CONTENTS

BUDGET 2011		**3**
(Lecture P646 – 20.31 minutes)		**3**
(Lecture B646 – 22.13 minutes)		**3**
PERSONAL TAX		**17**
Class 1 on contributions into FURBS?		**17**
A curious case of inducement	**(Lecture P647 – 8.56 minutes)**	**17**
Entertainers on Equity contracts employees for NI		**18**
Jointly held property		**20**
Employment income deductions		**20**
Should advice take into account a client's ill health?		**22**
Freezing injunction		**23**
Meaning of 'connected person' for EIS	**(Lecture B648 – 6.51 minutes)**	**24**
Interest Relief on loans to close companies	**(Lecture B649 7.03 minutes)**	**25**
CAPITAL TAXES		**27**
Practical points on the new CGT regime	**(Lecture P648 – 30.51 minutes)**	**27**
CGT and foreign currency	**(Lecture P649 – 20.41 minutes)**	**30**
Earn outs – a current perspective	**(Lecture B647 – 13.12 minutes)**	**32**
Valuing shares for CGT		**34**
Voidable dispositions		**34**
ADMINISTRATION		**36**
Validity of assessments on royalty payments		**36**
Increased penalties	**(Lecture P650 – 6.15 minutes)**	**37**
BUSINESS TAXES		**39**
Drawings and unrecorded expenditure claimed as wages		**39**
Whose money is it?		**39**
Thin capitalisation—legislation compatible with European law		**40**
Deduction for amortised goodwill		**41**
VALUE ADDED TAX		**43**
Flat rate scheme (FRS) – what goes in BOX 6?	**(Lecture B650 – 26.29 minutes)**	**43**
Applies only to buildings completed on or after 1 March		**44**
Brief 16/11 covers interim application		**44**

Disclaimer
Reed Elsevier (UK) Limited takes every care when preparing this material. However, no responsibility can be accepted for any losses arising to any person acting or refraining from acting as a result of the material contained in these notes.

All rights reserved. No part of these notes may be reproduced or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of Reed Elsevier (UK) Limited

Budget 2011 (Lecture P646 – 20.31 minutes) (Lecture B646 – 22.13 minutes)

Note: It must be remembered that these proposals are subject to amendment.

PERSONAL TAXATION	2011/12	2010/11
Personal allowance		
general	£7,475	£6,475
personal allowance income limit	£100,000	£100,000
aged 65 or over in tax year	£9,940	£9,490
aged 75 or over in tax year	£10,090	£9,640
age allowance income limit	£24,000	£22,900
minimum where income exceeds limit	£7,475	£6,475
Married couple's allowance (10% relief)		
either partner aged 75 or over in tax year	£7,295	£6,965
age allowance income limit	£24,000	£22,900
minimum where income exceeds limit	£2,800	£2,670
Blind person's allowance	£1,980	£1,890
Income tax rates		
Starting savings rate	10%	10%
on income up to	£2,560*	£2,440*
Basic rate	20%	20%
on taxable income up to	£35,000	£37,400
Higher rate	40%	40%
on taxable income over	£35,000	£37,400
Additional rate	50%	50%
on taxable income over	£150,000	£150,000
Lower rate on dividend income	10%	10%
Higher rate on dividend income	32.5%	32.5%
Additional rate on dividend income	42.5%	42.5%
Pension schemes allowances		
Annual allowance	£50,000	£255,000
Lifetime allowance	£1,800,000	£1,800,000
ISAs		
overall limit	£10,680	£10,200
cash limit	£5,340	£5,100

*Starting rate applies only to savings income. If taxable non-savings income is above this limit, the starting rate is not applicable.

COMPANY TAXATION	FY2011	FY2010
Corporation tax rates		
All companies (except below)	26%	28%
Companies with small profits	20%	21%
— 20 / 21% rate limit	£300,000	£300,000
— marginal relief limit	£1,500,000	£1,500,000
— marginal relief fraction	3/200	7/400
— marginal rate	27.5%	29.75%

CAPITAL GAINS TAX	2011/12	23.6.10–5.4.11
Rate — standard rate	18%	18%
— higher rate	28%	28%
— trustees and personal representatives	28%	28%
— entrepreneurs' relief rate	10%	10%
General exemption limit	£10,600	£10,100

INHERITANCE TAX	Transfers after 5/4/2009
Threshold	£325,000
Death rate	40%

VAT	
Standard rate after 3 January 2011	20%
Standard rate 1 Jan 2010 to 3 Jan 2011	17.5%
Registration threshold after 31 March 2011 (previously £70,000 after 31 March 2010)	£73,000

NATIONAL INSURANCE 2011/12

(2010/11 in brackets where different)

Class 1 contributions

Not contracted out

The employee contribution is 12% (11%) of earnings between £139 (£110) and £817 (£844) p.w. plus 2% (1%) of all earnings above £817 (£844) p.w. The employer contribution is 13.8% (12.8%) of all earnings in excess of the first £136 (£110) p.w. Between £102 (£97) and £139 (£110) p.w., no employee contributions are payable but a notional contribution is deemed to have been paid to protect contributory benefit entitlement.

Contracted out

The 'not contracted out' rates for employees are reduced on the band of earnings from £102 (£97) p.w. to £770 p.w. by 1.6%. For employers, they are reduced on the band of earnings from £102 (£97) p.w. to £770 p.w. by 3.7% for employees in salary-related schemes or 1.4% for employees in money purchase schemes.

Class 1A and 1B contributions	13.8% (12.8%)
Class 2 contributions	
Flat weekly rate	£2.50 (£2.40)
Exemption limit	£5,315 (£5,075)
Class 3 contributions	
Flat weekly rate	£12.60 (£12.05)

Class 4 contributions

9% (8%) on the band of profits between £7,225 (£5,715) and 42,475 (£43,875) *plus* 2% (1%) on all profits above £42,475 (£43,875).

ADMINISTRATION OF TAX

Security for PAYE and National Insurance Contributions

HMRC will have the power to make regulations enabling them to require a security from employers for PAYE and National Insurance contributions considered seriously at risk of non-payment. Non-payment of a security will be a criminal offence liable to a fine.

The most common form of security is a cash deposit held by HMRC or paid into a joint HMRC/taxpayer interest-bearing banking facility. A security can also be a third party guarantee provided by an approved financial institution, normally a bank.

Subject to consultation responses, the aim is to implement the policy on 6 April 2012.

© Reed Elsevier (UK) Limited

PERSONAL TAX

Rates and Allowances for 2012/13

For 2012/13 the personal allowance for those under 65 will be increased to £8,105, and there will be a reduction in the basic rate limit to £34,370. All other income tax personal allowances and limits subject to indexation will be increased in line with the Retail Prices Index.

Furnished Holiday Lettings

Legislation will be introduced in Finance Act 2011 to amend the tax treatment of furnished holiday lettings (FHL) as follows. The changes have effect on and after 1 April 2011 for companies and on or after 6 April 2011 for individuals and partnerships, unless indicated otherwise:

FHL in both the UK and the European Economic Area (EEA) will be eligible as qualifying FHL. This treatment is currently non-statutory;

- the minimum period over which a qualifying property must be available for letting to the public in the relevant period will be increased from 140 days to 210 days in a year with effect from April 2012;
- the minimum period over which a qualifying property is actually let to the public in the relevant period will be increased from 70 days to 105 days in a year with effect from April 2012;
- losses made in a qualifying UK or EEA FHL business may only be set against income from the same UK or EEA FHL business; and
- a 'period of grace' will be introduced to allow businesses that do not continue to meet the 'actually let' requirement for one or two years to elect to continue to qualify throughout that period.

Income Tax and National Insurance Contributions Reform

The Government is to consult on options to integrate the operation of income tax and National Insurance contributions (NICs). A consultation document is to be published later in 2011 setting out current differences and options to address them. The contributory principle of NICs is to be retained and NICs will not be extended to those over state pension age or to additional forms of income.

Non-domicile Taxation

Changes are to be introduced to the tax regime for non-UK domiciled individuals. The Government intends to implement the changes with effect from April 2012 following consultation on the detail. The changes will include removing the tax charge on remittances of income or capital gains to the UK for the purposes of commercial investment and introducing a higher £50,000 annual charge for individuals who have been UK resident for 12 years or more who claim the remittance basis.

