sharp and the deceased's brother.

In the Court, the Judge construed the NRB gift as a gift of the full statutory NRB without any allowance for the second gift. It was not a gift of the NRB remaining available after allowing for the second gift (£300k-£169k = £131k). He construed that the gifts were intended to be tax-free.

Not all commentators have agreed with the judgment of Justice Peter Smith and the case is going on appeal. Others have contended that the Judge called it correctly in light of the unclear wording of the Will.

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If the value of the property had increased to the level of the NRB, the deceased's brother would have received nothing and the Judge found it difficult to believe that is what the testator would have wanted. He commented that 'it is so unlikely as to be incredible'.

What is interesting is the Judge's harsh criticism of the RSPCA for taking the case ('a matter of regret that this action was ever brought'). This has been picked up by various newspapers too. Alternatively others have argued that it is perfectly acceptable for a charity to challenge where it has an arguable case. In fact, they may even be under some obligation to seek the maximum pay-out from these larger potential donations. Others have seen this as an avaricious attack by charities to claim more money.

So what lessons can be learned here? Firstly, the unclear Will drafting led to a costly (and probably distressing) court case. More clarity, such as saying the gift of the NRB is what is left after the specific gifts, would have helped. By referring to the NRB (or maximum amount without a liability to IHT) in a Will did not help. It left the question open to interpretation and of course the vagaries of what may happen to the NRB over time.

The second point is around how you should leave the residue of an estate to a major charity is involved. Again better wording would have hopefully prevented the charity having the right to challenge the administration of the estate or the interpretation of the Will.

Hastings-Bass principle applied

A recent decision has considered whether a settlement could be avoided by applying the *Hastings-Bass* principle and/or on the ground of mistake. In *Pitt & Anor v Holt & Anor,* Mrs Pitt's husband had suffered serious head injuries in a road accident and was unable to manage his own affairs. Mrs Pitt was appointed his receiver under the Mental Health Act 1983 by the Court of Protection. A damages claim of £1.2m was arrived at with the approval of the court to be implemented by way of a structured settlement.

Mrs Pitt, acting on the advice of her solicitors and financial advisers, decided to create a discretionary settlement under which she and her children would be beneficiaries along with her husband. The income tax and CGT implications of the arrangement had been considered but not the IHT position. The tax became payable on the creation of the settlement, on subsequent capital distributions, after ten years and on Mr Pitt's death.

The prime purpose of the trust fund within the settlement was to provide for Mr Pitt's future care. Clearly if IHT had been considered action could have been taken eg creating a settlement which would have been exempt from IHT such as a discretionary trust for disabled persons under s89, IHTA 1984. Mrs Pitt applied to set aside the settlement.

The High Court held that a wife was entitled to unravel a settlement and assignment made by her as receiver for her late husband, where the IHT position had not been taken into account when the settlement was established, using the principle in *Re Hastings-Bass (dec'd)* [1975] Ch 25. The key point was that it was for Mrs Pitt to decide whether or not it was in Mr Pitt's interest for her to dispose of his property to trustees under the settlement. Therefore the rule in *Hastings-Bass* was capable of applying in the present circumstances.

The impact of IHT with the creation of a discretionary settlement was important and IHT was a relevant consideration which ought to have been taken into account before the settlement and assignment were entered into. It was also clear that the question of IHT was simply not addressed by any of the advisers to Mrs Pitt and therefore not by Mrs Pitt herself.

As an aside had it been necessary to decide the case solely on the basis of mistake, the court would not have upheld the claim.

Atkinson v HMRC TC 420

A recent tax tribunal has looked at the meaning of agricultural property for IHT purposes. One of the partners in a farming partnership lived in a bungalow on the farm until ill health required him to move into a care home. His possessions remained there and he made occasional visits to the bungalow.

The issue was around whether the property had been occupied for the purposes of agriculture for the period of seven years ending with his death. HMRC argued that Mr Atkinson could not have realistically have been said to have been in occupation or that the property was being used for the purposes of agriculture. However, the tribunal said that Mr Atkinson was a partner in the farming partnership until he died. Therefore the bungalow was used to accommodate the diminishing needs of one of the partners. Accordingly the bungalow was agricultural property and the relief was available.

