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Personal Tax

Payment for loss of pension rights

The taxpayer company was the employer of the two employee taxpayers. It agreed to establish a joint venture (KNDL) with another company. Some 2000 employees, including the two employee taxpayers, were transferred to KNDL. Industrial action was threatened by the employees transferred. After several meetings, the taxpayer company agreed to make payments totalling £5,000 per employee in consideration of the loss of their pension rights. The instant dispute concerned the status of those payments. The First-tier Tribunal found that the payments had been made to secure the motivation of the employees and would therefore be taxable as earnings under ITEPA 2003, s 62(2). The taxpayers appealed against the tribunal's finding that the payment had been made to motivate the employees, rather than to compensate them for lost pension entitlements, and against the consequent finding that the sum should be taxed as income.

The Upper Tribunal considered the application of the Income Tax (Earnings and Pensions) Act 2003, s 62(2).

(1) The judge had been entitled to find that the payments had been made, *inter alia*, to secure the motivation of the employees.

(2) The right approach was "to use the words of the statute". The relevant statute was ITEPA 2003, s 62(2) which defined "earnings". The fact that a payment had characteristics of capital might mean that the payment would not fall within that definition and hence would not be taxable. The £5,000 payments came within the definition of earnings given in that section. It followed that they could not escape taxation as being capital in nature.

Kuehne & Nagel Drinks Logistics Ltd and ors v Revenue and Customs Comrs [2010] UKUT 457 (TCC)

Compensation for loss of office or employment – compromise agreement

In February 2004 the appellant, who was of West African origin, was employed by a US investment bank ("the employer") in London. His base annual salary was £72,816, to which a discretionary bonus could be added, and he also enjoyed benefits in kind, including membership of the employer's life assurance and medical insurance plans and he also participated in the bank's UK group pension plan. Following an incident on the trading floor in June 2004, the appellant took a two week leave of absence and thereafter he was sent on three month training course to the employer's head office in New York. On his return to his position in London, the appellant alleged that he was either ignored or abused. In March 2005 the appellant requested that grievances – relating to claims of racial discrimination and harassment – be formally dealt with by the employer's internal grievance procedures, and that process continued until July 2005. At the same time, following legal advice from the law centre which he consulted throughout the process, the appellant lodged a complaint with the employment tribunal. The appellant's employment with the bank ended on 26 August 2005. In his employment tribunal claim the appellant claimed constructive dismissal, racial discrimination, victimisation and harassment. As the appellant was dissatisfied with the outcome of the internal grievance procedure, he continued his proceedings with the employment tribunal. He also lodged a further complaint with the employment tribunal in October 2005 claiming he was constructively dismissed as a consequence of the unreliable and biased nature of the grievance process and the decisions of the grievance panel. In addition, he made formal grievance complaints to the New York office. On 18 October 3005 the appellant and the bank entered into a compromise agreement under which the appellant waived all legal claims he might have against his employer and he received £500,000 ("the settlement payment"), which his employer paid after deducting income tax of £103,400. According to cl 3.2 of that agreement, the settlement payment was paid for three purposes: (i) as compensation of the appellant's employment; (ii) in satisfaction of all claims in respect of such termination, including the appellant's claims made in employment tribunal proceedings; and (iii) in satisfaction of all possible claims arising in the UK or in any other country. The appellant did not include the settlement payment in his self-assessment tax return on the grounds that it was not income from his employment nor a payment received in connection with the termination of his employment (within the meaning of ITEPA 2003 s 401). HMRC subsequently amended the appellant's tax return, treating £28,000 as damages for injured feelings (and therefore

not taxable), and the rest of the settlement payment as a payment received in connection with the termination of his employment and as such subject to income tax (except for the first £30,000, which was free of tax in accordance with ITEPA 2003 s 403), requiring the appellant to pay a further £72,192.54. The appellant appealed contending that of the settlement payment, only £18,206.40 was a payment in connection with the termination of his employment, with the balance being compensation for discrimination and other infringements of rights not relating to financial loss flowing from the termination of the employment. He submitted: (i) for the settlement payment to be taxable under ITEPA 2003 s 410, it had to be a payment which was in connection with his employment. Whilst a small amount of the settlement payment (relating to his three month notice period) could be said to relate to the termination of the employment, it was self-evident that by far the greater part related the discrimination and harassment claims which he had made since June 2004 and the injury to his feelings as a result of such incidents: there was no way in which the amount of the payment could be related to his financial loss on the termination of his employment. There was not sufficient connection between the greater part of the settlement payment and the termination of the employment; (ii) the settlement payment related to a racial discrimination claim, not an employment termination claim; and (iii) his total period of employment was just over one year and seven months. A termination payment would amount to £18,206 and the balance was related to the discrimination and harassment claims which were unrelated to the termination of the employment and therefore outside the income tax charge. HMRC contended: (i) compensation awards for injury feelings for discrimination should not normally exceed £25,000, even in the most serious cases of discrimination. They had been prepared to allow £28,000 and the burden was on the appellant to show that a larger sum was justifiable in his case; and (ii) much of the settlement payment was received by the appellant in respect of discrimination which was the cause of the termination of his employment and therefore was in connection with such termination and in consequence within the ITEPA 2003 s 401 charge. It followed that the balance of the settlement payment, £472,000, was an employment termination payment.

The tribunal considered that it was necessary for the purposes of ITEPA 2003 s 401 to identify whether a payment was received in connection with the termination of the employment, so that **the proper starting point was the amount which could be identified as such a payment** and not, as HMRC had approached the present case, the amount which could be shown as being for some other purpose. It was reasonable to assume that in any negotiations for a settlement payment in a case such as the present, the employer would recognise that the dismissal brought about by his acts of discrimination could result in the employee being out of comparable work for a period beyond his mere notice period. That might be especially so in the relatively restricted employment "marketplace" of City traders, where there was undoubtedly fluidity of movement between jobs, but also where, however unfairly, there might be some reluctance on the part of an employer to engage as an employee someone who had left his previous employment by reason of claims of discrimination. Whilst it was not possible to be exact, as there was no evidence in the appellant's case, it was reasonable to assume that for someone in his position, with under two years of service, a payment representing loss of earnings for a period of 18 months would form part of a settlement agreement. Such a settlement would take into account not just basic salary, but an estimate of the bonus which might be anticipated in a situation where an annual bonus was discretionary but in reality and expected and significant part of the total remuneration package. The appellant enjoyed certain benefits in kind and the value of those benefits for the 18-month period would also form part of a settlement which it was reasonable to assume would be negotiated in circumstances such as the present. The correct calculation, therefore, was his basic annual salary at the date his employment ceased was £74,000; in the previous year he had received a bonus of approximately £20,000, but it was reasonable to assume that, had he continued in employment, his advancement would have merited an increased bonus, say £25,000; the annual value of the employer's contribution to his pension plan would have been in the order of £7,000; and the annual value of his benefits in kind in the order of £4,000. That gave an annual total figure of £110,000, and, for an 18-month period, £165,000. It was therefore reasonable to conclude that of the settlement payment, £165,000 could be apportioned to compensation for financial loss resulting from the termination of the appellant's employment by reason of the discrimination he claimed, and that such amount was the payment he received in connection with the termination of his employment. That amount (less the deduction of £30,000 provided for in ITEPA 2003 s 403) was the amount which was chargeable to tax under ITEPA 2003 s 401. The corollary was that the balance of the settlement payment (£335,000) was outside the income tax charge. That might be seen as a large amount by way of settlement for non-pecuniary loss as a result of alleged discrimination and harassment. The figure of £28,000, in the context of the present case, was largely irrelevant for the following reasons: (i) the tariff set by the

Court of Appeal was by way of guidance in the case of awards made by employment tribunals and did not directly relate to payments negotiated by parties (although it would influence what the parties agreed if employment tribunal proceedings were the only background to their negotiations); (ii) the Court of Appeal had made it clear that if the case warranted aggravated damages, then such damages had to be assessed by reference to the particular circumstances of the case, and such damages were outside the tariff; and (iii) the appellant made racial discrimination and harassment claims against a US employer which might have resulted in his receiving damages payable under US legislation had the matter been dealt with in the New York court. Thus the case had to be seen in its particular and untypical circumstances – namely the appellant's likely rights under US legislation and the employer's likely concern as to its reputation and privacy – and so a settlement payment out of the ordinary magnitude (at least in a purely UK context) was not quite so surprising. Accordingly, a sum of £135,000 was chargeable to income tax under ITEPA 2003 s 410. It followed that the appeal would be allowed in part.

Appeal allowed in part.

Oti-Obihara v Revenue and Customs Comrs TC 819

Disguised remuneration (L*ecture P642- 5.54 minutes & P643 – 9.50 minutes)*

On 9 December 2010, the Government issued draft legislation, introducing rules which will apply where, in substance, employment income is routed through third parties.

The new regime seeks to impose employment taxes (ie. PAYE and NICs) where employers arrange funded provision of what is effectively any reward, recognition or loan in connection with an employee's past, present or future employment.

In principle, any form of remuneration arrangement is caught and so the rules are likely to have wide-ranging implications for the way in which employers remunerate their staff and for the associated costs which they bear in this regard.

Scope of the legislation

The legislation applies to all forms of arrangement which involve the rewarding, recognising or providing of loans to employees. Funded remuneration arrangements are within the scope of this regime and include:

1. trusts holding or managing money or assets as part of an employee trust arrangement;
2. other group companies holding or managing money or assets as part of employee remuneration arrangements; and
3. the employer or other employees holding or managing money or assets for the purposes of such arrangements.

While completely unfunded arrangements should remain outside the scope of the new rules, the legislation will potentially apply to situations where an employer enters into any security or hedging planning with third parties (such as banks or asset managers) in order to manage risk exposure in relation to remuneration arrangements.

Specific exemptions are available for approved share plans and registered pension schemes. However, any holding or management of money or assets by a third party is theoretically caught by the new legislation if it relates to employee remuneration, benefits, pensions or the managing of risk in respect of such arrangements.

Impact of potential charges

An employment taxes charge will arise when any of the following events occur:

1. earmarking sums of money or assets for particular persons;
2. payment of sums of money (which includes loans) or the transfer of assets; and
3. allowing the use of assets.

The legislation is due to take effect from 6 April 2011; however, there are anti-forestalling provisions which operate from 9 December 2010.

Where the new employment taxes charge applies, PAYE and NIC liabilities will be triggered which can be pursued against the employer if the third party does not settle them. If the employee does not reimburse the employer within 90 days for any PAYE borne by the employer, the tax charge is grossed up.

Under existing legislation, the provision of benefits from certain remuneration arrangements such as employer-funded retirement benefit schemes may not have been subject to PAYE and NICs. Employers should therefore consider the impact of any unexpected tax charges and the associated reporting obligations which may now arise.

Employers will also need to think about certain 'legacy' problems (as they are often called). In some cases, benefits provided to employees who have ceased employment may not have been subject to PAYE and NICs under existing legislation. This is set to change. In addition, the new employment taxes charge can apply after the death of the employee. Employers will have to consider the potential tax exposures which may now arise and the associated practical implications. Another factor is that, where the law triggers a tax charge, this may also generate a concomitant tax deduction for the employer who is funding the scheme.

Impact on employee benefit trusts

A contribution to an employee benefit trust of itself is not caught by the new regime and so this will not give rise to a tax charge.

Sub-funds

With effect from 6 April 2011, earmarking sums or assets, however informally, will crystallise an employment taxes charge. The relevant sum or asset being earmarked can include amounts derived from that sum or asset. Therefore, investment returns could potentially be treated as a new earmarking event (although formal clarification from HMRC is awaited on this point).

Loans

Pre-9 December 2010 loans remain subject to the normal benefit in kind rules and, if loans are written off, the existing tax and NIC regime will apply – this means that HMRC will invariably try to argue that a loan waiver is caught by Class 1 NICs.

Where new loans are taken out to replace existing ones or the term of an existing loan is extended, it is likely that this will cause a new tax charge to arise.

Loans taken out from 9 December 2010 onwards will be subject to PAYE and NICs on the value of the loan provided. However, if that loan is repaid before 6 April 2012, a charge will be avoided.

Distributions to family members

Previously, trustees of employee benefit trusts could make tax-free distributions to members of an ex-employee's family, provided that the distribution was not indirectly for the ex-employee's benefit. The new rules include provisions which are effective from 9 December 2010 onwards and which tax any distributions to an employee, an ex-employee or a person 'linked' with them.

Going abroad

In the past, employees have often attempted to step outside the taxation provisions by relocating abroad and then receiving their distributions free of income tax. The new proposals characterise a distribution from an employee benefit trust as employment income for the tax year in which it is received and so are able to charge to tax any part of that distribution which relates to duties performed in the UK, even if, at the time of the distribution, the employee (or ex-employee) is non-UK resident.