Statutory Residence Test

The Government is to consult on the introduction of a new statutory definition of residence. A consultation document will be published in June 2011 with the intention of implementing the definition from April 2012.

EMPLOYMENT TAX

Company Car Benefits

For 2011/12 the multiplier used to calculate the taxable benefit of free fuel for company cars is increased to £18,800.

For 2013/14 onwards, the percentages used to calculate the taxable benefit of a company car will be increased by one percentage point for all cars with carbon dioxide emissions between 95g/km and 220g/km.

Approved Mileage Allowance Payments

Regulations will be laid immediately to increase, from 6 April 2011, the rate of approved mileage allowance payments for cars and vans from 40 pence to 45 pence for the first 10,000 miles of

business travel in a tax year. HMRC guidance will also be updated to permit an allowance for passenger payments currently in place for employees at a rate of 5 pence per passenger per mile to be extended to volunteers.

Employer-supported Childcare

Finance Act 2011 will restrict the level of income tax relief available to higher rate and additional rate taxpayers so that it matches the amount available to basic rate taxpayers. This will be achieved by reducing the monetary value of the income tax exemption for higher rate and additional rate taxpayers.

For those joining employer-supported childcare (ESC) schemes on or after 6 April 2011, the income tax exemption will be limited as follows:

- basic rate taxpayers, £55 per week;
- higher rate taxpayers, £28 per week; and
- additional rate taxpayers, £22 per week.

The change will apply only to individuals who join ESC schemes on or after 6 April 2011. Those who were members of ESC schemes prior to that date will be unaffected by the change.

National Insurance: Reduction in the Contracting Out Rebate

The contracted out rebate for defined benefit schemes is to be reduced for 2012/13 onwards from 3.7% to 3.4% for employers and from 1.6% to 1.4% for employees.

BUSINESS TAX

IR35 Review

In response to the Office of Tax Simplification's proposals, the Government has decided to retain IR35 but improve the way it is administered. Changes will aim to provide greater pre-transaction certainty, greater clarity through publishing guidance on the types of cases HMRC believe to be outside the scope of IR35, limit reviews to high-risk cases carried out by specialist teams and establish an IR35 forum to promote more effective engagement with interested parties.

CAPITAL ALLOWANCES

Annual Investment Allowance: Reduction to £25,000

The maximum amount of Annual Investment Allowance, which enables businesses to claim full tax relief on most plant and machinery expenditure in the year it is incurred, is to be reduced from £100,000 to £25,000. The decrease in the limit will apply from 1 April 2012 for businesses within the charge to corporation tax and 6 April 2012 for businesses within the charge to income tax.

Transitional rules will apply to businesses that have a chargeable period that spans the operative date of the decrease.

Writing-down Allowances: Reduction from April 2012

Finance Act 2011 will introduce legislation to reduce the rate of writing-down allowance (WDA) on the main rate pool of plant and machinery expenditure from 20% to 18%. The rate of WDA on the special rate pool of plant and machinery expenditure will be reduced from 10% to 8%. The provisions will have effect for chargeable periods ending on or after 1 April 2012 for corporation tax, and on or after 6 April 2012 for income tax. Businesses whose chargeable period spans the date of the change will have a hybrid rate for the whole of that transitional chargeable period, calculated on a pro-rata basis. Oil and gas ring-fence activities will retain their existing capital allowances treatment.

Short-life Assets

Legislation will be introduced in Finance Act 2011 to enable businesses incurring expenditure on an item of plant or machinery from April 2011 onwards to make a short-life asset election in respect of that item if they expect to sell or scrap it within an eight-year cut-off period. This is an extension from the current four year period.

Enhanced Capital Allowances for Energy-saving Technologies

The list of technologies which qualify for enhanced capital allowances will be amended to include certain energy-efficient hand dryers. The criteria for automatic monitoring and targeting equipment will also be revised. The changes will have effect on and after a date to be appointed by Treasury Order to be made prior to the summer 2011 Parliamentary recess.

Generating Equipment

The Government is proposing to introduce legislation to clarify the capital allowances treatment of generating equipment installed by businesses under the feed-in-tariffs and renewable heat incentive schemes. A consultation document is to be issued in May 2011.

Enterprise Zones

The Government has announced the creation of 21 new Enterprise Zones.

Anti-avoidance

Current capital allowances anti-avoidance legislation applies to transactions where the sole or main benefit is one of obtaining an allowance. The Government intends to change this test to one that is in line with effective anti-avoidance tests elsewhere in the Taxes Acts.

Fixtures Mandatory Pooling

The Government will consult on plans to introduce changes to the capital allowances fixtures rules requiring that businesses must pool their expenditure on fixtures in a building within a short period of acquiring the building, in order to qualify for capital allowances.

CORPORATION TAX

Reduction in Main Rate

Legislation will be introduced in the Finance Act 2011 to reduce the main rate of corporation tax for all non-ring fence profits from 28% to 26% for the financial year beginning 1 April 2011, and from 26% to 25% for the financial year beginning 1 April 2012. The main rate for ring fence profits will remain at 30%.

Reduction in Small Profits Rate

The small profits rate of corporation tax for all non-ring fence profits will be reduced from 21% to 20% for the financial year beginning1 April 2011. The small profits rate for ring fence profits will remain at 19%.

Reform of Associated Companies Rules

The threshold at which the small profits rate applies is proportionally reduced depending upon the number of associated companies (i.e. companies under common control) there are in a group. For accounting periods ending on or after 1 April 2011, legislation will ensure that when establishing control of a company, HMRC will not attribute to an individual all the rights and powers of a person's relatives unless there is 'substantial commercial interdependence' between the companies in question. This legislation will put a long-standing concession (ESC C9) on to a statutory footing and extend it to all relatives.

Taxation of Foreign Branches

With effect for accounting periods commencing on or after Royal Assent to Finance Act 2011, UK resident companies may opt for their foreign branches to be exempt from UK corporation tax. No relief will be available for foreign branch losses (subject to transitional arrangements that will ensure that any outstanding loss relief claimed in the last six years is recaptured by the Exchequer). The election will apply to all foreign permanent establishments and will be irrevocable.

Other significant features include anti-avoidance provisions, a profit entry limit, and restriction to profits from full treaty partner jurisdictions for small companies. The exemption will apply to some, but not all, life insurance companies.

Research and Development

For expenditure incurred on or after 1 April 2011, and subject to EU state aid approval, the additional corporation tax deduction for qualifying research and development (R&D) expenditure given to small or medium enterprises (SMEs) will increase from 75% to 100% (giving a total deduction of 200%). The rate of Vaccine Research Relief for SMEs will be reduced to 20% from the same date.

The Government also intends from 1 April 2012 to:

- increase the SME relief by a further 25% (to 225%), again subject to state aid approval; and
- abolish Vaccine Research Relief for SMEs.
- The Finance Act 2012 will:
- simplify R&D tax relief rules for SMEs, including the abolition of the £10,000 minimum expenditure condition and the limitation to PAYE and National Insurance contributions paid; and
- make changes to the rules governing the provision of relief for work done by subcontractors under the large company scheme.

Interim Controlled Foreign Company Reform

Legislation will be introduced in Finance Act 2011 to deliver a package of interim improvements to the controlled foreign company rules as a first step to making the rules more competitive ahead of full reform in 2012.

Capital Losses after Change of Ownership (Simplification)

From the date of Royal Assent to Finance Act 2011, capital losses realised before a change in ownership of a company may only be used against gains arising on assets used in the same business that the company conducted before joining the group. (Currently this restriction applies to both realised and unrealised gains and such gains can only be offset against gains on assets used in the same trade.)

Companies will be able to elect whether restricted 'pre-entry losses' or other losses have been allowed against gains. The circumstances in which restricted losses may be utilised are to be extended. Once a loss has become subject to restriction then the same restriction continues to apply should the company subsequently join another group.

Where a loss on the disposal of an asset after a company joined a group is subject to restriction under the current rule, then it will be treated as one that arose before the company joined the group for the purposes of the amended rules.