Fryer (Executor of Patricia Arnold Deceased) v HMRC TC 398

The following analysis was provided by Peter Vaines in his April 2010 UK Tax Bulletin for Squire Sanders.

It will be well known that inheritance tax applies to transfers whereby the value of the individual's estate is diminished. This concept is extended by s3(3), IHTA 1984:
'*Where the value of a person's estate is diminished and the value of another person's estate or of any settled property in which no interest in possession exists, is increased by the first person's omission to exercise a right, he shall be treated as having made a disposition at the time (or the latest time) when he could have exercised the right, unless it is shown that the omission was not deliberate*.'

Mrs Arnold had a pension plan. If she died before taking her retirement benefits, the value passed to the trustees of a discretionary trust for her children. She did not take her retirement benefits at the age of 60 in September 2002, the normal retirement date, but died shortly thereafter. She was in fact seriously ill, being diagnosed with cancer in April 2002, but her failure to take her retirement benefits seemed to have more to do with the fact that she had no immediate need for the income.

HMRC said that there were three conditions to be satisfied for there to be a transfer of value:

- A deliberate omission to exercise a right;
- The taxpayers state is diminished; and
- The omission caused the value of the settled property to be increased.

There was no suggestion that there was any deliberate tax avoidance. It was simply a matter of reading the legislation and there was nothing to suggest that these conditions were not satisfied. Mrs Arnold did not fail to exercise her rights by accident; she had expressly rejected the opportunity to exercise the right to take her pension when maturity papers had been sent to her after her normal retirement date, and the value of the pension fund passed to the trust.

The Tribunal decided that the relevant conditions were satisfied and that a transfer of value had been made immediately before Mrs Arnold's death.

However, this conclusion is troublesome because although it is clear that Mrs Arnold's estate was diminished by her failing to exercise her right to claim the value of her pension during her lifetime, the settled property was not increased until after her death. The Tribunal said this did not matter – but many people will think that it matters rather a lot.

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The whole idea of a transfer of value in this context is that the diminution and increase occur at the same time. Otherwise it does not make sense. The Tribunal regretted that the taxpayer was not professionally represented, and there was a strong implication that not all of the relevant arguments were canvassed before the Tribunal. Maybe this was one of them – and maybe it will be on appeal.

Anyway, this looks extremely serious because anybody who has reached normal retirement age, has chosen to defer taking their pension entitlement (perhaps because it would put them into higher rate tax, or into the 50% rate − or worse, the 60% rate) and then dies before taking the benefits will make a transfer chargeable to IHT. This must apply to an enormous number of people.

There is a concession published by HMRC which it says means that the overwhelming majority of pension arrangements are not affected by this rule. HMRC says it would only make a claim in cases where there is evidence that the taxpayer's intention of failing to take retirement benefits was to increase the estate of somebody else – for example, having become aware that they are suffering from a terminal illness, they deferred taking retirement benefits. Even then, HMRC says it would not pursue the case where the death benefit is paid to the policy holder's spouse or dependants.

Although HMRC suggest that its practice will cover the overwhelming majority of pension arrangements, it is clear that their statement is in fact rather narrow – although at least we now know that we can rely on it. Anybody who has deferred taking their pension should pay the closest attention to the HMRC concessionary practice to make quite sure they fulfil every condition – otherwise their family will be in for an unwelcome surprise.

The Fourth Earl Of Balfour v HMRC

Another First-Tier Tax Tribunal case (the *Fourth Earl of Balfour v HMRC* TC69) looked at entitlement to BPR for IHT. This was a Scottish case involving Scots law but there were some interesting and useful factors for other parts of the UK.

Lord Balfour had an interest in a farming partnership and was the proprietor of a landed estate of approximately 2,000 acres that consisted of two in-hand farms, three let farms, 26 let houses and two sets of business premises. There were also some parks, which were let on a seasonal basis. Lord Balfour died in June 2003 and subsequently HMRC sought to deny BPR on the Earl's estate on the grounds that it was not relevant business property.