Contributed by Robert Jamieson

Disguised Remuneration - frequently asked questions

As noted above draft provisions were published on 9 December 2010 to allow comment on the legislation that the Government is introducing to tackle arrangements used for the purposes of disguising remuneration in order to avoid or defer income tax or national insurance contributions (NICs). These arrangements are also used to save beyond the annual and lifetime allowances in registered pension schemes.

As a result of the consultation process, HMRC have identified a number of areas where the Government recognises the need to make refinements to the legislation. HMRC have prepared an FAQ document to provide answers to common questions received by HMRC, to clarify the policy intention in a number of areas where the application of the draft legislation as published has raised concerns with external commentators, and to explain areas where the Government intends to make amendments. The primary aim of this legislation remains to protect the Exchequer. While HMRC wish to refine the legislation in order to limit impacts on employers and individuals where it is possible to identify arrangements that cannot be used for avoidance purposes, the relatively complex nature of many vehicles used in this sphere means that the legislation is also necessarily comprehensive.

The FAQs comprise 33 questions and answers and can be viewed in full on the HMRC website. Reproduced below are a selection of the published FAQs:

Scope of legislation

1. As drafted, the legislation will bring forward an income tax charge in genuine deferred remuneration arrangements, including those arrangements put in place to meet the requirements of the FSA's recently published Remuneration Code. Where deferred remuneration arrangements are entered into to meet the FSA requirements, or otherwise as good business practice or for reasons associated with corporate governance, is it the policy intention that the new legislation will apply?

As drafted, Part 7A is capable of applying in some of the scenarios put to us involving deferred cash or shares bonus arrangements at the time of the deferral, depending on how the arrangements were structured.

The policy intention is that the new rules should apply to arrangements involving a third party to reward employees and directors which seek to avoid, defer or reduce income tax and NICs and also to arrangements that are used as a tax-advantaged way to save for retirement, using an employer financed retirement benefit scheme (EFRBS) as an alternative to, or to top up, savings in a registered pension scheme. However, it is not the policy intention that the new rules should apply to deferred rewards which are subject to a specified vesting date and on which income tax under PAYE and NICs will be due, particularly where the reward is subject to meaningful and time-specific conditions which there is a realistic chance will not be met.

To address this concern, the intention is to amend Part 7A so that deferred remuneration arrangements which have the following characteristics do not give rise to a charge on earmarking at the time that the remuneration is deferred.

- The deferred reward must be subject to conditions which, if not met, will mean that there will be no possibility of the employee (or a person linked with the employee or chosen by the employee) receiving the full reward or retaining any form of current or future entitlement to the reward they do not receive.
- The arrangement must specify a date for the vesting of the reward. This vesting date must be at most five years from the date of grant. Where this condition is fulfilled, if vesting does not take place within five years of the date of grant, a Part 7A charge will arise unless an event has happened which means there is no possibility of the employee (or a person linked with the employee or chosen by the employee) receiving the reward.
- The nature of the deferred reward must be such that if it is provided on or before the vesting date, it will be chargeable to tax as employment income.

- The deferral or avoidance of tax must not be the main purpose, or one of the main purposes, of entering into the arrangement.

5. If a shares transaction is caught by the new rules, it appears that any subsequent dividend payment will be a payment within section 554C. Suppose, for example, that a public limited company makes an offer of shares to the public, some of its employees subscribe for shares in their employer, and these employees receive dividends on their shares. The employer company would then have to account for PAYE. Is that correct?

It is not the policy intention that a dividend payment that simply happens to follow a shares transaction will normally be caught by the new rules. We are considering whether any amendment is required to the draft legislation to clarify this point.

Loans

13. The scope of Part 7A is very wide in relation to loans. It appears that any loan made by any third party to the employee on or after 9 December 2010 will be caught by Part 7A. Is this intentional?

Yes. If a loan is made by a relevant third person (as defined in section 554A(7)) on or after 9 December 2010 under an arrangement to which section 554A applies, it is within the scope of Part 7A. Unless the loan meets the test for the "commercial transactions" exclusion in section 554F, or it meets the test for the exclusion for employee benefits packages at section 554G, the making of the loan will be a relevant step to which Chapter 2 of Part 7A applies.

Part 7A is not targeted at particular types of intermediary (e.g. EBTs and EFRBS). This is intentional; targeting particular types of intermediary would simply encourage the use of alternative vehicles for tax avoidance purposes. Similarly, excluding loans made by particular types of intermediary would inevitably result in the structuring of loan arrangements through excluded third parties.

The Government accepts that including group companies in the definition of a "relevant third person" will give rise to a situation whereby a variety of transactions (including the making of loans), entered into for commercial and otherwise innocent purposes, but which may not meet the strict qualifying conditions for the exclusions in sections 554F and 554G, would be caught by the proposed legislation. The intention is that Part 7A will be amended to address this concern about group companies and the changes will be subject to an anti-avoidance purpose test.

We are also considering whether certain short-term loans applied to specific transactions should be excluded from a Part 7A charge. Any such exclusions would be subject to an anti-avoidance purpose test.

14. There don't appear to be any relieving provisions if a loan is repaid. What is the tax position where a loan, which has been subject to PAYE on the full amount advanced, is repaid in full?

The anti-forestalling rules allow credit for repayment of any part of a loan made in the period from 9 December 2010 to 5 April 2011 (inclusive). Where such a loan is made the Part 7A charge will be based on the amount of the loan less any repayments made before 6 April 2012.

However, there is no provision for credit to be given for the repayment of any loan made by a third party on or after 6 April 2011.

Pensions

15. Will Part 7A apply to genuine EFRBS where funds are being held and invested to provide for a specific employee's retirement without any loan arrangements being entered into?

Yes. Like other intermediary vehicles, EFRBS have been used to provide loans and to avoid tax. In any case, new and extensive use of EFRBS to provide retirement benefits is not in keeping with the principle of creating a more affordable pensions tax regime. Without action, EFRBS providing pensions and other retirement benefits would be more tax advantaged than registered pension schemes for pension savings beyond the new, reduced annual and lifetime allowances.

Section 554E(1)(g) does not provide an exemption for genuine EFRBS. The provision applies only where the sole purpose of an arrangement is to make payments to or in respect of a member and the payments are deemed by statute to be paid by a registered pension scheme (although not actually paid by such a scheme). The most common example is where a registered pension scheme provides a pension by purchasing an annuity from a life insurer for payment to the member. The exclusion does not apply where the payments under the arrangement **would have been** authorised payments if they had been paid by a registered pension scheme but are not so paid nor treated as so paid for the purpose of Finance Act 2004.

16. Will Part 7A apply to unfunded unapproved retirement benefits schemes?

Part 7A will not create tax charges for wholly unfunded unapproved retirement benefit schemes.

However, it is apparent from representations made since the draft legislation was published on 9 December 2010 that a number of arrangements exist whereby the employer promises to provide retirement benefits through a relevant third person. Instead of the employer paying contributions at the time of giving the promise, under the arrangements employers give employees various levels of security, backed by assets held by the employer. These arrangements are neither funded upfront nor wholly unfunded. The intention is that Part 7A will be amended to address such arrangements.

If an employer earmarks a sum or asset with a view to a relevant third person paying a pension or other relevant benefits, the intention is that this earmarking will be a relevant step.

The intention is that there will be two exceptions to this rule. First, this rule will not apply if the relevant third person is:

- a registered pension scheme;
- an overseas pension scheme; or
- a scheme in respect of contributions to which the employer may claim either transitional corresponding relief under article 15 of SI 2006/572 (the Taxation of Pension Schemes (Transitional Provisions) Order 2006) or relief under double taxation arrangements.

Second, this rule will not apply if the earmarking is carried out with the sole purpose of actually paying an immediate contribution.

The Government has also said that pursuant to the reductions in the annual and lifetime allowances for registered pension schemes it will continue to monitor changes in patterns of pension savings behaviour and will be ready to act if necessary to prevent additional fiscal risk in this area. (Paragraph 2.31 of "Restricting pensions tax relief through existing allowances: a summary of the discussion document responses" published on 14 October 2010.)

Employee share schemes

23. Where shares are allocated to named employees to meet future liabilities under an employee share plan or a long term incentive plan (LTIP), will a charge arise under the disguised remuneration measure?

Under Part 7A as drafted, a charge could arise under such circumstances. However, our policy objective is to tackle arrangements established for the purposes of tax avoidance, and it will be necessary to achieve this in a proportionate and well-targeted way.

To address this concern, the intention is that the legislation will be amended so that arrangements which have the following characteristics do not give rise to a charge on earmarking at the time that the shares are earmarked.

- The payment of the shares must be subject to conditions which, if not met, will mean that there will be no possibility of the employee (or a person linked with the employee or chosen by the employee) receiving the shares or retaining any form of current or future entitlement to the amount they do not receive.
- The arrangement must specify a date for the vesting of the shares. This vesting date must be at most five years from the date of grant. Where this condition is fulfilled, if vesting does not take place within five years of the date of grant, a Part 7A charge will arise unless an event

has happened which means there is no possibility of the employee (or a person linked with the employee or chosen by the employee) receiving their benefit from the plan.

- The nature of the arrangements must be such that, if vesting does occur on or before the vesting date, there will be a charge to tax on employment income.
- The deferral or avoidance of tax must not be the main purpose, or one of the main purposes, of entering into the arrangement.

Residence and domicile

27. It appears that a tax charge could arise under Part 7A after the employee has left the employment and has been resident outside the UK for a number of years. Surely this can't be intended?

A tax charge could arise under Part 7A if a relevant step is taken in a tax year in which the employee is non-resident. The value of the relevant step is attributed to the periods that it would have been "for" if it had been earnings from the employment. If the employee was resident, or performing the duties of the employment, in the UK in a period to which the value of a relevant step has been attributed, that value is chargeable to tax under Part 7A in the tax year in which the relevant step is taken, regardless of whether the individual is non-UK resident at that time.

Where a relevant step is taken in a year before the employment has started or after it has ceased and the value can't be attributed to a particular period, the full value of the relevant step is treated as being "for" the first or last tax year in which the employment was held. If the individual was UK resident in the tax year which the value of the relevant step is "for" it is chargeable to tax under Part 7A in the tax year in which the relevant step is taken, whether or not the individual is non-UK resident at that time.

This is essentially no different from the position where an employee receives earnings in a tax year in which they are not resident in the UK.

Commencement of the new rules and anti-forestalling provisions

29. Will the continued provision after the date from which the legislation applies of an asset or loan made available before the legislation applies count as a relevant step because it's continuing?

No. Loans which were paid and assets made available before the legislation applies are outside the scope of Part 7A. But, for example, if an asset provided before 6 April 2011 is subsequently reallocated to somebody else, this will trigger a new charge under section 554C or 554D as appropriate.

However, some of the types of transaction which are only within the scope of this measure from 9 December 2010 or from 6 April 2011 (as applicable) are not accepted by HMRC as effective in avoiding tax under existing law. Such transactions include the earmarking of funds held in a discretionary trust before 6 April 2011 as well as other transactions where a realistic view of the facts is that earnings have been paid. HMRC will continue to challenge such transactions under the existing law, including in litigation where necessary.

30. Do the anti-forestalling provisions apply to loans made before 9 December 2010 which are still outstanding on 6 April 2011?

No. Only loans made between 9 December 2010 and 5 April 2011 (inclusive) will be within the scope of the anti-forestalling provisions.

However, the anti-forestalling provisions do apply to loan arrangements entered into before 9 December 2010 if the loan is actually paid on or after that date. For example, if a loan arrangement was entered into before 9 December 2010 but the loan was not paid before that date, the loan is not excluded from the anti-forestalling provisions simply because the agreement to make the loan was entered into before 9 December 2010.

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32. Where a loan is made by a third party but subsequently repaid before 6 April 2012, will a tax charge arise under the proposed legislation?

If the loan is advanced between 9 December 2010 and 5 April 2011 inclusive and is subject to the anti-forestalling provisions, a Part 7A charge will only arise if the loan is not repaid in full before 6 April 2012.

However, where the making of a loan on or after 6 April 2011 gives rise to a relevant step, a tax charge will arise at the time of payment whether or not the loan is subsequently repaid by 6 April 2012.

Extracts from HMRC Guidance, 22 February 2011

Offshore bonds to mitigate high income tax rates? *(Lecture P644–16.31 minutes)*

Introduction

An offshore insurance bond is a life assurance ‘wrapper’ around a collection of investments. Just as with their UK equivalents, the investor is not taxed on the income and gains of the underlying assets. Tax charges can only arise on eventual disposal of some or all of the bond for money or money’s worth and may then be mitigated by top slicing relief (the detail of which will not be covered in these notes).

They have always been marketed to wealthy individuals as tax-efficient, long-term growth investments, but anti-avoidance legislation and high charges have often restricted their use. In recent years, however, the charges have dropped dramatically and are now competitive with many UK investment vehicles.

These lower charges, together with the changing fiscal landscape since 2008, have increased demand for these products.