Degrouping Charge

For companies leaving groups on or after the date of Royal Assent to Finance Act 2011, the following changes are to be made to the operation of the degrouping charge:

- where a company leaves a group as a result of a disposal of shares by a group company, any degrouping charge will be made by way of an adjustment to the chargeable gain or allowable loss on the share disposal; consequently any exemption or relief that may apply to the share disposal (e.g. substantial shareholding exemption (SSE)) will also apply to the degrouping charge; alongside this amendment the SSE rules will be amended so that (for disposals on or after the date of Royal Assent to Finance Act 2011) they will apply when trading activities are transferred to a newly incorporated group company which is then sold out of a trading group;
- the degrouping charge may be reduced where it is just and reasonable to do so, taking into account the amount of share capital of the companies being sold, and the circumstances under which the company leaving the group acquired the asset which gives rise to the charge;
- the associated companies exception will be clarified to ensure that no degrouping charge will be triggered in respect of an asset that has been transferred between two companies belonging to the same sub-group if those companies leave the group together (identical provisions will also be introduced for intangible assets);

- the facility to roll over a degrouping charge on the acquisition of a replacement asset will be repealed; and
- the current rules permitting an election to be made to reallocate a gain or loss to another group company will be extended so that they can also apply to a stand-alone degrouping gain or loss. As a result of this, the specific facility to transfer a degrouping charge between group companies will be repealed.

In addition, anti-avoidance provisions have been announced which will apply where a company leaves a group on or after 23 March 2011. These provisions target avoidance using the current associated companies exception, and will ensure that the degrouping charge cannot be avoided by a series of transactions undertaken within a group before a disposal.

Corporate Capital Gains: Value Shifting (Simplification)

Legislation will be introduced in Finance Act 2011 to simplify anti-avoidance rules applying to the computation of corporate capital gains and losses. Value shifting provisions increase the consideration used to compute a gain or loss on the disposal of an asset if a scheme has reduced the asset’s value and confers a tax advantage. The proposed legislation will replace existing value shifting provisions with a new targeted anti-avoidance rule. It will also only require a loss computation on a company share disposal for the effect of depreciatory transactions if it takes place less than six years before the sale. The measure will have effect where companies dispose of shares or securities on or after the date that Finance Act 2011 receives Royal Assent.

Loan Relationships and Derivative Contracts (Disregard) Regulations

The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256) provide that, in certain circumstances, the debits and credits on a company’s loan relationships and derivative contracts are not brought into account for tax purposes until some later time. The foreign exchange gains and losses on the loan relationship or derivative contract are matched with the equal and opposite foreign exchange gains and losses on the foreign exchange asset, and are not brought into account until the foreign exchange asset is disposed of. At present, the rules on the matching of share capital do not provide for tax to follow the economic outcome where companies invest in foreign currency assets through a partnership, or where a company sells foreign currency shares but expects to receive the proceeds at a later date.

The Regulations will be amended to allow companies to be taxed on the basis of the economic outcome where they issue foreign currency preference share capital to raise foreign currency finance, invest directly in foreign currency partnerships or in foreign currency assets through a partnership, or agree to sell foreign currency shares and receive the proceeds at some future date. The changes relating to foreign currency preference shares and the net asset value of foreign currency shareholdings will take effect for accounting periods beginning on or after 1 July 2011.

The changes relating to investment in foreign currency partnerships, and the future disposal proceeds of foreign currency shares, will take effect for accounting periods beginning on or after 1 January 2012.

Amendments to the Tax Treatment of Financing Costs and Income

The ongoing consultation on the debt cap rules has identified practical issues with their application that need to be addressed. The Government will conduct informal consultation with stakeholders. Following this further consultation, legislation will be published in draft in autumn 2011 and introduced in Finance Act 2012. The legislation will aim to allow businesses to more easily apply the debt cap rules.

Consultation on Devolving Corporate Taxation to Northern Ireland

The Government is working with the Northern Ireland Executive to rebalance the Northern Ireland economy and on 24 March 2011 will publish a consultation paper looking at mechanisms for devolving the rate of corporation tax to the Northern Ireland Executive.

Patent Box

The Government proposes to introduce a 10% rate of corporation tax for profits arising from patents, effective from 1 April 2013. A consultation document will be published in May 2011.

CAPITAL GAINS

Increase in Lifetime Limit for Entrepreneurs' Relief

The lifetime limit on gains qualifying for capital gains tax entrepreneurs' relief will be increased from £5m to £10m for qualifying disposals on or after 6 April 2011.

Rollover Relief and the Single Payment Scheme

Legislation is to be introduced to restore the availability of capital gains tax rollover relief for payment entitlements under the EU single payment scheme. The current legislation has become ineffective following the replacement of the relevant EU Directive in January 2009.

INHERITANCE TAX

Reduced Rate

The rate of inheritance tax will be reduced from 40% to 36% for deaths on or after 6 April 2012 where at least 10% of a deceased's net estate is left to charity.

SAVINGS AND INVESTMENTS

Enterprise Investment Scheme and Venture Capital Trusts

Subject to state aid approval, Finance Act 2011 will introduce legislation to increase the income tax relief given under the Enterprise Investment Scheme (EIS) from 20% to 30% of the amount subscribed for shares from 6 April 2011. In addition, with effect from 6 April 2012, Finance Act 2012 will increase the:

- employee limit to fewer than 250 employees for both EIS and Venture Capital Trusts;
- size threshold to gross assets of no more than £15m before investment for both schemes;
- maximum annual amount that can be invested in an individual company to £10m; and
- annual amount that an individual can invest under EIS to £1m.

Finance Act 2012 will also introduce legislation providing that companies whose trade consists mainly of feed-in tariffs or similar subsidies will only be able to benefit from the schemes for shares issued from 23 March 2011 where commercial electricity generation commences before 6 April 2012.

Introduction of Junior ISAs

The Government plans to introduce a Junior ISA, which is expected to be available from autumn 2011. They will be available to UK resident children aged under 18 who do not have a Child Trust Fund account and will be tax-relieved.

Qualifying Time Deposits

With effect from 6 April 2012, taxable interest on new qualifying time deposit accounts will suffer deduction of income tax at source.

PENSIONS

Reduction in Annual Allowance and Lifetime Allowance

Although there are no limits to how much can be saved in registered pension schemes, there is an overall limit on the total amount of an individual's tax-relieved annual pension savings (including any employer contributions), known as the annual allowance. There is also an overall limit on the total amount of tax-relieved pension savings that an individual can have in his or her lifetime, known as the lifetime allowance. In both cases, tax charges apply if the allowance is exceeded.

The annual allowance is to be significantly reduced from £255,000 to £50,000 for 2011/12 onwards. The lifetime allowance is to be reduced from £1.8m to £1.5m from 6 April 2012.

© Reed Elsevier (UK) Limited

There are also a number of other changes to the annual allowance rules for 2011/12 onwards as follows.

- The rate of the annual allowance charge (currently 40%) will be the individual's marginal tax rate.
- The method of computing pension savings (to be measured against the annual allowance) alters for defined benefits schemes and cash balance arrangements but not for money purchase arrangements; in particular, for defined benefit schemes, the valuation factor changes from 10 to 16.
- A carry-forward facility is introduced whereby any unused part of the annual allowance for a tax year is automatically carried forward for up to three tax years. The current year's annual allowance is always treated as used up first. If this is insufficient to avoid a charge, any unused annual allowance from the three previous years can then be used; the earliest year's unused allowance is used first and so on. Unused allowances for 2008/09, 2009/10 and 2010/11 can be carried forward to 2011/12, but, for this purpose only, the unused amount for any of those years is computed under post-2010/11 rules. Therefore, it is assumed that the annual allowance was only £50,000 for each of 2008/09, 2009/10 and 2010/11 and pension savings for those years are recalculated as if the new rules had already been in place.
- The annual allowance rules will normally apply in the year of taking benefits but there will be exemptions in the year of death or where the individual retires because of severe ill-health.
- Exemption from the annual allowance charge for those with enhanced protection will no longer apply.
- Inflation-linked increases in expected pensions for deferred members of schemes will not count towards the annual allowance charge.
- An individual with an annual allowance charge of over £2,000 will in most cases be able to elect for his pension scheme to pay the tax on his behalf, with his scheme benefits then being actuarially reduced.

Pension savings for a tax year are tested against the annual allowance over a 12-month period which does not necessarily match the tax year. The period is known as the pension input period. At 14 October 2010 when the reduction in the annual allowance was first announced, some individuals will already have been in a pension input period that started in 2010/11 and will end in 2011/12. Because it was originally expected that the 2011/12 annual allowance would remain at £255,000, those individuals may have already made pension savings of more than £50,000 for that pension input period. To cover this situation, there are transitional rules for such pension input periods. Broadly, in order to avoid an annual allowance charge:

- the pension savings for this transitional pension input period must not exceed £255,000; and
- the pension savings for that part of the transitional pension input period that begins on 14 October 2010 must not exceed £50,000.