Lord Balfour made no distinction between the partnership and the estate. He seemed to take the view that everything was run as a single business. The total trading turnover regularly exceeded the letting income for the years under review, but not always by very much. The tribunal concluded that the whole of the activities represented a single business. This is interesting because arguable the farming partnership could be regarded as a separate activity from the letting of residential and commercial premises.

Then there was consideration of whether the business carried on by Lord Balfour consisted wholly or mainly of making or holding investments. That would disqualify it from BPR by reason of s105(3), IHTA 1984. The tribunal saidno and to suggest that the activities carried on by Lord Balfour consisted wholly or mainly of the making or holding of investments would be to belittle the efforts made by Lord Balfour properly and profitably to manage the various components of such an estate. Even the residential letting aspects required Lord Balfour's experienced business acumen and careful planning. They were an important component in the overall business; the cottages were historically part of the overall farming enterprise or housed fulltime estate workers. The tribunal said they had no difficulty in concluding that the business was not wholly or mainly making or holding investments, and it was unnecessary to make any quantitative analysis of the various activities.

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The tribunal went on to say that even if they assumed that the letting of the 26 houses and cottages constituted the making or holding of investments, they were not satisfied that the estate management and farming activities represented a business that consisted wholly or mainly of making or holding investments. On this basis, BPR was available in full.

What matters here is that the letting of the properties was considered part of the farming business. Equally it might have been argued that this unincorporated business fell under s112, IHTA 1984 (excepted assets) because it might be difficult to say that the let properties (other than those let to the farm workers, of course) were used wholly or mainly for the purposes of the farm business.

Contributed by Francesca Lagerberg, Head of Tax at Grant Thornton UK LLP

5.3 Incorporation of medical practices

Lecture B612 (16.14 Minutes)

Lecture B613 (11.54 Minutes)

There are many structures through which medicine can be practiced:

- Sole practitioners
- Expense sharing practices
- Partnership Act 1890 partnerships
- Limited Liability Partnerships
- Limited Companies

In theory all of these structures are available to doctors and dentists, we must be very careful when deciding which ones we actually use.

Factors to consider

The main factor to consider is the commerciality of the situation. In the government's White paper published in July 2010, they made it very clear that National Health structures would be allowed to fail. Does this mean that unlimited structures under the Partnership Act 1890 will lose favour?

However, we must consider current statute and regulations as well as the general taxation considerations that one would apply to any client thinking incorporating.

Most doctors have some form of NHS practice and so we must also consider the problems of superannuation.

Reasons for incorporating

Sometimes the commerciality may have an overarching reason as to why incorporation may be preferable:

- the practice may not want to enter into a long lease in the names of aging partners who would remain liable for rental payments for years to come
- it would enable contracts with the NHS and private providers to be passed on within the practice when GPs retire

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- triggers a deemed cessation of the old trade this giving the partners three years in whoich to sell their surgery and claim entrepreneurs' relief

Tax planning

Traditionally transferable goodwill has been capitalised and then draw this out 'tax free' over the next few years. But don't forget that profits have to be generated before the loan can be repaid, on which corporation tax would be due.

Rules about companies and medics

The Dentist Acts control who can undertake acts of dentistry and do allow incorporation. There is a lot of detail about who should control the Board of directors and the company's operations but little detail on who should comprise the shareholders. Unlike a dentist practice set up as a partnership where all partners need to be dentists, as a company, a non-dentist spouse could become a shareholder.

For doctors, the rules are completely different. For a GMS or PMS practice, the only people who can be both directors and shareholders are members of the 'NHS family'. No outside shareholders at all are permitted.

Superannuation

We need to take great care when deciding whether to incorporate when it comes to superannuation. Partnerships are fine for dealing with the NHS superannuation scheme and so to are sole trader practices. Limited companies should be fine but limited liability partnerships are simply not an option. You will seldom find them outside of private medicine.

GPs will need earnings or salary on the region of £20,000 to be able to absorb the tax relief on the superannuation contributions.

Other factors

Doctors and dentists must have a 'loss of earnings' insurance in place because by law, they will be required by law to provide any locum needed and still meet the practice costs. The extraction of dividends is probably not going to count as earnings for these purposes.