In particular

- By holding investments in one of these bonds, investors may be able to avoid the 50% and 42.5% income tax rates introduced last year; and
- Resident but non-UK domiciled investors who have been here for > 7 years can avoid having to pay the £30,000 remittance basis charge if their overseas investments are held in one of these bonds, as there will be no ‘income’ to remit to the UK.

Professional advisors dealing with high net worth individuals are therefore more likely to come across these investments than in the past. It is important that they are aware of some of the potential drawbacks to them as well as understanding the scope for tax savings that they can offer. In particular, it is very important not to fall foul of the nasty ‘personal portfolio bond’ (PPB) rules.

Advantages of offshore bonds

Like UK bonds, an amount equal to 5% p.a. cumulatively of the amount invested can be drawn down from the bond each year without triggering any immediate tax charges (although these drawdowns are taken account of eventually when calculating the overall profit at a withdrawal constituting a chargeable event for income tax purposes); these drawdowns can produce effective income for the investor.

There are no income tax or CGT concerns until any benefits are actually withdrawn exceeding the cumulative 5%, by which time the investor may have a lower tax rate than at present or, perhaps, have emigrated to a low tax country.

They are available in a wide range of currencies, which expatriates in particular often find attractive.

They are widely used in IHT planning (e.g. ‘gift and loan’ trusts).

Sheltering offshore investments in an offshore bond may enable non-domiciled investors to avoid the £30,000 remittance basis charge.

UK investors who are likely to spend significant periods outside the UK but eventually return here, such as internationally mobile executives, can benefit from ‘time-apportionment relief’.

This ignores the proportion of gain that arises on the bond while the person has been non-resident; there is no equivalent relief for other offshore investments, such as directly held roll-up funds, or for UK insurance bonds.

Disadvantages

For a UK resident investor, the transfer of existing investments into an offshore bond represents a disposal for CGT or (for roll-up funds) income tax, so setting up the bond can trigger tax liabilities.

The PPB rules (see below) can produce large, unforeseen tax charges if care is not taken.

Although bond profits are subject to income tax charges, there is no relief for losses on insurance bonds; many bonds entered into in the last decade are still showing significant losses.

Some investors (wrongly) believe that they can withdraw 5% every year and pass it on to their children while taking advantage of the 'regular gifts out of surplus income' exemption for inheritance tax; this is incorrect, as what is being gifted is capital, not income.

As the investor is not taxable on the underlying income, no tax credit is given for dividends received in the bond; this will reduce the effective return on dividends. For example, a 4% net dividend yield is rolled up in the bond and forms part of the eventual bond profit that will be taxed at (say) 20%, giving a post tax dividend yield of only 3.2% for a basic rate taxpayer rather than the full 4%.

Personal portfolio bonds

Investment bonds are subject to the tax provisions of s.515-526 ITTOIA 2005. This legislation sets out an annual UK tax charge on profits on investments where the benefits are "personal to the policyholders". The definition of policies where this charge applies is one where:

- Any of the benefits are determined by the value of, or income from, property; and
- Some/ all of the property that determines the benefits may be selected by the policy holder.

Further definitions allow for the policyholder or their agent to select units and shares in certain collective investment schemes and into cash without making the policy a PPB.

Therefore most offshore bond providers restrict the investments that can be held to collectives and provide a list of permitted investments.

The main permitted investments are:

- UK authorised unit trusts and OEICS,
- Approved investment trusts
- Some (but not all) non UK collective investment schemes
- Exchange-traded funds that are traded on a regulated exchange
- Cash for non-speculative investment (NB This may exclude foreign currency deposits held for speculative gain)

If breached (e.g. non-qualifying investments are held in the bond), the PPB rules trigger an annual deemed gain of (broadly) 15% of the initial investment plus previous deemed gains combined. The charge therefore ratchets up each year. For example, if £100,000 is invested in a PPB, the deemed gain is £15,000 in the first year; 15% of £115,000 in the second year (i.e. £17,250); 15% of £132,250 (i.e. £19,838) in the third year, etc.

Remember that these deemed gains would be subject to income tax, potentially at 50%. It is therefore very important to stick to the list of permitted investments.

Conclusion

Although offshore bonds now have clear tax attractions for high net worth individuals, there are several factors, both tax and non-tax, that should be considered before deciding on whether they are an appropriate investment vehicle. Those most likely to find them beneficial as a long-term investment are UK investors who will spend a significant period of their ownership overseas, those who are intending to emigrate abroad before encashing benefits and UK resident but non-domiciled investors who wish to avoid the £30,000 remittance basis charge.

Contributed by Kevin Read

Grace v HMRC (2011) *(Lecture P641 – 18.27 minutes)*

You may remember the case of Mr Lyle Grace, the South African long-haul pilot who worked for British Airways, mainly on the route between Gatwick and Cape Town. This case was initially heard a few years ago at around the same time as the original hearing in the Robert Gaines-Cooper saga.

Mr Grace was non-UK domiciled and a non-UK citizen. He did not have any family in the UK, except for his ex-wife (who he had only seen a couple of times in 20 or so years) and their 2 children with whom he had no contact in the period under review. His home in Cape Town South Africa had all the trappings of a person's home. Mr Grace was a member of clubs near his home and used the local leisure amenities on a regular basis.

He also owned a house in Crawley (near Gatwick) which he used during his stop-overs between flights. However he spent very little time in the UK when not required by BA to be here.

He was present in the UK for part of each year because of his employment with BA. His annual UK days were averaged at around 106 in the period under review.

HMRC argued that his regular returns to the UK to pilot long haul flights for British Airways were not for "some temporary purpose only" (as per S.336 ICTA 1988). Instead his UK visits were for a regular and permanent purpose, and this made him UK resident. Interestingly the "91 day" average rule found in IR20 was largely ignored, as the rule has no basis in either statute or case law.

In 2007 the Special Commissioners held that Mr Grace was not resident in the UK despite the fact that has regularly "failed" the 91-day test. This decision was then overturned by the High Court in 2008, so the taxpayer appealed to the Court of Appeal.

In 2009 the Court of Appeal concluded that the Special Commissioner had misdirected herself in law. It therefore referred the case back to what is now the First Tier Tax Tribunal (FTTT).

The FTTT has now heard the case (decision published February 2011) and has concluded that Mr Grace **was UK resident and ordinarily resident in the UK** for the years in question (being 1997/98 to 2002/03 inclusive).

The FTTT considered a comprehensive range of facts about Mr Grace's life and the extent of his ties to the UK. It considered HMRC's stated tests of residence and the frequency of his short visits to the UK. Much weight was put by the Tribunal on Mr Grace's employment with BA in the UK and his "settled abode" in the UK.

Mr Grace had been resident in the UK from 1988 until 1997. He then moved to Cape Town where his family and friends were. Mr Grace argued that he made an active decision to move permanently to Cape Town and he would thereafter effectively commute to the UK for his work.

The decisive point in this case seems to be that the Tribunal did not consider that Mr Grace had made a "distinct break" from the UK in 1997. You may recall that the lack of a "distinct break" from the UK was also a crucial determining factor in the Courts finding that Robert Gaines-Copper was also UK resident.

Residence (under case law principles as opposed to statute) has an "adhesive" nature, such that an individual who has been resident in the UK has to demonstrate a "distinct break" in the pattern of their life in order to become non-resident.

Whilst in was apparent that Mr Grace did spend more time in South Africa than he had done previously and he created more social and family ties there, he continued to be employed in the UK and he continued to occupy his UK home.

Mr Grace argued that his presence in the UK lacked the "quality" of real residence. He claimed to have no hobbies, pastimes or social life or in the UK. He argued he was simply resting and recharging his batteries in the UK before and after flights. All he did in the UK was sleep, eat, watch TV and surf the internet. In contrast he described his life in South Africa as "gregarious". South Africa was where the focus of his life was, and where he spent his leisure time with friends and family. He stored his private aircraft in Cape Town. His house in Cape Town was in a genuine residential area and was a substantial property that he considered to be his "home".

The FTTT observed that it did not matter that Mr Grace had a more active social life in South Africa than he did in the UK. The point was that he deliberately chose to spend some of his leisure time in the UK (even if he was largely just resting between flights).

It was also noted that although an individual could be UK resident if they lived in rented accommodation or used hotels in the UK, if they stay in their own house then it makes it more likely that they will be UK resident, particularly if that house has all the hallmarks of a home (as Mr Grace's house in Crawley did).

Arguments that the house was like a hotel were dismissed. Unlike a hotel, the house belonged to Mr Grace and was used by nobody else. He kept his car, furniture and personal possessions at the Crawley home, he received mail and did paperwork there, he did his own washing and shopping whilst staying there, he was registered with a dentist close by. The Tribunal found that the use of his own house in the UK pointed to Mr Grace being UK resident.

However it seems clear that if he had sold his house near Gatwick and had stayed in a hotel when he returned the UK, HMRC would probably have considered he had severed all ties with the UK and was no longer resident here for tax purposes (the likelihood is that he would never have been selected for investigation in the first place).

The next important feature in this case was Mr Grace's long term employment with British Airways.

The Tribunal noted that this employment was (and still is) a very important part of Mr Grace's life, and without his job with BA he would not be in the UK. It made his presence in the UK a permanent feature of his life which will continue as long as he remains in this employment. His employment formed the basis of the “settled purpose” for which he was in the UK, and this made him much more than a “visitor”. His job was the reason for the frequency and predictability of his return visits to the UK (Mr Grace was required to fly every 28 days to maintain his pilot's licence) and it gave rise to the frequent use of his UK house which was found to be a settled abode. The Tribunal found that the short, very frequent and predictable visits to the UK to fulfil employment duties were sufficient to amount to residence.

Another important issue here is that Mr Grace was not tax resident in South Africa under their residency rules (the number of days he spent in South Africa were not sufficient to make him Tax Resident there under South African tax law). If Mr Grace had been Tax Resident in South Africa, then the UK/South Africa Treaty (Article 4) would have been used to determine his tax status and South Africa would have “won” due to the tie-breaker.

Therefore conventional wisdom is for an individual to establish a tax residence somewhere (ideally in a country with a Double Tax Treaty with the UK).

Shepherd v HMRC (2005)

Mr Grace is not the first BA pilot to be targeted by HMRC.

In Shepherd v HMRC from 2005, Mr Shepherd (another BA pilot) was held to be UK resident in 1999/2000 despite only having been in the UK for 80 days that year. Mr Shepherd bought a new house in Cyprus, and lived there with a degree of continuity. He therefore argued that there had been a material change in the character and quality of his presence in the UK and as such he ceased to be UK resident.

HMRC disagreed. Mr Shepherd worked in the UK, stayed in the family home and visited friends in the UK. Because of this, the fact that he had spent less than the 90 days per tax year in the UK did not it itself make him non-UK resident.

HMRC argued that the “90 days” requirement was never a rule which in itself established non-UK residence. IR20 stated that in order to establish non-UK residence, an individual must have gone abroad either permanently or for a settled purpose, and the UK visits must average less than 90 days. Both tests must be satisfied. Therefore in order to claim non-UK residence Mr Shepherd would need to show that he had gone abroad permanently or for a settled purpose before the 90 day test would even be looked at.

In this case, Mr Shepherd hadn't satisfied this and therefore the 90 day test was irrelevant.

Mr Shepherd’s position was also made worse by the fact that he couldn't even establish treaty residence in Cyprus.

Conclusion?

The Tribunal's decision in Grace is a reminder that short, frequent and predictable visits to the UK in connection with a UK employment can be sufficient to establish residence.

In order to illustrate a "distinct break", those who have been UK resident will need to show that their main ties to the UK (e.g. employment and accommodation) have been significantly reduced. Merely establishing additional ties elsewhere is not enough.

This decision also demonstrates the difficultly which individuals who have retained UK accommodation might have in showing that they have become non-resident.

Contributed by Steve Sanders, Tolley Tax Training

UK residence issues arising from events in Egypt, Libya and Tunisia

An individual's UK residence can hinge on how many days they spend in the UK in a tax year. The political unrest in Egypt, Libya and Tunisia has resulted in the evacuation of individuals from those countries.

HMRC was asked to confirm that any extra days spent in the UK purely as a result of these evacuations would constitute 'exceptional circumstances' and so be disregarded in considering whether an individual is resident in the UK under the 90 day averaging rule (see paras 2.2.1 and 8.9 in HMRC6).

HMRC has confirmed that:

'For those individuals who are evacuated from Egypt, Libya and Tunisia due to the current political situation, this situation would be treated as an exceptional circumstance and therefore covered by existing guidance in HMRC6. **This will remain the case for the period that the FCO advice for the country they are leaving is in place.**'

By way of further clarification HMRC has further advised that:

'Exceptional circumstances will only apply for the period individuals were advised by the Foreign and Commonwealth Office to leave Egypt, Libya and Tunisia and the week thereafter.'

Readers should remember that where an individual is present in the UK for 183 days or more in a tax year, including any days spent here because of exceptional circumstances, then they will be resident in the UK for that year. HMRC has also reminded taxpayers that they will need to evidence that any days spent in the UK were a direct result of the 'exceptional circumstances'.