As regards the lifetime allowance those with savings above £1.5m, or who believe the value of their pension fund will rise above this level through investment growth without any further contributions or pension savings, will be able to apply for a new personalised lifetime allowance of £1.8m providing they cease accruing benefits in all registered pension schemes before 6 April 2012. Applications must be received by HMRC before that date.

Removing the Effective Requirement to Annuitise by Age 75

Current legislation effectively imposes a requirement to use savings in defined contribution registered pension schemes to provide an income by age 75. The provisions imposing this requirement are amended or repealed with effect (broadly) from 6 April 2011. On and after that date members of such schemes who have not yet taken a pension may defer the decision indefinitely. Changes also affect the use of a drawdown facility, treatment of lump sums, and inheritance tax effects.

Employer Asset-backed Pension Contributions

The Government will consult on changing tax rules to limit the amount of tax relief available to employers when they make asset-backed contributions to their defined benefit pension schemes, so that tax relief accurately reflects the increase in fair value of the pension plan assets.

CHARITIES

Gift Aid Benefit Limits

The upper limit on benefits that donors making large donations to charities and community amateur sports clubs can receive, where donations of more than £10,000 are eligible for Gift Aid tax relief, will be increased from 6 April 2011 (or accounting periods ending on or after 1 April 2011 for corporate donors).

The overall limit is increased from £500 to £2,500 (still subject to a maximum 5% of the gift).

Self-assessment Donate Withdrawal

The Self-assessment Donate Scheme, under which taxpayers were able to direct that a tax repayment due from HMRC should instead be made direct to a charity of their choice, is to be withdrawn for tax returns for the year 2011/12 onwards and earlier years where repayments are made on or after 6 April 2012.

Substantial Donors to Charity

Following representation by the charity sector, the anti-avoidance legislation surrounding donations is to be revised to ensure better targeting and to reduce the administrative burden. The revised legislation will deny tax relief on donations only where the donor is party to arrangements the main purpose, or one of the main purposes, of which is to obtain a financial advantage for the donor or a connected person from the charity, either directly or indirectly. There will be a carve out for relevant housing providers and charitable payments made to a charity for onward transmission to a non-charitable body.

The revised legislation will have effect in relation to donations made on or after 1 April 2011.

Gift Aid

From April 2013 charities and community amateur sports clubs that receive small donations of £10 or less will be able to apply for a Gift Aid repayment on total donations of up to £5,000 without the need to obtain Gift Aid declarations, provided that they have been operating the Gift Aid scheme for at least three years and have a good compliance record.

In 2012/13 HMRC intend to introduce a new online system for charities to register their details for Gift Aid and to make Gift Aid claims.

ANTI-AVOIDANCE

Disguised Remuneration

There is to be anti-avoidance legislation included in Finance Act 2011 aimed at those who use third party arrangements, commonly involving trusts and other vehicles, to avoid, reduce or defer liabilities to income tax (and National Insurance contributions) on rewards of an employment. It will have effect for 2011/12 onwards but see also the anti-forestalling provisions below.

A new income tax (and National Insurance) charge will apply where a third party provides an employee with reward, recognition or a loan in connection with the employee's employment. Third party arrangements that are not tax avoidance will as far as possible be excluded; examples include genuine deferred remuneration arrangements which last less than five years and genuine commercial arrangements for the provision of designated employee car ownership schemes.

The legislation applies equally to third party arrangements that are used in addition to, or instead of, registered pension schemes to remunerate individuals above the annual and lifetime allowances for registered schemes.

The new income tax charge will apply to:

- sums or assets that are earmarked for employees by trusts or other intermediaries;
- loans provided to employees by trusts and other intermediaries;
- assets provided to employees by trusts and other intermediaries; and
- sums or assets that are earmarked by the employer with a view to a trust or other intermediary providing retirement benefits to the employee.

The charge will be based on:

- the full amount of any sum of money made available, including the value of any loan; and
- the higher of cost and market value of any asset used to deliver the reward or recognition, for example where the asset in question is transferred or otherwise made available for an employee's use and benefit as if the employee owned the asset.

The amount chargeable will be employment income and will also be PAYE income, which means that PAYE must be accounted for by the employer at the time the income is treated as arising to the employee, i.e. when the money, asset or loan is earmarked or provided.

Anti-forestalling provisions apply to the payment of sums and the provision of readily convertible assets (i.e. assets easily convertible into money) for the purposes of securing the payment of sums (including loans) where:

- the sum is paid, or the asset is provided, on or after 9 December 2010 and before 6 April 2011; and
- if it had been paid or provided on or after 6 April 2011, it would have been caught by the new legislation above.

Chargeable income will be deemed to arise on 6 April 2012 if the sum paid has not been repaid, or the readily convertible asset has not been returned, before that date and has not otherwise been charged to tax as earnings. It will be PAYE income.

Derecognition of Loan Relationships

Revised anti-avoidance rules are to be introduced to counter arrangements under which corporation tax profits fall out of account, or losses are claimed, as a result of the derecognition of a financial asset that is a loan relationship or a derivative contract. The provisions will apply where amounts in respect of such assets are not fully recognised in a company's accounts as a result of tax avoidance arrangements to which the company is a party, provided that the company continues to be party to the relationship or contract. Credits and debits will have to be brought into account as if the amounts concerned had been fully recognised. Furthermore, any losses arising from the derecognition of the asset will not be allowable. These rules will apply to debits and credits arising on or after 6 December 2010.

Additionally, with effect from 23 March 2011, a company will be required to bring into account any difference between the accounts carrying value and the fair value of a derivative contract as a credit for the period in which tax avoidance arrangements are entered into.

Loan Relationships, Derivative Contracts and Group Mismatches

New anti-avoidance provisions are to be introduced to prevent groups of companies using loan relationships or derivative contracts to gain a tax advantage as a result of asymmetries in the way the group members bring amounts into account for corporation tax purposes.

An interim measure will apply to debits and credits arising on or after 6 December 2010 and will deal with specific disclosed schemes. This will be replaced by a generic measure which will apply to arrangements to which a company is party on or after the date of Royal Assent to Finance Act 2011. This measure will impose symmetrical tax treatment where either:

- obtaining a tax advantage from asymmetrical treatment was certain from the start and the expected tax advantage is at least £2m; or
- one of the main purposes of any group company was to obtain the chance of a tax advantage and such an advantage is more likely to result from the scheme than a disadvantage.

Functional Currency of Investment Companies

An anti-avoidance provision is to be introduced to prevent companies retrospectively choosing a functional currency (the currency in which their profits are computed before conversion into sterling) in order to gain a tax advantage. The provision will apply for periods of account beginning on or after 1 April 2011 so that, where a company changes the currency in which accounts are drawn up, no foreign exchange gains or losses from loan relationships or derivative contracts will be brought into account for tax purposes in the first period of account under the new currency.

With effect from the same date a company whose main purpose is to make investments will also be able to make a prospective election for a functional currency for tax purposes, other than the currency of the accounts, where this reduces its compliance burden. An elected currency will only be acceptable if there is a reasonable basis for its use.

Plant and Machinery Leasing

HMRC have identified an avoidance scheme involving the sale, leaseback, and reacquisition of plant and machinery over a short period with the aim of claiming tax relief twice on a single amount of expenditure. The scheme is dependent on the lessee paying an amount under a guarantee of the value of the plant or machinery at the end of a long funding finance lease (the 'residual amount'). Legislation will be introduced to counter the scheme and to ensure that tax relief available to a lessee under such a lease, whether through capital allowances or otherwise, does not exceed his actual expenditure.

The legislation will have effect in relation to new arrangements guaranteeing a residual amount under a long funding finance lease entered into on or after 9 March 2011 and to pre-existing arrangements where payment under a guarantee has not been made prior to that date.

Sale of Lessor Companies

Changes are to be made to the sale of lessor company charge, and the option to elect out of the charge is to be removed. The changes are intended to ensure that the full amount of profits from a business of leasing plant or machinery that are deferred for tax purposes are brought into charge at the time of the sale. Broadly, the changes will apply where the sale or transfer triggering the charge takes place on or after 23 March 2011. Where an opt-out election is made in respect of the sale of a company before that date and there is a disposal event involving plant or machinery on or after that date, the full value of the plant or machinery will have to be taken into account in calculating the disposal value.