In some circumstances it has been possible to negotiate that the amortisation of goodwill might count as notional income.

Who has goodwill to transfer?

Private consultants may have personal goodwill but this is unlikely to be transferable to the company

Doctors with a patient list are precluded from selling that list and so they do not have goodwill to transfer. On the other hand, dentists can sell their patient list and so the right to the future income from the patient list is transferable goodwill. However, would the NHS contract be transferable to the company?

Doctors and goodwill

So with doctors it has been illegal to sell goodwill for essential services or any registered list of patients. However, from 1 April 2004, this has been possible for private, additional & enhanced services but the practice would lose preferred status as a NHS tenderer.

It is also possible to incorporate any medical entity which does not have a patient list such as an APMS provider who runs a 'walk-in' centre.

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Dentists and goodwill

Dentists can sell new NHS contract but it is not guaranteed that the contract will be continued by PCT or Local Health Board (LHB). The purchaser could be paying for something that had no value. It is very important to find out the reaction of PCT/LHB prior to novation!

- Some are relaxed
- Some will renegotiate
- Some put control clauses (allows operation but can block sales of shares)

Accounting for goodwill

Currently there are very flexible accounting standards for SMEs in the UK which allow amortisation of goodwill over its useful economic life. However, as IFRS for SMEs approaches, that flexibility might disappear and the ability to amortise goodwill might disappear.

Tax relief on amortised goodwill

If the practice exited in any way, shape or form prior to 1 April 2002, no tax relief will be available. However where a dentist became a principle from 1 April 2002 relief is available.

Earnings and tax

Typically dentists will earn around £130,000k and doctors around £110,000 and so clearly incorporation becomes attractive, especially if retaining profits or undertaking capital expenditure:

- 50% tax rate if earning > £150k
- Withdrawal of personal allowance once income > £100,000
- New tiered superannuation at around £102,000 resulting in doctors' 90% marginal rate of tax

Full distribution basis

Medics often work on a full distribution basis. How best to extract profits from the company is important. As the table for 2011/12 shows dividends are better than salary.

50% income tax & 2% NIC		**Effective tax rate**	
	CT rate	Salary	Dividend
Profits > £1.5M	27%	57.82%	53.36%
Marginal rate	28.75%	57.82%	54.48%
Profits < £300K	20%	57.82%	48.89%

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Remaining self employed

There are benefits to remaining self employed:

- 51% marginal rate
- Cars and other benefits are more amenable
- Do not need to worry about distributable reserves/Overdrawn loan accounts

Hybrid structure

Perhaps the solution is a hybrid structure to gain the best of both worlds:

- Store profits in company at SCR
- Benefits provided through LLP (dentist) / partnership (doctor)
- Cars remain depooled for balancing allowances on sale
- Gains attributable to individual members and taxed at 10 or 28%

But even this has its downsides:

- LLPs not available to GPs
- No AIA for hybrid structure
- Difficult to novate NHS contract
- Watch SDLT on formation
- VAT planning – exempt v non exempt supplies

Prepared from the lecture by Bob Truncheon

5.4 Superannuation developments for medical professionals

Lecture P613 (19.34 Minutes)

Pensions overview

The taxpayer has always been able to claim tax relief at their marginal rates of tax on pension contributions made with companies also claiming corporation tax relief for contributions that they make on employees' behalf.

Contributions can be made up to a maximum of 100% of relevant earnings but total contributions, including employer contributions, cannot exceed the annual allowance.

There is a huge amount of freedom on how money is withdrawn from the fund but there is a lifetime limit placed on that fund with funds in excess of this limit being taxed at 55%.

Restrictions were brought in in the Finance Act 2009 which introduced a Special Annual Allowance charge and then in Finance Act 2010, it was proposed that from 6 April 2011, the High Income Excess Relief Charge.

However, it appears that this charge will not actually be brought in, as the coalition is looking for a more straightforward way to achieve similar results and has published a consultation documents to this effect. Broadly this looks to restriction to the annual allowance to around £30,000 to £45,000 as well as freezing or lowering the lifetime limit to around £1,500,000. Excess contributions would be taxed at the taxpayer's marginal rate of tax and any excess on the fund would be taxed at 55%, as at present.