The relevant periods and areas where an FCO advisory to leave has been, or is currently, in force are:

Egypt – For the period 29 January to 15 February 2011 those in Cairo, Alexandria and Suez were advised to leave.

Libya – Since 20 February 2011 the FCO have advised those who could to leave, this advisory remains in place.

Tunisia – For the period 15 January to 20 January 2011 the advisory was in place.

At the present time there are no restrictions on travel to Egypt or Tunisia.

Quasi-Legal General, 01/03/2011

Company cars – advisory fuel rates from 1 March 2011

These rates apply to all journeys on or after 1 March 2011 until further notice, allowing them to reflect fuel prices more quickly. For one month from the date of change, employers may use either the previous or new current rates, as they choose. Employers may therefore make or require supplementary payments if they so wish, but are under no obligation to do either.

Engine size	Petrol	Diesel	LPG
1400cc or less	14p	13p	10p
1401cc to 2000cc	16p	13p	12p
Over 2000cc	23p	16p	17p

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

Will the rate per mile figures change if fuel prices go up or down?

The rates are reviewed twice a year. Any changes will take effect on 1 June and 1 December and will be published on the HM Revenue & Customs (HMRC) website shortly before the date of change.

HMRC will also consider changing the rates if fuel prices fluctuate by 5 per cent from the published rates when each review is made and we consider the price change will be sustained.

Employers should make themselves aware of any changes by referring to this page in late May and November each year. It is the primary source of information.

VAT

Customs will also accept the figures in the table for VAT purposes though employers will need to retain receipts in line with current legislation.

HMRC Information, 28/02/2011

PAYE – Getting ready for the New Year *(Lecture B644 – 16.27 minutes)*

National Insurance contributions 2011/12

The National Insurance contribution rate rises proposed by Mr Darling take effect now, but the Government has taken steps to mitigate the impact on employers.

To mitigate the effect of the changes, there is a significantly above inflation rise in the employer threshold for NIC from April 2011, the entry point for contributions rising by £21 above indexation. Note that the corresponding threshold for employee contributions will **not** increase as the above inflation rise in income tax personal allowances will produce a similar shelter for employees. This adds a small amount of complexity, as there will in future be two thresholds for NIC – the lower one applying to employee contributions and a higher amount for employer contributions. Note also that the "final" employee rate (also applying to the self employed) will increase from 1% to 2% next year; this rate currently applies on earnings and profits in excess of £844 per week.

Table: rates and limits for NIC 2011/12

	2011/12	2010/11
Lower earnings limit	£102	£97
Primary threshold (employee)	£139	£110
Secondary threshold (employer)	£136	£110
Upper Earnings Limit	£817	£877
Primary main rate	12%	11%
Primary residual rate	2%	1%
Secondary rate	13.8%	13.8%

The effect of increasing the threshold means that employers with staff earning at a relatively modest salary may see their employee NIC bill fall as a result of the two changes, even though there has been an increase in the rate from 12.8% to 13.8%. Those employing higher paid staff will suffer an increase in employment costs as the increased threshold will not cover the cost of additional contributions on pay in excess of £400 per week.

Tax rates and thresholds 2011/12

The level of allowances and tax rates were confirmed in the Autumn of 2010 – in the absence of a Pre Budget Report the figures were issued around the time of the Chancellor's autumn statement.

Table: rates and limits for tax 2011/12

	2011/12	**2010/11**
Personal allowance	7,475	6,475
Age related allowance : 65 – 74	9,940	9,490
Age related allowance : 75 and over	10,090	9,640
Income limit for personal allowance	100,000	100,000
Income limit for age related allowances	24,000	22,900
Basic rate band (20%)	35,000	37,400
Higher rate limit (40%)	150,0000	150,000
Additional rate	50%	50%

So the blanket new tax code will be 747L and employers have been instructed to apply an increase of 100 to all L codes.

Note also that there are far more codes around than hitherto, many of which are collecting additional tax owed from earlier years.

Taxation of company cars

<u>Overview</u>

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.

FA 2010 - 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.

New guidance on the amended canteen rules start at EIM21671

Childcare tax scheme changes from 6 April 2011

The changes affects employers operating two types of scheme :

- Childcare vouchers
- Directly contracted childcare

The change does not affect employers operating workplace nurseries. These continue to be a tax free benefit without limit provided conditions are met.

Affected employees

The changes only affect employees joining schemes on or after 6 April 2011. Existing employees within a scheme can continue to benefit from marginal rate relief on their childcare support, but the change withdraws relief in excess of basic rate for new joiners.

"Existing employees"

To meet the definition of existing employees, the individuals must have submitted an application to the employer on or before 5 April 2011, and be eligible to receive tax and NIC exemption on that date. This means that the child must be born or placed for adoption at 5 April 2011 otherwise no tax and NIC exemption would be due. It is not necessary that the first voucher is provided by 5 April 2011, just that the individual has applied for the scheme and is entitled to the tax exemption.

How it works

When an employee joins a scheme on or after 6 April 2011 the employer must carry out a "Basic Earnings Assessment". This is to establish their marginal tax rate for these purposes, and is carried out when the employee joins the scheme and annually at the start of the tax year thereafter.

Comparison

Compare earnings from the basic earnings assessment with the higher and additional rate thresholds. Employers will need to adjust for personal allowances (to the extent available) – they may be able to use coding notice for relevant tax year, but need to beware of double counting benefits.

Table : tax free amounts 2011/12

	Basic rate and existing members	**Higher rate**	**Additional rate**
Weekly	£55	£28	£22
Monthly	£243	£124	£97
Annual	£2,915	£1,484	£1,166

Excess payments

- Tax – include on P11D at the end of the year
- NIC – if excess vouchers then include in payroll and account for employer and employee NIC at the time provided
- NIC – if excess directly contracted childcare NIC is Class 1A and reported on P11D accordingly

50% tax rate

It has not been possible to reflect in coding notices the need for an individual to suffer 50% tax in one employment as a result of multiple employments. This issue will crop up for those who have multiple employments which put them over the £150,000 limit. Those with a single employment will not be affected.

HMRC is working to identify those affected and they will be included within Self Assessment from April 2011 to allow this liability to be collected.

For 2011-12 the problem has been solved by the creation of a new code, and employees liable to 50% in full on all payments will be coded D1 (the D0 code applies to collect 40% tax from all pay).

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Unsigned P46

Where a new employee fails to sign P46 (that is, fails to complete any of certificates A, B or C) in the past he has been put on Emergency code of BR. Because this does not allow higher or additional rate tax to be collected, from April 2011 those who do not sign P46 will be put onto the new emergency code of 0T Week 1/Month 1. This will allow the higher rates of income tax to be collected month by month, so the employee will not have the benefit of paying only BR for the period during which he does not have a correct code (this can sometimes be an extended period).

"Post P45" termination payments

When a taxable element of a termination payment is due to be paid to an employee leaving his job, it is not unusual for this to be paid after the employee has technically left the employment. Normally the P45 is raised and the termination payment is made after this (frequently only by a day or so) and the payment separately reported. When this happens, the standing instruction has been to deduct basic rate tax from the taxable amount, leaving the employee to account for the balance of the tax due. Once again this leaves those due at 40% or 50% with a significant tax free loan, and this practice is also to cease. In future the default code for post P45 payments will also be 0T.

In-year online filing

All employers are required to file forms P45 and P46 electronically from April 2011. Until this time, only employers with more than 50 employees were subject to mandatory electronic filing of in year forms. HMRC announced in Employer Bulletin October 2010 that penalties for failure to file forms online would not be imposed immediately; no update of this position has yet been made.

Exemptions from the electronic filing Regulations

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

a) employers who are authorised by HMRC to deduct tax in accordance with regulation 34 of the IT (PAYE) Regulations (i.e. domestic employers operating a simplified deduction scheme) and who have not received a tax-free incentive payment for filing online previously

b) employers who are a practising member of a religious society or order whose beliefs are incompatible with the use of electronic communications

c) care and support employers – that is employers who employ someone to provide domestic or personal services at or from the employer's home.

To qualify as a 'care and support employer':

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

There is no specific claim form so employers in categories (b) or (c) should send a written claim to their HMRC office giving full details. HMRC will then arrange for a paper P35.

Electronic P60s

Changes have been made to the PAYE regulations which will allow employers to provide P60 information to employees electronically. The changes come into effect for the tax year 2010-11 onwards, so that the first electronic P60's can be provided at the forthcoming year end process. The deadline for providing P60 information to employees has not changed.

Employers may want to agree with employees whether they wish to receive their P60 electronically. If the P60 is provided electronically, the employer will need to provide secure facilities for employees to view and print their P60. If this is not possible, an electronic P60 can be issued to an email address that has been provided by employees. If employees do not have access to a computer the employer must continue to provide a paper version of the P60.

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Any substitute P60s which arise from the output of an electronic P60 must carry the text ‘this is a printed copy of an eP60’. This must be at the top of the form near to the form title – P60 End of Year Certificate and in an acceptable font size, no smaller than point 10.

Duplicate P60s

Duplicate P60s for the tax year 2010-11 onwards, irrespective of whether they are provided on paper or electronically, will no longer need to carry a ‘duplicate’ annotation.

Employer CD-ROM

The Employer CD-ROM will not be issued this year, and instead the range of tools on it will be available to download from HMRC’s website. Employers who cannot do this because they do not have adequate internet access may still be able to obtain a CD-ROM, but this is expected to be an exceptional case.

Employers who have used the software on the CD-ROM to maintain payroll records (only suitable for less than 10 employees) must ensure that they have updated their installation as of September 2010 to allow them to use the new online tools to complete their end of year returns for 2010-11. Employers can register for an email alert when the online tools are updated.

Late payment penalty

Finance Act 2009 Section 107 and Schedule 56 make provision for a new late payment penalty regime which will apply in addition to interest. The measures will commence by Order, and no start date has yet been announced. The provisions once again cover most taxes, and provide in particular for a penalty for late payment to apply as follows :

- PAYE – normal due date
- CIS tax – normal due date

PAYE / CIS in excess of 6 months

Penalties for very late payment of these amounts including amounts recoverable under MSC legislation:

- Initial penalty 5% of the tax
- Second penalty 5 months after first penalty date 5%
- Third penalty, 11 months after first penalty date 5%

PAYE and CIS of less than 6 months

The penalty is determined by the number of defaults in a tax year, that is late payments. The first default is ignored; after that :

- When there are 1, 2 or 3 defaults in a tax year the penalty is of 1% of the total of those defaults
- When there are 4, 5 or 6 defaults the penalty is 2% of the total of the defaults,
- When there are 7, 8 or 9 defaults the penalty is 3% of the total amount of the defaults, and
- For 10 or more defaults the penalty is 4% of the total defaults.

Any amounts that are unpaid more than 6 months after the penalty date are liable to 5%, and a further penalty of 5% applies after 12 months.

Section 108 permits the suspension of penalties during the currency of agreement for deferred payment – most of this relates to the old penalty regime. Regulations were issued in late July to the same effect for the new regime in relation to PAYE and CIS tax as no penalties for late payment existed under the old regime.

Contributed by Rebecca Benneyworth

Capital Taxes

PPR relief on property bought by father

The appellant's father bought a property in Lancaster and lived in it until 1996. It was used as a holiday home until 1997.

The appellant intended to live in the property from 1998 while studying at Lancaster University, but she changed her mind and took a course in Leeds instead. The father transferred the property to the appellant in 1998, and it was let until 2002.

The appellant sold the property in 2003. She claimed it was her main residence from 1998 to 2003, although she spent virtually no time living in it because she was at the Universtity of Leeds between 1998 and 2002.

She said she had intended to live in the house after her course finished, but she got a teaching post in Leeds and did not move back to Lancaster.

Alternatively, she claimed no capital gains tax was due on the sale proceeds because the property was job-related accommodation.

HMRC refused her claim.

The First-tier Tribunal said that, to qualify for only or main residence relief, the appellant would have had to occupy the property as her only or main residence.

Ownership alone did not qualify for relief. The flat had been let while she owned it and it was occupied during university vacations, these being the only times that she could have lived there.

With regard to job-related accommodation, this did not apply because the appellant was not required to live in the property for the purposes of her job.

The taxpayer's appeal was dismissed.

Alexandra Bradley (TC927)

Claim for relief from income tax for CGT loss on disposal of shares

The issue

Mr Fard held shares in FI Packaging Ltd. which ceased to trade on 14 October 2004 and went into administration thereafter, in the same year.

When the Company had been established, his father took shares and provided funds for the Company to trade and expand. He worked in the business for a minimal remuneration and his understanding with his father was that when the business was established his father would transfer shares to him in recognition of his contribution to building up the Company. This happened in 2002.

The issue to decide was whether Mr Fard was entitled to loss relief under section 574 ICTA in respect of the 66,668 Ordinary Shares in the Company which were acquired by him on 20 December 2002 on a transfer to him from his family.