Tax Treaties

Finance Act 2012 will include anti-avoidance legislation with the aim of ensuring that relief or exemption from UK tax will not be given where a claim is made under the UK's double taxation treaties and where arrangements have been made in relation to the claim to avoid tax. It is aimed at:

- UK residents (individuals, trustees and companies) who use tax avoidance schemes; and
- overseas residents who enter into arrangements to obtain benefits under the UK's double taxation treaties where they are not properly due.

STAMP TAXES

Stamp Duty Land Tax Avoidance

Finance Act 2011 will include three changes to stamp duty land tax to ensure that certain avoidance schemes are ineffective. The changes will apply on or after 24 March 2011. Subject to detailed transitional provisions, the changes will not apply to transactions or arrangements entered into before 24 March 2011 and completed on or after that date. The changes are as follows:

- the exception from the sub-sale rules relating to alternative finance reliefs will be extended to include all such reliefs;
- for the purpose of those reliefs, qualification as a financial institution will no longer be possible just by holding a consumer credit licence; and
- the chargeable consideration for exchanges involving a major interest in land will be the greater of the market value of the interest acquired and what the chargeable consideration would be under the normal rules.

Stamp Duty Land Tax: Bulk Purchases

Legislation is to be introduced in Finance Act 2011 to provide a relief for purchasers of more than one dwelling from the same vendor. Instead of the rate of stamp duty land tax being based on the total consideration, it will be based on the mean consideration, i.e. by the aggregate consideration divided by the number of dwellings (subject to a minimum rate of 1%).

VALUE ADDED TAX

Online Registration and Online Filing of Returns

The Government will require online VAT registration, deregistration and notification of changes with effect from 1 August 2012. The VAT registration threshold for businesses not established in the UK will also be removed from that date. The Government will also require all remaining VAT customers to file their VAT returns online and pay electronically from 1 April 2012.

Zero-rating: Splitting of Supplies

With effect from Royal Assent to Finance Act 2011, zero-rating will no longer apply to printed matter which is ancillary to a differently rated service where, if the service and printed matter had been supplied by a single company, the two supplies would have been treated as a single standard-rated, reduced-rated or exempt supply. This is an anti-avoidance measure to combat the splitting of an otherwise single supply into its component elements such that one or more of those elements may be zero-rated.

Costs Incurred by Academies

With effect from 1 April 2011, academy schools will be able to recover VAT on costs which are incurred to support their non-business activities (primarily the provision of free education). This is to ensure that academies are treated for VAT purposes in the same way as schools which are controlled by local authorities.

Car Fuel Scale Charges

The scale used to charge VAT on fuel used for private motoring in business cars will be amended from the start of the first VAT period beginning on or after 1 May 2011.The revised charges are:

	VAT fuel scale charge		
CO_2 emissions (grams per km)	12-month period	3-month period	1-month period
120 or less	630	157	52
125	945	236	78
130	1,010	252	84
135	1,070	268	89
140	1,135	283	94
145	1,200	299	99
150	1,260	315	105
155	1,325	331	110
160	1,385	346	115
165	1,450	362	120
170	1,515	378	126
175	1,575	394	131
180	1,640	409	136
185	1,705	425	141
190	1,765	441	147
195	1,830	457	152
200	1,890	472	157
205	1,955	488	162
210	2,020	504	168
215	2,080	520	173
220	2,145	536	178
225 or more	2,205	551	183

Change of Treatment of Business Samples

Finance Act 2011 will contain legislation to remove the restriction which limits VAT relief on samples to the first such sample. This follows the ECJ decision in *EMI* (Case C581/08), which held that this restriction was incompatible with European legislation.

The legislation will come into force with effect from Royal Assent to Finance Act 2011. It will, however, have retrospective effect and affected businesses may submit claims, subject to the capping restrictions.

Low Value Consignment Relief

Finance Act 2011 will introduce legislation to reduce, with effect from 1 November 2011, the threshold for low value consignment relief from £18 to £15.

Diplomatic Privilege

Finance Act 2012 will authorise indirect tax and duty reliefs for diplomatic missions, international bodies, visiting NATO forces and European research infrastructure consortiums. With regard to the first three categories, this will provide a statutory basis for reliefs which are currently given by extra-statutory concession.

Fraud on Imported Road Vehicles

The Government has launched a joint initiative between HMRC and the Driver and Vehicle Licensing Agency (DVLA) to combat VAT fraud on road vehicles brought into the UK. Finance Act 2012 will include legislation providing that vehicles entering the country for permanent use on UK roads will have to be notified to HMRC online before they are registered with the DVLA. Private individuals, and businesses which are not registered for VAT, will be required to pay the VAT due at the time of notification. VAT-registered businesses will continue to make payment through their VAT return.

EXCISE DUTIES

Fuel Duty Rates

The fuel duty escalator, which was introduced in 2009 and was intended to increase fuel duty each year until 2014/15, will be abolished and will be replaced by a ‘fair fuel stabiliser’. This will have the effect that when oil prices are high, fuel duty will only increase by the Retail Prices Index (RPI). However, if the oil price falls below a set trigger price on a sustainable basis, the Government is committed to increasing fuel duty by RPI plus one penny per litre in each such year. The Government believes that a trigger price of $75 per barrel would be appropriate, but will set a final trigger price and mechanism after consulting with oil companies and motoring groups.

The main fuel duty rate will be reduced by one penny per litre from 18.00 on 23 March 2011. The rate will then increase by 3.02 pence per litre on 1 January 2012. The 2012/13 increase in fuel duty will be implemented on 1 August 2012, when duty on rebated oils will also rise in proportion to the main rate. The duty differential for compressed natural gas will be maintained, but the differential for liquefied petroleum gas will be reduced by the equivalent of one penny per litre.

MISCELLANEOUS

Small Business Rate Relief Holiday: Extension

The small business rate relief holiday will be extended by one year from 1 October 2011.

Mutual Assistance Recovery Directive

The UK will implement the Mutual Assistance Recovery Directive agreed by EU Finance Ministers during 2010. Under this Directive, which covers all national taxes and duties, local taxes and motor taxes, EU member states can provide each other with assistance in the recovery of tax debts and duties, which includes service of documents and exchanging information in connection with the recovery of claims.

Legislation will be included in Finance Act 2011 and will come into force on 1 January 2012 when the Directive becomes fully applicable.

Personal Tax

Class 1 on contributions into FURBS?

The case

The taxpayer company invited M, a director of the taxpayer, to join a funded unapproved retirements benefit scheme.

By a trust deed dated 11 April 2002, the scheme was set up between the taxpayer as one party and M and BWCT Ltd, the trustees, as the other. Any property vested in the trustees for the purposes of the scheme was to be applied towards the provision of relevant benefits in accordance with the deed and rules contained in the schedule to the deed.

M accepted the invitation and agreed to be bound by the scheme's Rules. He had also stated that in the event of his death, he wished the trustees to exercise their discretion in favour of his wife.

On 11 April, the taxpayer's directors resolved that a contribution should be made to the trustees of the scheme. In respect of M, those contributions were treasury stock with a nominal value of £162,000 and £1,000 by way of a cash contribution.

HMRC decided that the taxpayer was liable to pay Class 1 national contributions in the period from 6 April 2002 to 5 April 2003, on sums paid into the scheme. The taxpayer appealed to the First-tier Tribunal.

It was directed that the appeal should be heard by the Presidents of the First-tier Tribunal and the Upper Tribunal (Tax and Chancery Chamber), as it was a lead case for a number of other appeals.

The issue

There was no dispute that the transfers of the gilts into the scheme had been made for the benefit of M. The critical question was whether they amounted to 'earnings paid' for his benefit.

The outcome

The tribunal decided that such contributions were not 'earnings paid' for 'the benefit of an earner' as required by s 6(1) of the Social Security and Benefits Act 1992, and did not fall within the payments referred to in para 2 of Pt 2 of the Social Security (Contributions) Regulations 2001, with the effect that they were to be disregarded in the calculation of earnings.