Defined benefit schemes

The consultation is proposing that the current capitalisation factor of 10 should be replaced with a factor of between 15 and 20. This means that the deemed contributions made in a year could spike dramatically with pay rises and promotions and therefore it is suggested that there should be some form of capping, accruing or spreading introduced.

Example

Dr John is 55 and part of the NHS superannuation scheme and has been for 35 years. He is promoted and receives a salary increase of £10,000. His pension entitlement is likely to increase by £5,660 per annum.

If this occurs in 2010/11, the deemed contribution that is made on his behalf using a capitalisation factor of 10 would be £56,600 which is well within the current annual allowance and no excess charge arises.

If this were to happen in 2011/12 with the annual allowance having been reduced to say £30,000, and using a capitalisation factor of 15, the deemed contribution would be £84,900. The excess of £54,900 would be taxed at 50%, giving a tax charge of £27,450.

Personal pension contributions for medics

Doctors and dentists have always been able to make contributions into personal pension schemes based on their private or non-superannuable income.

Dentists typically do a lot less NHS work than doctors and so top up personal pension contributions are crucial.

Typically doctors have large superannuation funds as much of their work is NHS based and so the lifetime limit is likely to become a problem.

Example

Dr Jones is a high earner and had been contributing for 40 years. He set up the pharmacy through a SIPP and the current market value of his share is £290,000. We are told that he is likely to receive a pension of £63,000 and a lump sum of £189,000.

This gives a fund as follows:

Pension capitalised (63,000 x 20)	1,260,000
Lump sum	189,000
SIPP fund	290,000
	1,739,000

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This is very close to the current £1,800,000 lifetime limit. If this limit is reduced, protection is needed and will be possible under the consultation.

Clearly you must monitor future contributions made either into the NHS superannuation scheme or into his personal pension scheme. Failure to do so could be negligence.

Corporates and hybrids – what is acceptable?

Whichever structure you decide to adopt, personal pension contributions are treated as normal.

However with superannuation, only certain bodies can be NHS employers:

Sole trader	OK
Partnership	OK
Limited company	Should be OK
Limited liability partnership	NOT available

Companies and associates

Please watch out for associates who decide to incorporate because of the tax advantages. They bring in their spouse as an equal shareholder who takes on much of the company administration. However, although effective for tax, the company does not hold a contract directly with NHS and so cannot be an NHS employer. Superannuation will be deducted on payments made to the company, the associate would not benefit.

Employer contributions

Remember, in addition to the doctor or dentist making contributions, the company can also make contributions which can form part of the doctor or dentist's overall package.

These contributions are deductible for corporation tax purposes if the contribution is wholly and exclusively for the purposes of the employer's trade.

Provided the package as a whole is reasonable, a large pension payment could be made for someone with a relatively low salary who is drawing dividends. Clearly we must consider the changes planned to the annual limit but a contribution of £20,000 to £30,000 should not be a problem.

Taken from the seminar by Bob Truncheon

5.5 VAT missing trader fraud update

Lecture B615 (30.45 Minutes)

Background

This lecture reviews recent case law developments in missing trader fraud and puts them in the context of HMRC's long-running fight against this concerted criminal attack on the VAT system. The lecture describes the general operation of a carousel fraud and the more sophisticated "contra-trading" version, and

explains the methods by which HMRC will typically attempt to prevent losses arising to the Exchequer from this cause.

The lecture also highlights the need for all traders and practitioners to be alert for the risk of involvement with fraudulent transactions. Some of those who are taken to court by HMRC are active or at least complicit in carrying out the fraud; but others are genuinely innocent traders who have been hoodwinked by the fraudsters. If the innocent trader has not done enough to be satisfied that the business' transactions are genuine, it may be that the Exchequer does not lose out – the innocent business does.

It is important to appreciate that carousel fraud does not just happen in the mobile phone and computer chip markets – now that special measures apply to both of those types of goods, people may attempt to carry out a fraud involving a wide range of goods or services. In any situation where a previously unknown customer approaches a business with a request to buy something in the UK and despatch it elsewhere in the EU, often with the source of the UK supply already identified, the trader should be suspicious. A crucial question is "Why do they need to involve me, when they already know where the goods are coming from? Why would they allow me to make a profit on this deal?" The answer is usually that there is no commercial reason.