The Tribunal

The Tribunal decided that the shares had been issued to Mr Fard's father and then transferred to Mr Fard; this did not directly involve the Company. They concluded therefore that the loss on the disposal of the 66,668 Ordinary Shares could not qualify for relief under section 574 ICTA as Mr Fard had not subscribed for them.

The appeal was dismissed

However, they were very critical of the implementation of HMRC's policy of "process now check later" which led to excessive repayments being made to Mr Fard on the basis of honestly made but incorrect claims.

Mr Fard now has to make significant payments of tax to HMRC in circumstances where this is likely to cause him acute financial difficulty as his family's financial circumstances have changed for the worse since the tax years in question. They strongly recommended that HMRC negotiate with Mr Fard so that he is given adequate time to make the necessary payments of tax. They also recommended that interest be waived.

F Fard v HMRC TC00941

Dividend waivers: Get the details right

When to use a dividend waiver

Dividends are paid at the same rate for each category of share in accordance with the number of shareholdings held. Such inflexibility could mean the distribution of profits not being made in the most tax efficient manner or produce difficulties for a shareholder who does not want or need the payment - a dividend waiver may offer the solution.

How it works

The shareholder voluntarily waives entitlement to their share of the dividend, allowing the distributable profits to be divided between the remaining shareholders in the proportion of their holdings.

Scenario 1

ABC Ltd has distributable profits of £50,000 and wants to pay a dividend of £400 per share; the shares are held by three brothers as follows:

A 50 shares

B 25 shares

C 25 shares

A can waive his dividend and B and C will receive £10,000 each with no matters arising; A's dividend remains within in the company.

Scenario 2

Same details as above with A waiving his dividend but B and C receiving an increased amount of £15,000 each (£600 per share). HMRC may challenge this waiver contending that A has settled £2,500 on each of his brothers and he will be taxed thereon on the grounds that an element of bounty is present. Although the actual total amount of dividend paid (£30,000) is less than the amount of distributable profit (£50,000), if A had not waived his dividend the company would not have had enough distributable profits to pay the increased £600 per share (£600 x 100 = £60,000).

When will HMRC become interested?

Comments made on AccountingWeb show inconsistency in HMRC's approach to dividend waivers despite instruction given in the ***'****Trusts, Settlements and Estates Manual'* (TSEM 4225). However:

- In practice HMRC are only likely to take the above settlement point where the waiver is considered to create a tax advantage.
- They will try to argue that the waiver indirectly provided funds for an 'arrangement' or 'settlement' under Income Tax (Trading and Other Income) Act 2005 Pt 5 Chpt 5 s623; an element of bounty being needed for the settlement provisions to apply.
- If the transfer is between spouses HMRC will deem the settlement to be one of income and unless there is an outright transfer/gift of ownership of the shares protection under s624 (husband and wife exemption) will not apply (Buck v HMRC **(SpC 716)**)**.**
- Buck v HMRC also confirmed that a company may legally distribute all of its distributable reserves/shares to a single shareholder if all of the other shareholders waive entitlement but again in the taxman's eyes that could represent bounty and if present the settlement provisions would apply.

Specific points

1. A formal deed of waiver is required, which must be signed, dated, witnessed and lodged with the company
2. It is imperative that the waiver be in place before the right to the dividend arises because a waiver *after* payment is a transfer of income which constitutes a settlement. Therefore an interim dividend must be waived before being paid; a final dividend is payable once approved at an AGM unless confirmed to be payable at a future set date.
3. HMRC would prefer to see a commercial reason for the waiver (again see Buck v HMRC). Therefore, best to state in the deed that the waiver has been made to allow the company to retain funds for a specific purpose.
4. Dividend waivers should be used sparingly - don't waive every year. HMRC will look more closely at arrangements which are repeated, the practical effect of which reduces the overall tax payable (again see Buck v HMRC).
5. Nothing should be given in consideration of the waiver.
6. A waiver may cover a single dividend, a series of dividends or dividends declared during a specified period of time.
7. Ensure that the dividend declared per share times the number of shares in issue does not exceed the amount of the company's distributable reserves (see scenario 2 above).

Are there any other options?

The shareholder who does not want the dividend will have to transfer his shares to another shareholder(s) before the dividend is declared. This will mean no further involvement in the company and would be more difficult to reissue shares to him at a later date; the procedure also needs Board approval.

Re-categorise the shares into A and B shares with the same rights except for dividends; then declare a dividend on the A share only. The owner of the B –type shares will not receive dividends for the time being but remains involved with the company.

Final Note

A waiver of dividends will not be chargeable to IHT as a transfer of value if made within 12 months before the right to the dividend arises. (IHTA 1984 s15).

From an article by Jennifer Adams writing on AccountingWeb

Administration

Business records checks under new programme *(Lecture P645 – 9.03 minutes)*

Introduction

HMRC recently announced a consultation on their planned programme of checks of business records within the small and medium enterprise (SME) sector. They attempt to justify the introduction of this programme by claiming that research by the OECD suggests (to HMRC that is) that poor business record keeping is responsible for a loss of tax in up to 2 million SME cases annually.

The consultation exercise is limited to consideration of the best way to implement the programme – not whether it is a good idea in the first place. It is therefore clear that the programme will be introduced and we all need to know the likely impact on our clients. A timely review of their business records would be a good start.

There is a resource issue here with HMRC trying to reduce the number of full enquiries by, in the case of this initiative, making sure that the business records are sound as the basis for presenting accurate returns to HMRC of the business income and expenditure. If they do not find this to be the case they will have identified a target for investigation.

Scope

No new legislation is proposed - the programme will use existing law regarding both record keeping requirements and penalties for failure to comply with those requirements, with penalties being imposed for significant record keeping failures.

This consultation is concerned with how best to implement a programme of Business Records Checks to achieve a major improvement in the standard of record keeping across the SME population, and to consider related issues. It is not looking at the appropriateness of existing legislation. Record keeping requirements were of course updated in Finance Act 2008 and guidance is continuing to be updated. Record keeping penalties will be considered as part of a separate review into HMRC's regulatory and specialist penalties.

Following consultation period, HMRC will publish a summary of the responses to the consultation explaining how those responses were taken into account in taking forward a programme of Business Records Checks. It is envisaged that this will be published around the end of March 2011.

The problem according to HMRC

Whilst the need to keep proper records in order to comply with tax obligations is widely acknowledged, HMRC's random enquiry programme indicates that poor record keeping is a problem in around 40% of all of the total of about 5 million SME cases. Research by the OECD indicates that poor business record keeping generally leads to an underassessment of tax even where there is an audit-type check into a return for the period covered by such records. On this basis, say HMRC, poor business record keeping is responsible for a loss of tax in up to 2 million SME cases annually.

According to HMRC, tax agents tell them that whilst they advise clients on what records to keep and how to keep them, many do not follow the advice given. This causes additional unnecessary work for those agents who have no way of enforcing the standards that they think necessary

The loss of tax through poor record keeping, particularly in the current economic climate, cannot continue says HMRC, and they are therefore determined to use the powers at their disposal to improve business record keeping and so reduce the loss to the Exchequer that stems from poor business records.

Objective of Business Records Checks

The stated objective is to:

- Use the powers of Schedule 36 FA2008 to check business records in up to 50,000 cases annually, beginning in the second half of 2011.

- Impose penalties for significant record keeping failure, thereby: bringing about an improvement in record keeping across the population of the (claimed) roughly 2 million SMEs whose records currently fall below standard.
- Thereby reduce the tax losses to the Exchequer that result from poor business records.

Issues covered

The consultation is concerned chiefly with how best to implement a programme of Business Records Checks with penalties for significant record keeping failures, which will attempt to establish:

- A clear understanding of the record keeping obligations.
- The level of penalties that need to be imposed for significant record keeping failures to bring about the behaviour change that HMRC wants to see.
- Whether a period of time (and if so the length of that period) should be allowed for business records to be brought up to standard before penalties for significant record keeping failures are imposed.

Other issues that the consultation wishes to explore and clarify are the interaction between:

- penalties for record keeping failures and penalties for inaccurate returns
- the record keeping obligations for different taxes, and the penalties for failures in relation to those separate obligations

Selection of cases, and the operation of Business Records Checks

HMRC plan to select cases for a Business Records Check on the basis of risk assessment, focusing on businesses that have features associated with poor record keeping.

A small proportion might be selected at random to verify the worth of Business Records Checks and to help improve the risk assessment criteria.

The corrective impact of Business Records Checks could be increased, and poor record keepers further encouraged to bring their records up to standard, through leverage. HMRC give an example of when they identify a business population as having the features associated with poor record keeping, they could write individually to that population explaining that:

- they are in a category at risk of having poor business records
- HMRC will be checking the business records of many of those in that population
- and that they are, therefore, more likely to be chosen for such a check in the coming year

Location, Duration and Extent of a Business Records Check

The law in Schedule 36 FA2008 allows an officer of HMRC to enter a person’s business premises and inspect statutory business records, where that is reasonably required for the purposes of checking that person’s tax position.

It is intended that Business Records Checks would be pre-arranged with at least 7 days notice. Traders and their agents will be made aware in advance and appointments made. Typically, a Business Records Check will consider a ‘sample’ of the records kept (not the records in totality), to check that a full and clear record is being kept of all business ‘money in’ and ‘money out’, and that the records allow an accurate interpretation to be made as to the nature of those receipts and expenditures.

Final HMRC comment

In somewhat conciliatory mood, HMRC state that it is not intended to begin a programme of Business Records Checks with penalties for significant record keeping failures without first providing for a period of adjustment. This approach will they claim allow a reasonable period for all SMEs to bring their record keeping up to standard.

Contributed by Gerry Hart

Documents required were reasonable to check position?

Mr Paul Whight had sold shares in a UK plc. The shares in the Company were sold, according to the Press, for more than £280 million. There was loss of potential capital gains tax in a significant sum in HMRC's view.

He claimed to be non-resident for exactly 5 years of assessment and HMRC wished to investigate the residence position and in particular wanted to see original documentation.

Mr Paul Whight appealed against a notice under paragraph 1 schedule 36 FA 2008 to produce documents. He argued that the obligations imposed by the Notice were onerous and unreasonable and accordingly the appeal should be allowed and the Notice discharged.

Mr Whight's argument

1. HMRC were bound by IR 20 following *the Davis and Gaines Cooper* case;
2. Enquiries should be limited to see whether or not paragraphs 2.1 to 2.3 had been fulfilled;
3. Anything further than that was onerous and therefore unreasonable.

HMRC's position

1. Information allowed HMRC to check the position under IR 20 and the wider general law;
2. In the context of what was required was not unreasonable.

Tribunal findings

HMRC has the right to check the position and in particular to see original documents.

They were happy that the information requested fell within the range of requests for information and documents reasonably required for the purpose of checking the taxpayer's tax position.

The Tribunal held that IR 20 was not a matter of law. IR20 warns taxpayers and advisers that the Revenue's determination of residence will often depend on its assessment of the facts. Whilst it might be convenient for the Taxpayer for HMRC to confine their enquiry to IR 20 matters, it is not in our view unreasonable for HMRC to request original documentation to check the position under both the general law and IR 20.

Appeal dismissed; The Tribunal directed that the documents and information requested be produced within 30 days of the issue of this decision as agreed by the parties.

P Whight v HMRC TC00938

Business Taxes

LLP – deductibility of expenses

Icebreaker 1 LLP was formed in February 2004 to conduct a trade of film distribution. In April 2004, six individuals joined the partnership, contributing capital of £1.52 million between them, 70% of which had been funded by non-recourse loans advanced by Bank of Scotland.

The partnership submitted its tax return, claiming most of its expenditure as a trading loss for the period. HMRC opened an enquiry into the return and eventually issued a closure notice, reducing Icebreaker 1's losses from £1,491,816 to £11,900.

The partnership appealed.

The First-tier Tribunal concluded that most of the losses claimed were not allowable and dismissed the appeal.

The partnership appealed.

The Upper Tribunal (Tax and Chancery Chamber) said TA 1988, s 74(1)(a) made clear that only sums wholly and exclusively laid for the purposes of the trade were deductible. Section 74(1)(f) provided that any capital withdrawn from, or any sum intended to be used as capital in, the trade was not deductible.

The focus was on the taxpayer's trade, not the recipient's use of the money. After considering in detail the evidence, the tribunal allowed some of the taxpayer's claims, but not those which were unrelated to the trade or were in the nature of capital.

The taxpayer's appeal was allowed in part.

Icebreaker 1 LLP v Revenue and Customs Comrs [2010] UKUT 477 (TCC)

Deductible medical expenses for a stunt performer

In *Parsons v Revenue and Customs Comrs [2010] UKFTT 110, (TC) TC 421*, the First-Tier Tribunal found that some costs claimed by a self-employed stunt performer were deductible but others were not.

In the case, the appellant worked as a self-employed stunt performer in films and television productions. In his tax returns, he claimed deductions for the cost of a knee operation, for chiropractic treatment, for sports massage, for dental treatment and for the cost of maintaining "health and fitness". HMRC issued assessments disallowing the deductions, and P appealed.