The effect of the scheme had not been to confer a beneficial interest in the gilts on M. M had had a right to ensure that the trustees had administered the trust properly. That had meant that the trust fund had to be applied to provide the benefits described in the events specified. He had not had a beneficial interest in any of the assets held in the trust.

Forde and McHugh Ltd v Revenue and Customs Commissioners [2011] UKUT 78 (TCC)

A curious case of inducement (Lecture P647 – 8.56 minutes)

The recent First-Tier Tribunal case of *Macey v HMRC (2010)* is the latest (although probably not the last) in a long series of disputes with HMRC concerning inducements to enter into a contract of employment.

It would appear that the finding in *Macey* indicates a change in the official approach to the tax treatment of such payments and (unless there is a successful appeal) it probably consigns decisions such as *Vaughan-Neil v CIR (1979)* and *Pritchard v Arundale (1971)* to the judicial dustbin.

Mr Macey was a partner in Ernst & Young who, in 2001, was encouraged to take up employment with a bank (Morgan Stanley) as Head of European Tax. He was to be paid a substantial salary (well in excess of his Ernst & Young profit share which was £480,616 for the year ended 30 June 2001). In addition, he received some restricted stock units in the bank which were specifically intended to compensate him for any disadvantage incurred in relinquishing his partnership with Ernst & Young.

Mr Macey must have taken considerable comfort from the *Vaughan-Neil* case, in which an individual was paid £40,000 as an inducement to give up his status as a practising barrister. HMRC accepted that this payment was not taxable as earnings. In *Jarrold v Boustead (1964)*, a rugby player received a signing-on fee for joining a rugby league club as a professional and the payment was held not to be taxable, being merely compensation for the loss of his amateur status. Perhaps more relevantly, in *Pritchard v Arundale (1971)*, a chartered accountant was encouraged to become joint managing director of a company and received 4,000 shares in that company as a contractual inducement to do so. The taxpayer was again successful – note that the shares were actually transferred from another shareholder, but there is no doubt that they were an inducement for him to take up the employment.

Strangely, none of these authorities seem to have been considered by the Tribunal (although there is reference to them in the judgment), the decision being that 'the one-off award of restricted stock units was granted as an inducement for the appellant to enter into the contract of employment with Morgan Stanley and to perform services for Morgan Stanley in the future'. But was this not exactly the position in *Pritchard v Arundale (1971)*? One of the terms of the contract relating to Mr Arundale's employment was that he would receive a specified number of shares in the employer company. Similar considerations apply to the other cases. Of course, the payment or the receipt of shares was an inducement to take up the employment, but that is not the end of the matter. Mr Vaughan-Neil gave up his status as a barrister, Mr Boustead gave up his status as an amateur rugby player and Mr Arundale gave up his established position and status as a practising chartered accountant receiving shares in compensation. Mr Macey was in a similar situation. However, 1971 was many years ago and it is instructive that the Tribunal did not bother to consider any of these cases – perhaps it is thought that they are no longer relevant.

One factor which might have distinguished Mr Macey's case from the earlier authorities is that his restricted stock units could only be realised after he had been employed by the bank for two years. This is in contrast to the position of Mr Arundale who received his shares before he started working for the company and, had he died prior to commencing the employment, his estate would have been entitled to retain the shares. However, this point was not mentioned in the judgment.

Interestingly, there is nowadays a much more compelling argument in HMRC's favour deriving from some recent legislation which brings into charge securities acquired by reason of a person's employment (including a prospective employment). S421B ITEPA 2003 provides that, where a right or opportunity to acquire shares is made available by a person's employer (or by a person connected with that person's employer), it is deemed to be made available by reason of the employment. This would seem to trump all the arguments on *Pritchard v Arundale (1971)* lines.

All in all, *Macey v HMRC (2010)* remains a rather curious decision.

Contributed by Robert Jamieson

Entertainers on Equity contracts employees for NI

HMRC say the First-tier Tribunal's decision in *ITV Services Ltd* (TC836) confirms the technical view and policy intention that most entertainers engaged on Equity contracts are to be treated as employed earners for National Insurance contributions purposes.

The case

ITV Services Ltd appealed against determinations made by HMRC stating that certain entertainers were to be treated as employed and that ITV was liable to pay secondary Class 1 National Insurance on their earnings under Social Security (Categorisation of Earners) Regulations 1978 (SI 1978/1689) as amended by Social Security (Categorisation of Earners) Regulations 1998.

The entertainers were engaged by ITV under several contracts, details of which were given in the First-tier Tribunal decision. Counsel for ITV explained that if the actors were paid a salary they were, for the purposes of the relevant legislation, employed earners. If their remuneration did not include payments of salary, they were self-employed.

ITV claimed it paid actors for being available to work: the fee paid was for work expected to be performed, rather than for work which had been performed. Payments were therefore not salary and the actors concerned were not eligible for state employee benefits.

ITV submitted that where a contract provided for a fixed fee, regardless of the amount of work actually performed, the remuneration in respect of that employment did not include any payment of salary.

Tribunal findings

The tribunal concluded that, except in ‘all rights’, the entertainers’ remuneration did include payment of salary.

The actors agreed to be available under the contracts, usually on an exclusive basis. Their contracts entitled them to remuneration that included salary, and thus ITV was liable to pay secondary National Insurance in respect of those payments.

The taxpayer’s appeal was allowed in part, issuing a decision in principle that the company was liable to pay National Insurance in respect of certain contracts.

‘All rights’ agreements are not paid by way of salary, because they are paid a single inclusive fee, with no reference to time. They are thus self-employed for both tax and National Insurance contributions.

ITV Services Ltd (TC836)

Following the ruling

The tribunal decided that there was an element of salary in the payments made under such contracts and confirmed that the essential quality of salary was to 'purchase the individual’s time for some definite or indefinite period, short or long, rather than to pay for specific services'.

HMRC say the test should be applied to contracts for all actors, whatever their status within their trade, and parties cannot contract out of the liability for Class 1 National Insurance if the nature of the contract is that it includes payment 'by way of salary.'

HMRC will apply the law immediately to all Equity contracts that are either newly entered into, revised, renewed or extended from the date of *Revenue & Customs Brief 10/11*.

It will be applied from 6 April in respect of all current Equity contracts that continue beyond the end of the 2010/11 tax year, which the department would previously have accepted as falling outside the regulations.

Payable at a specific period or interval

To be ‘salary’, the regulations say that a number of conditions need to be satisfied, one of which refers to ‘where there is more than one payment, (money is) payable at a specific period or interval; some entertainers do not receive payment in this way.

Many fees are due and payable only following the receipt of a valid invoice. Payment of invoices varies and can depend on:

- Date work is performed
- Date on which it is issued
- Date received by contractor
- Terms stated on the invoice

Invoices are not necessarily ‘payable at a specified period or interval’ so is it salary?

‘Extras’

Extras had only a walk-on part in the ITV decision.

Equity has an agreed schedule of day rates for walk-ons, and it was accepted by ITV that they fell within the deeming rules. No arguments in support of walk-ons being outside the deeming rules were put forward to the tribunal.

But what about ‘extras’ who are paid erratically, by invoice - Surely they are self-employed?

Jointly held property

Mr Paul Lorber appealed against HMRC's amendments of his self-assessment for 2002/03 and 2003/04 and against additional assessments for 1998/99 to 2001/02 inclusive.

"The Joint Account Issue"

Mr Paul Lorber included no entries on his tax returns for interest that had arisen on accounts held jointly with his wife, Susan. He argued that since 1995 his code number as shown on a Notice of Coding had been compiled on the basis that all the income belonged to Susan and none to him. Paul said that as a result of this action, HMRC should be taken to have agreed that none of the relevant income belonged to him.

The facts were as follows:

- All the accounts and deposits were in the joint names
- Paul had unrestricted drawing rights
- No formal declaration or agreement with HMRC by Paul and Susan or evidence of such

There is nothing in the regulations that expressly limits the ability of HMRC to amend a coding notice or the nature of the amendment and given the terms of regulation 12(1)(f) it seems that HMRC had no choice whether or not they agreed that the income was Susan's and not Paul's.

There is nothing that prevents HMRC from agreeing to exclude 50 per cent of a person's non-PAYE income in calculating the Code if that is what the employee wants whether or not the employee asks for it because they think that only 50 per cent of the income is theirs.