Appeal court considers three cases

HMRC continue to wage war on carousel frauds through the First Tier Tribunal and the higher courts. Here is a summary of the outcome of cases in the last quarter.

The Mobilx case has been running for several years. The Court of Appeal has now joined the High Court and the Tribunal in dismissing the company's appeal against HMRC's refusal to repay input tax in respect of 85 deals, all of which led back to a fraudulent trader.

The Appeal Court's decision is an important examination of the meaning and application of the "ought to have known" test in Kittel. Moses LJJ explained that it was not enough for HMRC to show that a trader ought to have known that there was a possibility of a link to fraud, for example by the general connection of the trade in mobile phones and CPUs to fraudulent activities. However, if the only reasonable explanation for the transaction in which the trader was involved was that it was connected with fraud, and if it then turned out that the transaction was indeed connected with fraudulent evasion of VAT, then he should have known of that fact. Further, if it was established that a trader should have known that by his purchase there was no reasonable explanation for the circumstances in which the transaction was undertaken other than that it was connected with fraud then such a trader was directly and knowingly involved in fraudulent evasion of VAT. Such a trader forfeited the right to deduct input tax.

The High Court's decisions to refuse input tax credit to Calltel Telecom Ltd and Opto Telelinks (Europe) Ltd were also confirmed. By contrast, the Appeal Court also dismissed HMRC's appeal in the case of Blue Sphere Global Ltd: the High Court judge had not erred in concluding that the Tribunal had not found sufficient grounds to show that the trader ought to have known that its transactions were connected with fraud.

The judgment includes a note to the Tribunal not to concentrate on the due diligence procedures undertaken by taxpayers, but rather on the underlying question – should the trader have drawn the inescapable conclusion from that due diligence that the transactions were connected with fraud? Many Tribunals have noted that the checking carried out by traders often appears aimed at providing a paper trail for HMRC rather than serving any real commercial purpose.

Court of Appeal: Mobilx Ltd (in Administration) and others v HMRC

Refusal of zero-rating

A company appealed against the refusal to allow zero-rating on 128 supplies of Red Bull to Spanish and Polish customers who were missing traders. The Tribunal concluded that there was no persuasive evidence that the goods had arrived at their destinations, and the test in Teleos (that the supplier had taken all reasonable steps to be satisfied about the bona fides of the transaction) was not satisfied. The examination of a sample of transactions does not necessarily show what would have satisfied the Tribunal, but it is a good illustration of what is definitely not enough.

First Tier Tribunal (TC00472): Integral Resources (UK) Ltd

Refusal of input tax

A company appealed against the refusal of input tax of £167,000 for the quarter ending October 2006. The appeal was dismissed on the basis that there was a fraud and the appellant ought to have known that the transactions were connected with it. The circumstances of the transaction were wholly uncommercial and the director was a man of sufficient knowledge and experience to understand the implications.

First Tier Tribunal (TC00540): Roma II Ltd

A company appealed against the refusal of input tax of £2.26m for the three one-monthly return periods March, April and May 2006. The appeal was dismissed: HMRC did not prove actual knowledge of the fraud, but they satisfied the "ought to have known" test in respect of each of the 19 deals that were the subject of their decision to refuse repayment.

The company had claimed and been repaid nearly £2.9m of VAT, mainly in relation to mobile phone business, in the previous 12 months.

The Tribunal noted that the director was very well informed about the development of case law on MTIC fraud, quoting in one letter remarks made by a judge only the week before in the High Court. It appeared that the company had carried out checks in an attempt to satisfy the requirements of Notice 726, but had not really been interested in preserving the integrity of the VAT system.

First Tier Tribunal (TC00440): Blada Ltd

A trader that had done no previous business claimed a repayment of £1.1m in respect of sales of CPUs worth £6.7m in the quarter to July 2005. The suspicious transaction led an officer to check the quoted serial numbers with Intel, the manufacturer, and so to discover that it appeared that the transaction involved boxes intended to look like genuine Intel CPUs but probably not containing the goods described on the invoice.