The First-Tier Tribunal allowed the appeal in part. The appellant had injured his knee while performing a stunt, and needed the operation to continue performing similar work. On the evidence, in a physically less demanding job he could have carried on working in the meantime, and it was only because of the particular demands of the kind of work that he does that he could not carry on working until the operation was done. The same reasoning applied to the chiropractic treatment and to the massage, which were needed because he had injured his back while working. Similarly, the dental treatment all related to injuries to the appellant's teeth sustained in the course of his work and it was necessary for him to have the dental treatment in order to continue working. However, the tribunal held that the cost of maintaining P's health and fitness were not allowable as a deduction, since the expenditure was not related directly and specifically to maintaining the specialised skills that the appellant must have to remain on the stunt register. Maintaining health and fitness is a general human need, even if it also serves the purposes of the trade or profession. Accordingly the expenditure had a dual purpose, and was not allowable as a deduction.

Parsons v Revenue and Customs Comrs

The home as the business base *(Lecture B641 – 9.44 minutes)*

Is it the base for the business?

This has long been a problematic issue in a number of situations where it may be difficult to properly establish that the business base of a self-employed person is his home. The issue is not just relating to the running costs of the business base, but of often greater significance is the need to establish the home as the business base if a claim for travel costs is to be valid in respect of travel to and from the home and where the individual is visiting in the course of the business.

The recent tribunal case of ***Paul Mellor v HMRC TC00906*** was determined for the taxpayer and may well provide the chance to make claims for motor expenses in circumstances that previously were doubtful. This is not simply because of the taxpayer's victory, which on its own seemed hardly a surprise, but is more due to the thinking behind the tribunal's decision.

Subject to any HMRC appeal the position can now be summarised below as the basis for possible claims for the self employed who use their home as the business base but travel to actually do the core work:

1. Mr Mellor was a self employed electrician, acting mainly for contractors rather than for domestic clients. He travelled from home to client sites. He claimed tax relief on motor costs to/from home and each site, on the grounds that his home was his business base and *Horton v Young 47 TC 60* applies.
2. HMRC claimed that although some work connected with his business may be done at home, that was not the location where he exercised his trade, with the facts in the Horton case being different. They instead argued that the case of *Newsom v Robertson 33 TC 452* was relevant and that his trade did not start until he reached the client's premises where he was to undertake the work.
3. The use of the home for the business involved the following:
    - Preparing quotes
    - Preparatory work (although sometimes a site visit was also made before the contract started)
    - Preparing the contract
    - Telephone queries
    - Keeping his tools and equipment
    - Location of his business records
    - Address used for correspondence and for PII cover
4. HMRC argued that unlike in the Horton case, Mr Mellor was not a team leader and did not hold any meetings at his home. Basically, the use made of his home did not make it an office.
5. The tribunal concluded that a sub-contractor such as Mr Mellor must have a base for his business. His work on plans and quotes at home must be a part of his trading activity which did not therefore cease when he arrived at home to deal with these. Accordingly his base for the business was his home.

What running costs of the home can be claimed?

If it can be established that the business base is the home there is plenty of scope for claiming tax relief on the running costs by reference to the usual requirement the expense being wholly and exclusively incurred for the purposes of the business.

Indeed there is even more scope following what is said in *para BIM47815* of the *Business Income Manual* when it refers to the 1975 case of *Caillebotte v Quinn* as the authority for being able to apportion the use and cost of a home on a time basis and to allow the expenses of the room during the hours in which it is used exclusively for business purposes.

In particular it says there can be a valid claim for apportioned mortgage interest; telecommunications (including the line rental); insurance (including a household policy); repairs and maintenance.

There are several examples given by HMRC of this approach in *para BIM47825*.

Contributed by Gerry Hart

Deduction of travel and accommodation expenses for scaffolder

The case

Mr. Reed undertook work as a scaffolder for O'Reilly Scaffolding originally as an employee, then as self employed from April 2003 to April 2005

He appealed against the disallowance of expenses relating to the:

- cost of travel from his home in Grimsby to his rented accommodation in Birmingham
- rent on the accommodation in Birmingham paid by him

For 2003/04 and 2004/05, the issue was whether the expenses were incurred wholly and exclusively for the purposes of his trade as a self-employed labour-only scaffolder?

His base

HMRC contended that throughout the period that Mr Reed was working in the Birmingham area for O'Reilly Scaffolding, he lived at a property in Birmingham, owned by Philip O'Reilly, and accordingly his business was based in Birmingham. Travel expenses between Grimsby and Birmingham should not be allowable and nor should his accommodation expenses as they were incurred to allow Mr Reed to live nearer to his work.

Mr Reed claimed that he lived in Grimsby and that this was his business base throughout. The accommodation used by Mr Reed in Birmingham was used only when he was working within daily travel of that accommodation and was used as an alternative to hotel accommodation. When working at other locations he stayed in a hotel or similar accommodation or he travelled to and from his home in Grimsby.

From Mr Reed's home in Grimsby, he was directed to areas of operation outside Birmingham with regular frequency. In many cases Mr Reed was able to work from his base in Grimsby, travelling daily to the place of work designated for that day. On other occasions it was necessary for him to use hotel accommodation or bed and breakfast accommodation as appropriate, together with the rented accommodation in Birmingham.

Findings

Mr Reed was an itinerant worker whose home or base of operations was Grimsby. As such, his travel and subsistence expenses were wholly and exclusively incurred in the course of his business.

Sean Reed v HMRC TC00969, 28 January 2011

Deductible travel and subsistence for commercial pipe fitter

The facts

Mr Kenyon is a self-employed commercial pipe fitter. In 2003, he worked in a number of places around the UK for a week or two at a time before going on holiday. He became ill, had a heart-bye pass and was off work from October 2004 to September 2005.

In early 2006 he returned to Brewchem in Greenwich but was unhappy with the work and so left to work on Scottish oil rigs but failed a medical and so returned to Brewchem for 3 months before he could take the test again. On the second attempt, he passed but was too late to take up the rig work which occurs between April and September, so he returned to Brewchem.

He always returned to his home after each job finished and before he took on a new assignment.

HMRC say that he predominately worked with Brewchem for the 3 years under review. As Brewchem represented his principal place of work he could not deduct the costs of his travel and

subsistence when travelling from his home on the Wirral to London and back again. His returns had been filled in negligently and the discovery enquiry was in time.

He appealed against HMRC's refusal to allow his travelling and subsistence expenses for the years 2004/5, 2005/6 and 2006/7 in the sums of £8,836, £6,882 and £11,987.He claimed that he worked from home and since he travels to various sites from his home he ought to be allowed deductions for travel and subsistence.

Findings

It was clear that Mr Kenyon was working as a self-employed pipe fitter. During the period from 2003 to 2007 he had worked at various sites many of them not related to Brewchem. There was no doubt that his home was his work base.

As they decided that he was based at home and travelled round the country working, they decided his travelling expenses should be allowed, as these were incurred wholly and exclusively to get him to his place of work.

As to the accommodation, the expense must be "wholly and exclusively" for the purposes of the trade. The Bed and breakfasts were necessary for somewhere for Mr Kenyon to sleep and were not therefore "wholly and exclusively" for the trade.

Discovery assessment

To make a "Discovery" one of two conditions must be satisfied:-

1. The further tax that is due must arise from fraudulent or negligent conduct of the taxpayer, or a person acting on his part, or
2. HMRC could not have been reasonably expected, on the basis of the information available to them to be aware of the underassessment when the enquiry window is closed.

HMRC opened a discovery enquiry into the 2005-6 return.

The three self-assessment returns filed by Mr Kenyon revealed at box 3.56 the figure claimed for travel and subsistence. The figure represented about 25% of his turnover and the Tribunal consider that HMRC should have been put on enquiry as to why it was so high.

The Tribunal concluded that Mr Kenyon was careless in completing his return for 2007, and negligent when completing his 2008 return as his numbers did not stack up. As a result, HMRC were entitled to raise a discovery assessment out of time

Alan Kenyon v HMRC TC00968

Changes to Furnished Holiday Lets (FHLs) *(Lecture B642 – 20.21 minutes)*

The key changes

The draft legislation to effect the proposed FHL changes was published in December 2010 and makes three key changes:

1. With effect from 6 April 2011 loss relief is restricted to the same FHL business
2. With effect from 6 April 2012 the qualifying days that the property must be available for letting is increased from 140 days to 210 days
3. With effect from 6 April 2012 the qualifying days that the property must actually be let is increased from 70 days to 105 days with a two year period of grace where this condition is the only one not met.

There does not appear to be any changes to the 155 days of longer term occupation when considering the 105 days.

So generally it will be harder to qualify as an FHL but when you do qualify you receive the same favourable status as before – with the exception of treating losses as a trading loss. Losses are still available for relief but only against future profits from the same FHL business. The change to losses should be manageable from a client perspective.

105 day letting test

The most problematic change will be the increase in days let from 70 days to 105 days. This will be hard for some properties to meet every year but there is a two year period of grace if you fail to meet the 105 day let condition.

Once a property qualifies as holiday accommodation in one tax year the owner may elect to treat the property as continuing to qualify for up to two later years even though it does not meet the 105 day letting condition in those years. The election has to be made in the first tax year in which the letting condition is not met. If it is not made for the first of the tax years it cannot be made for the second. An election for a tax year must be made on or before the first anniversary of the 31 January following the tax year.

The period of grace will only apply if you breach the 105 day test alone. So if the property is not available for the 210 days there is no period of grace and you will lose FHL status immediately.

Unfortunately the draft legislation does not appear to allow the period of grace to apply in 2012/13 as this will mean you are using 2011/12 as the "qualifying year" for the period of grace. The new provision only applies from 6 April 2012 so the first year it could apply to would be 2013/14 if you met the 105 day test in 2012/13. It is my understanding that this is the interpretation which HMRC favour.

The rules for averaging remain the same post 5 April 2012 and are likely to be more relevant given that we have the new 105 day condition to meet. Averaging would appear to be separately calculated for UK FHLs and the EEA (non UK) FHLs. So a UK holiday lets cannot be averaged with a Spanish holiday let. This appears to apply from 6 April 2011 by way of an new para 326(7). So prior to 6 April 2011 it may be possible to average a UK FHL with a Spanish FHL (for example) so that they both qualify for FHL status.

Example 1 - Jane

In 2012/13 Jane has two Scottish properties which are commercially let as furnished holiday accommodation as follows:

Property 1 - let for 120 days

Property 2 - let for 100 days

All other FHL conditions met.

Under averaging these properties both qualify as an FHL in 2012/13 as the two property average is 110 days.

Example 2 - Kate

In the years up to and including 2012/13 Kate has a property in Wales which has previously qualified as an FHL.

In 2012/13 the property is let for 107 days and continues to qualify as an FHL.

In 2013/14 the property is let for 104 day which is one day short of the required 105 days.

Kate's property will however continue to qualify as an FHL for 2013/14(and 2014/15 if needed) under the period of grace rules. It will fall out of FHL status from 2015/16 if it has breached the 105 day test in 2013/14, 2014/15 and 2015/16.

Example 3 - Craig

In the years up to and including 2012/13 Craig has a property in Poole, Dorset which has previously qualified as an FHL.

In 2011/12 the property is let for 90 days which met the 70 day test for that year and continues to qualify as an FHL.

In 2012/13 the property is let for 100 days.

Craig's property will cease to qualify in 2012/13 as the period of grace rules cannot not apply for that year The period of grace cannot rely on a year prior to the introduction of the new rules on 6 April 2012.

Example 4 -Liz

In the years up to and including 2012/13 Liz has two properties in Cornwall which qualify as an FHL.

UK Property 1 - let for 120 days

UK Property 2 - let for 96 days

All other FHL conditions met.

Up to and including 2011/12 these properties have previously qualified as an FHL as they were let for more than the required 70 days.

For 2012/13 the two properties will continue to qualify as the average is 108 days. It is important that it does meet the letting conditions in 2012/13 in order to get access to the period of grace for later years should lettings fall.

In 2013/14 UK Property 1 is let for 110 days and UK Property 2 is let for 98 days. From April 2013 UK property 2 ceases to meet the averaging rules as the two property average is 104 days.

UK property 2 gets two years period of grace and if it still fails to meet the 105 (individually or averaged) within that time then UK property 2 drops out of FHL status from 2015/16.

But UK property 1 remains an FHL providing it exceeds the 105 days.

Capital allowances

There are some changes to capital allowances which introduce a new s.13B into CAA 2001.

In my opinion the changes require further HMRC guidance as the legislation is not entirely clear.

Essentially when a property ceases to qualify as an FHL we have to value its qualifying assets at market value and then put the disposal proceeds in the capital allowances computation. This will create a balancing adjustment if the FHL business comprises one property but is unlikely to create such an adjustment if there are multiple FHLs – proceeds just reduce the pool.