No formal declaration and so appeal dismissed

"The section 660A/B Issue"

The second issue was whether income from a number of building society accounts and deposits should be taxed on Paul as settlor for funds that beneficially belong to his minor children where the funds came originally from their grandfather?

The accounts were created while Paul held Power Of Attorney for his father and some money was used to help Paul and Susan buy a house for Susan.

The Tribunal concluded that there was nothing inherently wrong in investing children's funds in a house which was to be a home for their mother and, presumably, for the children when they are staying with her.

The interest arising from the funds had been consistently returned for tax purposes as the children's own income.

They therefore allowed the appeal.

PA Lorber v HMRC TC00977

Employment income deductions

Decision

This decision concerned expenses claim made by Mr Paul Lorber for the year ended 5 April 2003. The claim had been partially refused in a letter from the Inspector of Taxes of 17 February 2005. Mr Lorber appeals against the decision to the extent that it disallows his expenses claim.

The case

In the year in question Mr Lorber was an elected borough councillor in the London Borough of Brent. He had been a councillor for over twenty years and was the leader of a group of ten Liberal Democrat Councillors. He received a "councillor's allowance" of £7,000 a year and a special responsibility allowance of £4,500 a year. A short summary of the disputed expenses is as follows:

- £2,006.80 of "home expenses" were claimed and one-sixth of that (£334.40) was offered.
- £80 was claimed for costs of child minding: this was wholly disallowed.

- Amount claimed in respect of "subscriptions and publications": disallowed.
- £1,200 was claimed as "communication" expenses: this was wholly disallowed.

The home expenses

HMRC allowed one-sixth of Mr Lorber's home expenses which comprised council tax, gas and electricity bills for 2002/03.

Mr Lorber's evidence was that he used one bedroom in his house as an office. In addition he used other rooms in the house for meetings with his colleagues and visits from constituents. While the actual figures provided by Mr Lorber may have be correct, neither HMRC nor this Tribunal were provided with any information about how many rooms have been occupied for meetings etc. and for how much time they had been used for those purposes.

Appeal dismissed.

Child care

The Tribunal read the Independent Panel's "Review of Councils in London: 2003 Review" produced in the summer 2003 and noted that they expressed the view that allowances should be paid to the councillor, at a rate to reflect local costs, before expenses of arranging the care of children while the councillor is attending, among other things, council and committee meetings. That recommendation no doubt reflected the fact that, for tax purposes, child care expenditure is not allowable as a deduction in computing taxable earnings. This is because child care expenses are not dictated by the requirements of the job of being a councillor; instead they have to be incurred to meet the personal circumstances of the councillor.

That is the reason why they thought HMRC were correct in disallowing Mr Lorber's claim for £80 for child minding expenses.

Subscriptions and publications expenditure

Mr Lorber claimed an unspecified amount for subscriptions and publications.

Section 201 of ICTA and section 343 to 345 ITEPA allow a deduction for subscriptions to approved societies. Mr Lorber did not satisfy the Tribunal that the Association of Liberal Democrat Councillors is was an approved society for this purpose.

Communication expenses

Mr Lorber claimed £1,200 for producing a monthly Newsletter and Special Street Letters necessarily incurred in the course of his duties as a councillor. The key question was whether the expenditure was also incurred for the purpose of advancing the interests of the Liberal Democrats in Brent Council? In which case, it must be disallowed.

On examining the newsletters and the special street letters, they found:

- Every one had the LDP label and states who the members of the group are
- Every paper gives their address and most provide the means of communicating with them
- Only one invited the recipient to join the Liberal Democrats
- None of the Street Letters canvass subscriptions to the Liberal Democratic Party
- 2 asking for contributions state that "donation" is to FOCUS (issues of local concern)
- None of the newsletters and street letters had anything to do with elections
- None sought to canvass the votes of the recipients

The Tribunal concluded that the expenditure was not for political purpose but rather in his leadership role and as "advocate and champion of the ward" that Mr Lorber incurred the expenditure

Mr Mr Lorber's appeal succeeded for his claim of £1,200 expenditure on communications.

TC00986: P A Lorber

Should advice take into account a client's ill health?

The claimants were the executors and daughters respectively of the deceased who died in 2007 during a heart procedure in Thailand. A fortnight or so earlier the entire issued share capital of the deceased's successful family business, had been sold in a management buy-out (the MBO) for a total consideration in cash and loan notes of approximately £3.5m. The deceased's liability to capital gains tax as a result of his disposal of his shares before his death was substantial as was the liability for inheritance tax. The defendant was a well known national firm of solicitors who were retained by the deceased and his daughters to act in relation to the MBO. The claimants brought an action against the defendant on the basis that the defendant knew that the deceased's health was weak, and, therefore, given the deceased's imminent heart operation, the defendant ought to have advised the deceased to have postponed the MBO until after the operation.

The main issues were:

(i) whether the defendant was under any duty to give such advice, having regard to the scope of the duty of its retainer; and

(ii) if the defendant was under such a duty, its failure to give the advice caused the claimants to sustain the losses claimed. There was no real dispute between the parties as to the applicable legal principles, but there was a dispute regarding how those principles should be applied to the facts of the instant case.

In response the courts held:

(1) A solicitor's duty to his client was primarily contractual and its scope depended on the express and implied terms of his retainer. The key implied term of any solicitor's retainer was that the solicitor had a duty to exercise reasonable care and skill. The extent of his duties depended upon the terms and limits of the retainer and any duty of care to be implied had to be related to what he had been instructed to do. The duties owed by a solicitor to his client were high, in the sense that he held himself out as practising a highly skilled and exacting profession but the court had to beware of imposing upon solicitors duties which went beyond the scope of what they had been requested or had undertaken to do. The scope of the duty to exercise reasonable care and skill depended on the circumstances of the case and would depend first and foremost upon the content of the instructions given to the solicitor by the client. One of the relevant circumstances was the nature of the client. Another relevant circumstance was the degree of expertise which the solicitor (or other legal advisor) held himself out as possessing. Where the retainer involved different areas of specialisation, an aspect of the duty of care involved coordination between the specialists. It was a solicitor's responsibility to ensure that it was clear what the solicitor was being asked to advise about. There could be circumstances in which the solicitor's duty extended to advising upon matters that lay beyond the express instructions that he had been given by his client. On the other hand, a solicitor was not under a duty to advise his client in respect of matters in relation to which he reasonably believed the client to be receiving advice from another advisor. If a solicitor wished to place limits upon the scope of his duty of care, then he had to ensure that the client had clearly understood and consented to that.

In the instant case, the defendant's retainer extended to giving the claimants advice as to the tax consequences flowing from the MBO, but not to advising them on how the transaction fitted into their personal financial and tax planning positions.

(2) In the instant case, in all the circumstances, it could not be said that once the defendant had become aware of the deceased's ill health and the planned heart procedure it came under a duty to give advice about the tax consequences and hence to suggest that the deceased defer completion of the MBO until after the heart procedure. Furthermore, if the defendant had come under a duty to advise the claimants as to the tax consequences, they would not have come under a duty to advise

them to defer the completion of the MBO until after the heart procedure. At most the defendant would have been under a duty to advise the claimants as to the options available to them. Deferring completion of the MBO was by no means the only option. The claimants' alternative case also failed for that reason.

Mason and ors v Mills & Reeve (a firm), March 2011

Freezing injunction

The Revenue and Customs Commissioners (the Revenue), raised assessments against the taxpayer pursuant to s 29 of the Taxes Management Act 1970 (TMA) in respect of income tax and capital gains tax. A direction was also made pursuant to reg 72(5) of the Income Tax (Pay as You Earn) Regulations 2003, SI 2682/03 (the Regulations) in respect of income tax not deducted by an employer and interest under s 86 of the TMA and reg 72(7) of the Regulations. The assessments and directions were in respect of purported under-declared income and capital gains tax in the self-assessment return of tax by the taxpayer for the relevant years. The taxpayer denied that the tax was payable and was seeking to appeal the assessments to the First-Tier Tribunal. An assessment under s 29 of the TMA gave rise to a statutory debt enforcable under s 68 of the TMA in the High Court. The Revenue claimed in the High Court in respect of the debt. It also applied for a without notice worldwide freezing injunction against the taxpayer (the freezing injunction). The Revenue followed the practice set out in *Re Q's Estate*[1999] 1 Lloyd's Law Reports 931 under which the judge was apprised, at a hearing, of the request for a freezing injunction, which was to be made once the assessment and directions had been served, and asked, whether in principle he would be willing to grant such an injunction. Following a positive indication from the judge, the Revenue served the taxpayer with the assessment and direction on the morning of 17 February 2011. The freezing injunction was granted very shortly thereafter. Although the assessment and direction were served on 17 February, the debt did not in fact fall due for another 30 days. On the return date, the Revenue applied for the freezing injunction to be continued. The taxpayer contended that the freezing injunction should not be continued on two principal grounds: (a) that at the without notice application the Revenue did not have an existing cause of action against him; and (b) that there was no real risk of dissipation or secretion.