The Tribunal considered that it was not relevant that the trader was unaware that the goods were not genuine. HMRC had evidence which cast considerable doubt on the validity of the invoice, and in those circumstances the decision to refuse input tax credit was a reasonable one.

During the initial enquiry into the goods, the freight forwarder's report of a "closed box" inspection had been given to the officer. When it became apparent that the claim would be refused, the freight forwarder claimed also to have carried out an "open box" inspection and found that the goods were genuine. The Tribunal did not accept this on the basis that Intel's evidence was overwhelming proof that the boxes cannot have been what was described on the invoice.

First Tier Tribunal (TC00444): Premier Joint Ventures Ltd

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A similar decision was confirmed in another case involving five transactions in memory cards. HMRC successfully cast doubt on the invoice documentation, and the trader was not entitled to credit. Once again, there is a detailed examination of the various transactions and the procedures adopted by the company, which were found wanting.

First Tier Tribunal (TC00464): F I Promotions Ltd

Dispute about offset of credit

HMRC formed the view that a mobile phone trader was connected with fraudulent trading and issued a number of decisions and assessments concerning input tax and output tax. The trader appealed against all these decisions and assessments, and one of the appeals was allowed when HMRC failed to comply with an "unless" order. The effect was that HMRC owed the appellant £12.95m of input tax.

HMRC did not pay this amount. Instead, it offset various other amounts which were under appeal, and eventually paid the taxpayer just £2.4m. The taxpayer appealed to the High Court, arguing that HMRC had no right to do this, and they should have paid the amount held to be due by the Tribunal's ruling.

The High Court dismissed the appeal. The Tribunal's decision was not an order for payment but a determination of a particular dispute. The effect of the resolution of that dispute could be carried through into the other appeals as HMRC had done. As appeals could not be entertained unless the VAT in dispute had been deposited (or hardship had been accepted by HMRC or the Tribunal), the offset of a credit against the amounts in dispute in other appeals was a reasonable action.

High Court: Infinity Distribution Ltd v HMRC

Liquidators sue the directors

An unusual case involved a claim by the liquidator of a company against the directors for fraudulent trading under s.213 Insolvency Act 1986. In effect, the liquidator was acting on behalf of HMRC, who were the largest creditor in the liquidation.

The company had entered into transactions between August and September 2001 that could not have been profitable unless a VAT fraud was intended – the only way the company would have made any margin was by retaining the VAT element from sales. There were three people involved in the company: the first and second claimed that the third was the "mastermind". However, the Court ruled that the first respondent should be liable for the whole of the company's debt, and the second respondent should be liable on a joint and several basis for 50% of it. It appears that no judgment was made against the third respondent.

High Court: Goldfarb v Higgins and others

Another case brought by a liquidator claimed that the directors were responsible for carrying out fraudulent transactions and diverting the proceeds of sale from the company to third parties, in breach of the duty of trust which is part of their office. The company's accounting records showed sales of some £93m, but far less had ever passed through its bank accounts.

The liquidator claimed this amount from the former directors in the High Court, and judgment was awarded. However, as the defendants seem to have disappeared, it is unlikely that the money is recoverable.

High Court: UK Communications Ltd v Nahim and another

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Notice 726: procedures for checking validity of transactions

Notice 726 on "joint and several liability for output tax" contains a section which, while not prescriptive nor exhaustive, does set out the type of due diligence procedures that HMRC expect to see operated by businesses which might be exposed to the risk of involvement in carousel fraud. If there is a fraud, and a trader has either not carried out these checks or has ignored the results of them, then HMRC are likely to argue that the trader "had the means of knowing" or did not take all reasonable steps to ensure that the transactions were above board.