The assets are then an addition for the now “buy to let” property but where these are for use of the tenant no capital allowances can be claimed going forward – the 10% wear and tear allowance applies.

This does present issues with identifying and then valuing assets when properties breach the FHL conditions but with a two year period of grace this will only be necessary when a property has consistently breached the FHL status rules for two tax years. Unfortunately if the period of grace cannot apply in 2012/13 some clients will need to consider the capital allowances adjustments sooner rather than later.

In any event clients will need to keep some form of fixed asset register to identify the qualifying assets in each property.

Contributed by Dean Wootten

Furnished 'eco' holiday lettings – what qualifies as plant?

Mrs McMillin bought a house, some barns and an adjacent piece of land. The barns were demolished and building work started in July 2006 first on the main house and subsequently on four cottages. The first 'holiday let' of one of the cottages started on 31 March 2007, and in her Income tax return for the Tax year 2006 -07 she claimed Capital Allowances. Expenditure on various items was agreed between Mrs McMillin and HMRC and this appeal related to expenditure of £53,835 which had not been agreed on:

- Stone floors
- Windows
- Paint and decorating
- An Earth Bund.

Mrs McMillin contended that the expenditure on these items should all be allowed as losses against her income because the whole site, other than the shell of the buildings, should be classed as plant or alternatively each item should be classed as plant or machinery.

HMRC contend that each item is excluded from the definition of plant and machinery by statute.

Can the whole site be classed as plant?

The Tribunal considered that there are only extremely rare cases such as that involving 'dry docks' where premises themselves are plant and in our view holiday cottages are not obviously plant. There is always the possibility that they can be used as homes in the future particularly when they are solid buildings, well constructed in stone.

Holiday cottages are not analogous to caravans (List C in section 23 CAA 2001). This list did not contain a specific reference to holiday cottages or 'eco holiday developments'.

Stone Floors.

Mrs McMillin said that the flooring was an integral part of the heating system.

The Tribunal said that on balance, they found that the principal purpose of the slate on the ground floor was to provide a floor for the premises and not an integral part of the heating system.

List A in s21 CAA 2001 specifically notes that floors are assets which are treated as buildings.

Windows

The Tribunal found that not all the windows face south and that most of them could be opened which would defeat any insulation properties they contained. As such they were not sufficiently different from what might be classed as ordinary windows that they were obviously plant. They also found that they could not be classed as part of the heating system to come within item 3 in List C.

They were held to be part of the building.

Paint and Decorating

Mrs McMillan gave evidence that she believed that the paint applied to the walls of the cottages helps to keep the air clean. It was organic paint which is non polluting and dust free.

The Tribunal found that none of the information supplied showed that the paint had a function beyond that of covering the walls and making them easier to clean.

Earth Bund

The main purpose of the creation of the earth bund was to allow for disposal of waste /spoil from the building works which obviated the need for its removal. It was a secondary effect that the bund then provided insulation to the side of one of the cottages.

Summary

The Tribunal found that neither the whole site nor any of the individual items could be classed as plant or machinery such as to attract plant and machinery allowances and the appeal was dismissed.

McMillin v HMRC TC00943

Deduction of mortgage interest

Summary

Mr Paul T Stavrou appealed against an amendment to his 2004/05 return and discovery assessments raised against his returns for 2005/06 and 2006/07 relating to interest paid on a loan which the taxpayer claimed was part allowable for his trade and/or property business.

The Facts

Mr Stavrou carries on business as a sole trader selling fish and chips from his shop in North London. He derives trading income from this. His wife assists him in the business but she is not a partner in the business.

There is a flat above the shop which he lets out. He has Property Business income from this in the form of rent.

He bought a house as his main residence in December 2003. The price was £332,000. Completion was on 10 December 2003. This was done with the help of a mortgage from Birmingham Midshires with a mortgage letter to Mr and Mrs Stavrou and the property details were included. There was no mention of any dual purpose.

Tax relief claimed

Interest of £15,095.86 was paid for the period ended 31 March 2005.

Deductions of interest were claimed against the income from the fish and chip business and the rental business for 2004-05, 2005-06 and 2006-07.

The interest paid on the Mortgage was apportioned on the basis that £105,669.75 of the amount borrowed was effectively a replacement of the Business Loan which had been discharged on 9 September 2003. The appropriate proportion of the interest was claimed.

There was no evidence to support or corroborate this.

Findings

The tribunal found that the interest paid on the Midshires Loan did not have a business purpose element and that the new house could not have been purchased without the mortgage finance. The mortgage was not a replacement for refinancing of the business loan. .

Appeal dismissed

P T Stavrou v HMRC TC00937

Work by a sole trader or his company?

John Johnstone (JJ), a sole trader builder, appealed against an assessment for 2005/2006 in respect of omitted sales of £14,214 in relation to an Imperial Homes ("IH") contract, relating to work carried out between March 2004 and April 2005

He contended that the income belonged to Kinnera Homes Limited ("KH"), a property development company of which he personally owned 50% of the shares until 2005 when he purchased the other 50% from Mr Harry Drysdale ("HD").

The Facts

JJ owned land. In February 2003 he and HD, a joiner, decided to develop a site as a speculative development on a joint venture basis. They formed a company, Kinnera Homes Limited ("KH"). JJ owned 50% of the one hundred shares and HD the other 50%.

Land was bought by the company from JJ and developed to build six dwelling houses. JJ and HD, as sole traders, carried out work for KH at their normal charge out rates and KH contracted other trades as required.

In January 2004, an enquiry was made by IH for ‘new build’ properties on their land. In relation to the contract for IH:

- quotation for the work was prepared by JJ as a sole trader
- invoices were raised to IH by JJ
- payments were made to JJ's bank account

JJ stated that the work carried out on this contract was by his sole trading business which paid for all materials and labour and he explained this was then invoiced to KH although when asked to confirm this he stated he was unsure if paperwork ever changed hands between himself and KH.

Submissions by HMRC

HMRC say that the IH contract was carried out by JJ as a sole trader; that there is no evidence of a contract between JJ and KH in relation to this work; that there is no paperwork at all to connect KH to IH; that the original quotation was made by JJ on his sole trading business stationery; that three invoices were raised to IH by JJ again on JJ's stationery; that monies were paid to JJ as a sole trader by KH; that monies were received by JJ in a sole trader's bank account and that JJ correctly recorded the payments as a sole trader.

Findings

JJ kept good bookkeeping records and that the work for the second phase of the IH contract was quoted for by JJ as a sole trader, invoiced by him and the funds were received by him in the same way. There was insufficient evidence to show that the work for IH was as a result of a legal contract with KH.

Appeal dismissed

J Johnstone v HMRC TC00935

Profits assessed following Closure Notice and Discovery assessments

The facts

Mr Sudhan, from Pakistan, started a taxi business having previously worked in a factory. On 13 June 2007 a notice of enquiry was issued under s 9A of the Taxes Management Act 1970. Later, he was issued with a Closure Notice and Discovery Assessments. Mr Sudhan, appealed against a closure notice for 2005-06 and discovery assessments in respect of the years 2003-04, 2004-05, 2006-07 and 2007-08.

The challenge related to the quantum of profits assessed as a result of the closure notice and the discovery assessments.

Mr Sudham’s argument

He argued that the figures used by HMRC for mileage in calculating the assessable profits of his taxi business were incorrect.

The total mileage was a matter of record and had been derived from readings taken by Winchester Council.

The debate concerned the extent of private mileage and the fares likely to have been earned for normal local journeys as well as for airport trips.

Mr Sudhan had not been advised when starting his business that mileage for travel between home and work was to be treated for tax purposes as private mileage and this had led him to give a misleading answer to the original questions from HMRC about mileage.

Private mileage

The Tribunal concluded that the total figure accepted by HMRC for private mileage was relatively generous. Mr Sudhan indicated that he travelled home and back once or twice a week in the middle of his shift for family-related occasions. The Tribunal did not find this convincing, as a break in shift long enough to give time to travel 13 miles and back and to participate in the relevant occasion would take a very large time out of Mr Sudhan's customary evening shift.

Average trip fare

The Tribunal did not consider that the evidence was sufficient to displace the figure of £7.27 estimated by HMRC as the average fare. This was based on an average trip length of 3.2 miles, using the Winchester Council differential rates for the initial and subsequent parts of a journey, and taking into account the additional element where the journey was after 11 pm.

Tips

The difference between HMRC's figure and Mr Sudhan's was £1,381. The Tribunal found that there was nothing in the evidence to justify amending the level of tips assumed by HMRC at 5 per cent of the "total expected fares" figure.

Other factors

Their conclusion was reinforced by a number of other elements of the investigation:

- Substantial amounts were paid into Mr Sudhan's bank account with only limited documentation and vague knowledge of amounts borrowed and inherited
- His takings book contained no odd pence, and certain figures appeared repeatedly persuading the Tribunal that his business records were far less than adequate and questionable as to their accuracy.
- No daily records of income were kept, only a weekly figure.

Findings

The Tribunal confirmed the assessments in the figures reflected in HMRC's review letter dated 1 February 2010, and confirmed the penalties in the amounts shown in that letter.

Khalid M Sudhan v HMRC TC00956

Plumbers Tax Safe Plan – Disclosure scheme for plumbing industry

Plumbers, gas fitters and heating engineers are being targeted by the tax authorities in a clampdown on tradespeople failing to declare their earnings and pay tax.

Under the tax plan, plumbers, gas fitters, heating engineers and members of associated trades who have tax to pay which they have not yet told HM Revenue & Customs (HMRC) about can come forward by 31 May to tell the department of their intention to disclose what they owe. If they make a full disclosure, most face a low penalty rate of 10 per cent, with a maximum of 20 per cent. They have until August 31 to make their disclosure and arrange for payment to be made.

After that date, using information pulled together from various sources, HMRC will carry out targeted investigations aimed at those who have failed to come forward and make a full declaration. Substantial penalties or even criminal prosecution could follow.

The plumbers' tax safe plan (PTSP) is the first initiative in a campaign focused on tradespeople. It is designed to make it easy for those in the plumbing industry to put their tax affairs right - and keep them that way.

Mike Wells, HMRC's Director of Risk and Intelligence, said:

"Our aim is to make it as easy as possible for plumbers to come forward, make a full disclosure and benefit from a reduced penalty.

"We will be using various intelligence sources to target plumbers who have not declared their full income. I strongly urge any in this group who think they may owe tax on their income to get in touch with HMRC and get their tax affairs in order simply and on the best available terms.

"This is the first step in enabling those with undisclosed income or gains to avoid a full tax investigation with much higher penalties. The message is clear: contact us before we contact you."

The tax plan operates in two stages:

- From 1 March to 31 May, plumbers can register with HMRC to "notify" that they plan to make a voluntary tax disclosure.
- By 31 August, those who have registered must have told HMRC about tax due and have made arrangements to pay any tax interest and penalties due. This is called "making a disclosure".

How do plumbers let HMRC know that they intend to make a tax disclosure?

- Online by completing a notification form at **www.hmrc.gov.uk/plumberstaxsafeplan**
- Ring HMRC on 0845 600 4507 begin_of_the_skype_highlighting 0845 600 4507 end_of_the_skype_highlighting

A dedicated team will be on hand to help.

The benefit of the Plumbers Tax Safe Plan is that those who make a full disclosure:

- Will be offered a simple and straightforward way to put their tax affairs right; and
- Will be charged a low penalty rate - (10 per cent for most who sign up, with a maximum rate of 20 per cent).

HMRC Press Release, 01/03/2011

Corporation tax

A dividend checklist *(Lecture B643 – 8.46 minutes)*

Since the 1990s, it has been a common occurrence for proprietors of private companies to extract their profits by way of dividend, with many businesses now making distributions on a quarterly or even a monthly basis.

From time to time, these arrangements are challenged by HMRC who typically seek to argue that the payment represents earnings under S62 ITEPA 2003 rather than a distribution of profits. In order to avoid this problem, it is essential for companies to ensure that the proper procedure for declaring and paying dividends has been adhered to.

The dividend must be lawful

S830(1) Companies Act 2006 states that 'a company may only make a distribution out of profits available for the purpose'. The word 'profits' is defined in S830(2) Companies Act 2006 as a company's 'accumulated realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made'.

It is important for shareholder directors to appreciate that, even if the bank balance is in credit, the company still needs to have sufficient retained profits to cover the amount of the dividend at the date of payment.

Any dividend paid in excess of this amount is ultra vires and therefore unlawful. Accordingly, the company's financial status must be checked on the occasion of each payment – no interim dividend should be paid out beyond the level of any profits shown in the company's management accounts. Remember that full annual accounts are not required for the calculation of an interim dividend – in Para CTM20095 of the Company Taxation Manual, HMRC state that the accounts used must be those which 'enable a reasonable judgment to be made as to the amount of the distributable profits' (see also S839(1) Companies Act 2006).

It is not uncommon for HMRC to claim that shareholder directors of private companies which have broken the rules were aware (or at least had reasonable grounds to believe) that a dividend payment was unlawful.