Section 6.1

The following are examples of indicators that could alert you to the risk that VAT would go unpaid:

1) Legitimacy of customers or suppliers. For example:

- what is your customer's/supplier's history in the trade?
- has a buyer and seller contacted you within a short space of time with offers to buy/sell goods of same specifications and quantity?
- has your supplier referred you to a customer who is willing to buy goods of the same quantity and specifications being offered by the supplier?
- does your supplier offer deals that carry no commercial risk for you – eg, no requirement to pay for goods until payment received from customer?
- do deals with your customer/supplier involve consistent or predetermined profit margins, irrespective of the date, quantities or specifications of the specified goods traded?
- does your supplier (or another business in the transaction chain) require you to make 3rd party payments or payments to an offshore bank account?
- are the goods adequately insured?
- are they high value deals offered with no formal contractual arrangements?
- are they high value deals offered by a newly established supplier with minimal trading history, low credit rating etc?
- can a brand new business obtain specified goods cheaper than a long established one?
- has HMRC specifically notified you that previous deals involving your supplier had been traced to a VAT loss and/or had involved carousel movements of goods?
- has HMRC specifically notified you that HMRC date stamps have been present on goods offered for sale by your supplier, or that there is evidence of HMRC date stamps being removed from packaging. This would strongly suggest that the goods had been subject to carousel movement, which should alert you to a significant risk that the transactions entered into with that supplier may be connected with the non-payment of VAT;
- has HMRC specifically notified you that other MTIC VAT fraud characteristics (such as third party payments) have occurred in transaction chains involving your supplier?

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2) Commercial viability of the transaction. For example:

- Is there a market for this type of goods – such as superseded or outdated mobile phone models or non-UK specific models?
- What research have you done to test whether these goods are available as described and in the quantities being offered?
- Is it commercially viable for the price of the goods to increase within the short duration of the supply chain?
- Have normal commercial practices been adopted in negotiating prices?
- Is there a commercial reason for any third party payments?
- Are normal commercial arrangements in place for the financing of the goods?

3) Viability of the goods as described by your supplier. For example:

- Do the goods exist?
- Have they been previously supplied to you?
- Are they in good condition and not damaged?
- Do the quantities of the goods concerned appear credible?
- Do the goods have UK specifications yet are to be exported?
- Is your supplier unwilling to provide IMEI or other serial numbers?
- What recourse is there if the goods are not as described?

HMRC recommends that sufficient checks be carried out in each of the above categories to ensure that you are not caught in a fraudulent supply chain.

Section 6.2

The following are examples of specific checks carried out by businesses that took part in the consultation exercise in 2003 when these rules were introduced. These may also help you to decide what checks you should carry out, but this list is not exhaustive and you should decide what checks you need to carry out before dealing with a supplier or customer:

- obtain copies of Certificates of Incorporation and VAT registration certificates;
- verify VAT registration details with HMRC;
- obtain signed letters of introduction on headed paper;
- obtain some form of written and signed trade references;
- obtain credit checks or other background checks from an independent third party;

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- insist on personal contact with a senior officer of the prospective supplier, making an initial visit to their premises whenever possible;
- obtain the prospective supplier's bank details, to check whether:

  (a) payments would be made to a third party; and

  (b) that in the case of an import, the supplier and their bank shared the same country of residence.

- check details provided against other sources, e.g. website, letterheads, BT landline records.

Paperwork in addition to invoices may be received in relation to the supplies you purchase and sell. This documentation should be kept to support your view of a transaction's legitimacy. The following are examples of additional paperwork that some businesses retain:

- purchase orders;
- pro-forma invoices;
- delivery notes;
- CMRs (Convention Merchandises Routiers) or airway bills;
- allocation notification;
- inspection reports.

Again this is not an exhaustive list, but does show some of the more common subsidiary documentation.

Section 6.3

In each case, HMRC will be seeking to identify what actions or precautions you took in response to any indicators of risk. This will focus on the due diligence checks you undertook and, most importantly, the actions taken by you in response to the results of those checks. In each case, HMRC will consider:

- What due diligence checks were performed? This includes any checks designed to address the specific risks of a specific case;
- To what extent were your checks appropriate, adequate and timely in relation to addressing the risks identified?
- What did the results of the checks indicate?
- Did you take appropriate action in response to the results of the checks?

If you have genuinely done everything you can to check the integrity of the supply chain, can demonstrate you have done so, have taken heed of any indications that VAT may go unpaid and have no other reason to suspect VAT would go unpaid, the joint and several liability rules will not be applied.

Contributed by Mike Thexton

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