The main consequence of such persons receiving unlawful dividends is that they are required to repay the relevant amount to the company – see S847 Companies Act 2006. This point is often picked up when an insolvent company goes into liquidation, given that the liquidator will routinely review the actions of the company's shareholder directors over the three years prior to the start of the winding up.

HMRC will frequently be the company's largest unsecured creditor and, if the liquidator can recover additional funds, this will normally be for the benefit of the creditors.

A recent example is the case of *First Global Media Group Ltd v Larkin (2003)* which one commentator has suggested should be read by all tax advisers in order to 'appreciate how far HMRC will go in this matter'.

Declaration of dividends

By virtue of article 30 of the Companies Act 2006 Model Articles (which have replaced Table A for companies registered on or after 1 October 2009), directors can authorise the payment of interim dividends, but final dividends have to be approved by ordinary resolution of the members (ie. a simple majority). Following the enactment of the Companies Act 2006, this can be done in writing – meetings are no longer required.

Dividend payment dates

Dividends are treated as paid on the date on which an enforceable debt is created. For a final dividend, the relevant date is the date of declaration, unless a later date is specified. However, because an interim dividend can be varied or rescinded at any time before payment, it will only be regarded as due and payable when it is actually paid – see the decision in *Potel v CIR (1970).*

Dividend vouchers

A single dividend voucher covering the whole of the tax year is permissible. Dividend vouchers do not have to be presented at the time of payment.

Contributed by Robert Jamieson

Value Added Tax

Does planning restriction prevent zero rating?

Messrs Trathen and Goode purchased apartments from Mangogrove. They alleged that Mangogrove ought to have zero-rated those supplies, on the ground that the supplies were first grants of major interests in land by a person constructing a building designed as a number of dwellings (see VAT Act 1994, Sch 8, Group 5, Item 1). HMRC took the view that the supplies were not zero-rated by Item 1, since Note 13 to Group 5 prevented zero-rating where "the use of the building or part as the grantee's principal private residence, is prevented by the terms of a covenant, statutory planning consent or similar permission".

It was HMRC's case that use as a principal private residence was precluded by a planning condition that "the development hereby permitted shall be used for holiday purposes only and shall not be used for permanent residential accommodation". Part of the information about the planning permission stated that "The definition of "holiday purposes" implies the accommodation should only be used for holiday accommodation throughout the year … The accommodation should not be a person's main or sole residence."

Nonetheless, the appellants relied on *Frost v Feltham* [1981] STC 115 – a direct tax case on mortgage interest relief in which a pub licensee lived at a property only a few days each month but which was held to be his main residence – and *Livingstone Homes UK Ltd* 16649, in which the VAT Tribunal decided a case on this point in the appellant's favour, stating that "The two states of use, namely as a holiday dwelling house or as a grantee's principal private residence are not in our view mutually excluded and they are not in our view incompatible."

However, the Tribunal preferred the decisions in *Loch Tay Highland Lodges Ltd* 18785 and *Herling Ltd* TC00205, to the effect that designation as a holiday home precludes use as a principal private residence. The Tribunal agreed the several examples to prove that point given in *Loch Tay* and added this:

> "The only other example we can think of is where the person had an entirely peripatetic work pattern constantly visiting sites throughout the country staying in hotels or bed and breakfast establishments including at weekends as he was too far to travel home, and owning only a holiday home where he spent holidays. He would have no other residences and the holiday home might be the person's principal private residence (in Note 13) and not be permanent residential accommodation [as in the planning condition which applied in Mangogrove's case]. We would regard the possibility of such an example existing as *de minimis* and would ignore it."

The appeal was therefore dismissed.

David Trathen and Vaughan Goode; Mangogrove Ltd (third party) TC898

VAT treatment of commercially operated sports leagues

HMRC confirm that supplies made by commercial sports league providers are liable to the standard rate of VAT. If sports league providers feel they have been mislead by previous advice from HMRC officers, and they fulfil certain criteria, they should contact HMRC's Complaints Team.

It has been issued in response to enquiries from a number of organisations that run football leagues. The brief reflects what HMRC's policy has always been.

Background

There are a number of commercial organisations that run football and other sports leagues ("sports league providers") offering to do most or all of the following—

- organise a league
- allocate fixtures to teams in the league

- provide pitches for teams to play on (some league providers own pitches, others rent them from other parties)
- provide referees
- determine results
- keep and publish scores and league tables
- award trophies to winning teams

Payments for such supplies are collected in a variety of ways. The sports league provider may charge a one off "admin fee" to teams plus a "match fee" for each game that is played.

VAT liability

Some sports league providers have suggested that they are making supplies of land of a kind that are exempt under Group 1, Sch 9 of the VAT Act 1994 (they rely on Note 16 to Group 1 which allows a series of lets of sports pitches to be exempt, subject to certain conditions). They consider that the essential nature of their supplies is one of pitch hire.

HMRC disagrees with this analysis. We consider that the supplies made by sports league providers consist of a bundle of elements, which are integral to each other, but that it cannot be said that there is one principal element to which all others are ancillary. In these circumstances, it is necessary to establish the character of the overarching supply to determine whether it falls within the exemption. In HMRC's view, the overarching supply is of participation in a sports league, not a supply of land.

It is therefore HMRC's view that the supplies made by commercial sports league providers are liable to the standard rate of VAT.

However, supplies made by certain non-profit making bodies may fall within the Group 10 sports exemption. For details of the conditions that must be met for the Group 10 exemption to apply, please see Notice 701/45 Sport.

Claims of misleading advice by HMRC

Some sports league providers have asked HMRC to consider whether they have been in receipt of misleading advice from HMRC officers in the past relating to the liability of their supplies. Such cases must be considered on an individual basis by the appropriate Complaints Team. We would recommend sports league providers to contact their Complaints Team if they—

- consider that they have been misled by HMRC in relation to the liability of supplies
- have acted in accordance with the misleading representation
- would suffer real detriment if VAT was to be collected for past supplies

For information about our complaints procedure, go to www.hmrc.gov.uk, and under "quick links", select "Complaints".

HMRC Brief 04/2011 9 February 2011

Single or separate supplies for using 'play-barn'

The taxpayer owned a barn, which she rented out as "The Play Barn". It resembled a sports hall with sports pitches marked out on the floor. It also contained a small reception area, a dining room, and other facilities. The taxpayer used the barn to hold children's parties, at which she provided refreshments, use of play equipment and other services. She advertised a fixed price per child for use of the barn, which included the refreshments. The taxpayer claimed repayments of VAT but the respondent Revenue and Customs Commissioners contented that no repayments were payable. Proceedings took place before the first-tier tribunal (see [2009] UKFTT 298 (TC)). The first tier tribunal analysed the service provided by the taxpayer into six component elements, and then held that there had been two principal supplies, namely the use of the hall and the provision of refreshments, to one or both of which the other elements were ancillary. The Revenue appealed, arguing inter alia that there had been a single supply for VAT purposes.

It was settled law that where the transaction under consideration prima facie involved more than one identifiable supply, neither of which could be regarded merely as ancillary to the other, the correct tax treatment still depended on whether, from an objective view, they formed a single indivisible economic supply which it would be artificial to split. The determination of the question depended upon a global assessment of all facts relevant to the transaction under which the supply or supplies took place. That was the taxable event. That included a consideration of the terms upon which the supply or supplies were made, how they were invoiced and what the consumer in fact acquired under the contract. Every supply of a service would normally be regarded as distinct and independent. However, a transaction which formed a single supply from an economic point of view should not artificially be split into separate supplies. The fact that one element in a package supplied could not be described as ancillary to another element did not mean that it was to be regarded as a separate supply. The question was whether those separate elements were to be treated as separate supplies or merely as elements in some over-arching single supply. It was important to take an overall view at the level of generality that corresponded with social and economic reality. The assessment should be made from the perspective of the customer, as a typical consumer, not the supplier. The fact that a single price was charged for two or more elements was a relevant factor pointing to single supply, but it was not decisive. The test was not whether the different elements in the services provided by the taxpayer to its customers had value and utility in their own right.

In the circumstances, from the perspective of the customer, what was supplied was a group of facilities for a children's party, provided as a single supply. It was not correct to refer to it as the supply of a children's party, since no organisation or supervision of the children was provided by the taxpayer. It was trite to observe that a party for children would almost invariably involve the provision of some food and drink, and would often benefit from some play equipment. There were significant connecting elements between the use of the play barn and the provision of refreshments. Finally, all the various elements were available only as a single package at one all-inclusive price. Accordingly, it would be an artificial definition to characterise the transaction as separate supplies for VAT purposes.

The appeal would be allowed, the decision of the tribunal would be set aside, and the decision of the Revenue refusing to make the claimed repayments of output tax claimed by the taxpayer would be restored.

Revenue and Customs Comrs v David Baxendale Ltd [2009] All ER (D) 359 (Jul) applied.

Revenue and Customs Comrs v Bryce (t/a The Barn) [2010] UKUT 26 (TCC)

HMRC's position following the case of John Price

This Brief explains HMRC's policy following the First Tier Tribunal decision in the case of John Price (TC/2010/01287). The Tribunal agreed with the appellant that roller blinds were “building materials” and the VAT could be recovered under the DIY Housebuilders and Converters VAT Refund Scheme.

This Brief explains HM Revenue & Customs' (HMRC) policy following the First Tier Tribunal decision in the case of John Price (TC/2010/01287).

The Tribunal agreed with the appellant that roller blinds were “building materials” as defined by Note 22 to Group 5 of Sch 8 to the VAT Act 1994. As a result, the appellant was entitled to treat the VAT incurred on the purchase of the blinds as recoverable from HMRC under the provisions of the DIY Housebuilders and Converters VAT Refund Scheme (s 35 of the VAT Act 1994).

HMRC's position

HMRC's view remains unchanged in that roller blinds (and other “window furniture”) are not “building materials” as defined and will not be changing its policy. The Tribunal chairman did not hear any evidence on the point of what is and what is not a “building material” for VAT purposes but reached his conclusion as a matter of judicial notice, that is, as a common sense fact.

Given the small amount of VAT at stake in this particular case, HMRC will not be appealing this decision further.

Background

The construction of residential property is zero-rated for VAT purposes. The zero rate not only applies to the construction services but also to the "building materials" incorporated into the property by the person(s) supplying those construction services.

It has never been HMRC's policy that the zero rate should apply to all goods that were incorporated into residential property by builders during its construction. Their policy has always been to restrict the zero rate to those basic materials such as bricks, mortar, timber, glass etc., that make up the structure of a property and to those standard fittings and fixtures such as kitchen units, work surfaces, sinks and draining boards, wash hand basins, baths and toilets that enable the property to function.

To achieve the above result, "building materials" have been defined in law as meaning, in relation to any description of building, "goods of a description ordinarily incorporated by builders in a building of that description (or its site)". Certain goods are specifically excluded from the definition, for example, fitted furniture, electrical and gas appliances but with some exceptions made for kitchen furniture, boilers etc.

DIY house builders, to the extent that they purchase building materials and use their own (or others') labour to incorporate those materials into their properties, are unable to benefit from the above zero rate on "building materials". However, they can claim the VAT incurred on the purchase of those materials through a refund scheme. The restriction on the zero rate for building materials noted above also restricts the amounts of VAT recoverable through the refund scheme.

Flat Rate Scheme and bank interest *(Lecture B645 – 25.34 minutes)*

In a recent article, Neil Warren and Mike Thexton explained a number of areas in which they believed the VAT Flat Rate Scheme for small businesses can cause uncertainty and problems. They took a discussion paper to the HQ of the Flat Rate team in Liverpool and talked it over with them.

One of those issues was the question of whether bank interest received by a small company should be charged to the FRS as "exempt business income". They were adamant that it should be: to be helpful, they have clarified their view in the new version of Notice 733 which was issued on 1 April 2009. It now expressly includes "bank interest on a business account" at para.6.2 as an example of exempt income that must be included in FRS turnover and therefore subject to a payment of VAT in Box 1. In the previous version of the Notice there was no reference to interest.

Mike believed that interest on a bank account is not "consideration for an exempt supply" when received by a small company, but rather passive income that is earned in the capacity of a mere investor. It is therefore outside the scope of VAT, and should be excluded from the FRS.

In a lengthy appeal process, which Mike explains in this month's seminar, the First Tier Tax tribunal considered the position of bank interest. Two companies were involved in two separate cases that were heard at the same time.

1. Fanfield held modest sums of interest on fixed term deposits to present better a balance sheet. They originally accounted for flat-rate VAT on interest, but later sought repayment
2. Thexton Training who held a deposit account which was operated in passive manner with only seven transfers out over four years, three of which were to settle corporation tax bills.

The argument put forward was that interest, in these circumstances, was outside the scope of VAT as it not arise in the course of or furtherance of business.

The Tribunal agreed. Such interest did not form part of relevant turnover for the flat rate scheme.

Fanfield Ltd v HMRC

Thexton Training Ltd v HMRC TC00919