The taxpayer submitted, inter alia, that the court did not have jurisdiction to grant a freezing injunction as case law established that, before a freezing injunction could be made, an applicant had to have an existing cause of action and as the debt was not due for another 30 days there was no existing cause of action in place. The Revenue submitted, inter alia, that under s 37(1) of the Senior Courts Act 1981 and existing authority it was just and convenient to grant and continue a freezing injunction in all the circumstances. Those circumstances being that the Revenue were seeking the freezing injunction in support of the discharge of their statutory duties to collect tax after the tax debt came into existence but before it became payable. Further, the effect of the assessments was to render the Revenue a creditor of the taxpayer in the sum assessed and the court would protect a debtor against injury by the proposed dissipating of a creditor's assets.

The application would be allowed.

In the instant case, the court had jurisdiction, in the strict sense, to grant an injunction in respect of a tax debt which although not payable on assessment was due and not contingent. The court was not constrained by authority and there was sufficient immediate interest to support the Revenue's application. The Revenue were creditors of the taxpayer and were acting in pursuance of their statutory duty. Further, on the evidence, there was risk of dissipation of assets and the freezing order would be continued albeit in less stringent terms.

Revenue and Customs Commissioners v Ali

Meaning of 'connected person' for EIS (Lecture B648 – 6.51 minutes)

It will be remembered that the First-Tier Tribunal's decision in *Taylor v HMRC (2010)* from early last year dealt with the question of whether an individual is connected with a company for EIS purposes.

It is well known that, if a person has more than 30% of the shares in a company, he is connected with that company and so is disqualified from relief.

The precise test (now found in S170 ITA 2007) is somewhat more complicated. The individual in question must not possess more than 30% of:

- ordinary share capital of the company;
- loan capital and the share capital of the company; or
- voting power in the company.

Mr Taylor had an interest in the company and, although he owned less than 30% of the shares, he held more than 30% of the loan capital. He obviously did not breach conditions (i) and (iii) above and he claimed that he did not breach condition (ii) either, given that he did not hold more than 30% of the loan capital *and* more than 30% of the share capital.

HMRC argued that this was not the correct interpretation. Mr Taylor possessed more than 30% of the aggregate of the loan capital and the share capital and therefore he was connected with the company.

On Mr Taylor's construction, the reference to share capital in condition (ii) is virtually redundant because, if someone has more than 30% of the share capital, he is likely to be caught by (i) anyway – however, note that condition (i) refers to 'ordinary' share capital, whereas condition (ii) includes *all* share capital.

Nevertheless the First-Tier Tribunal accepted this analysis, although their reason for doing so was not entirely clear. Unfortunately for the taxpayer, in *HMRC v Taylor (2010)* the Upper Tribunal has now reversed this decision in a judgment handed down on 23 November 2010 and confirmed the HMRC view. It has to be said that this seems the more natural meaning of the words.

As an interesting aside, the Upper Tribunal observed that exactly the same criteria are used in connection with the legislation on purchase of own shares and that the same meaning must be given to the words there as well.

Contributed by Robert Jamieson

On 23 November 2010 the Upper Tribunal allowed HMRC's appeal against the decision of the First Tier Tribunal in Revenue and Customs Commissioners v Taylor & Haimendorf above.

The Respondents applied for permission to appeal which would be allowed if:

- the proposed appeal would raise some important point of principle or practice: or
- there is some other compelling reason for the relevant Appellate Court to hear the appeal."

Respondent's case

The Respondents did not seek to challenge the decision insofar as it held that the issued share capital under s291B(1)(b) ICTA 1988 should be computed at the nominal value.

The main ground on which permission to appeal is sought is that there are many anomalous results which flow from holding that paragraph (b) constitutes an aggregate test rather than a dual test.

However, the decision recognises that there are anomalous results in certain circumstances.

The application further submits that therefore "it is at least clearly arguable" that the construction urged by the taxpayers is correct.

Decision

The judge did not see that the proposed appeal on the grounds set out would raise an important point of principle or practice. This is not a case where the construction adopted in the decision always has

capricious results. On the contrary, it was a case where there are potential anomalies whichever of the two alternative constructions was adopted, depending on the circumstances.

The application for permission to appeal is refused.

Costs

HMRC applied for their costs of the appeal.

Much of the concern raised in the Respondents' observations was directed to the conduct by HMRC leading up to the hearing in the FTT. However, the costs for which HMRC now apply relate only to the appeal in this Tribunal.

The respondents argued that:

1. the amount claimed in the statement of costs as regards attendance on documents, put at over 38 hours amounting to £8010, is disproportionate for a case where the relevant documents were few in number.
2. as this was an area of ambiguity in the statutory provisions, it is not right that they should have to pay all HMRC's costs of a case that clarifies the law.

Decision

The judge agreed with the disproportionate claim; the case facts were not in dispute and were readily ascertainable. HMRC, did not explain why so much time was required. Total hours were reduced to 6 and costs reduced £7085.

On point 2, HMRC won and this is not a case to be considered of such public importance that it would be right not to follow the usual practice that the losing party should pay the other side's costs.

HMRC were awarded their costs.

Revenue and Customs Commissioners v Taylor & Haimendorf (Costs),

FTC/43/2010, Upper Tribunal (Finance and Tax)

Interest Relief on loans to close companies (Lecture B649 7.03 minutes)

The recent case of *Torkington v HMRC (2010)*, heard by the First-Tier Tribunal last autumn, is a helpful decision which gives a wide interpretation to the conditions for relief of interest paid on a loan involving a close company. The relevant test in what is now S392 ITA 2007 is that the money borrowed must be applied 'in lending to (a close company in which the borrower had a material interest) money which is used wholly and exclusively:

- for the purposes of the business of the company; or
- for the purposes of the business of any associated company . . . which is also a close company'.

Mr Torkington borrowed money and advanced it to a close company in which he had a material interest and that company, in turn, lent the money to an associated company resident in Canada. HMRC contended that the money lent to the company was not used wholly and exclusively for the purposes of its business because it was simply on-lent to another company. The other company was certainly an associated company which used the money for the purposes of its business, but it was not a close company given that it was non-UK resident. This looks to be correct since the company was based in Canada – if it had been resident in the EU, the position could well have been different.

The key question was whether, when the UK company borrowed money from Mr Torkington and lent it to its Canadian associate, it was using the money wholly and exclusively for the purposes of its business. HMRC argued that it was not – it was merely an intermediary providing finance by way of a back-to-back loan to the Canadian company. However, the Tribunal decided that the reference to 'business' in what is now S392 ITA 2007 indicated that a flexible and wide approach should be adopted. Given that this was a commercial arrangement (there was a 3% interest rate turn on the loan to the Canadian company), it represented the carrying on of a business sufficient to satisfy the statutory requirement. There is a celebrated statement in the *American Leaf Blending Co* case where Lord Diplock in the House of Lords said:

‘In the case of a company incorporated for the purpose of making profits for its shareholders, any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business.’

This latest case is further support for the contention that, in a tax context, the meaning of the word ‘business’ can be extremely wide.

Contributed by Robert Jamieson

© Reed Elsevier (UK) Limited

Capital Taxes

Practical points on the new CGT regime (Lecture P648 – 30.51 minutes)

Extension of basic rate band

It should be remembered that, where an individual's taxable income for a tax year is less than his basic rate band (currently £37,400 but falling to £35,000 for 2011/12), gains up to the amount of the unused portion of the band are charged at 18%. Gains above that limit are charged at 28% (S4(5) TCGA 1992). Gains which are eligible for entrepreneurs' relief are treated as utilising any unused part of the individual's basic rate band in priority to other gains (S4(6) TCGA 1992) – this prevents taxpayers maximising the benefit of any unused basic rate band for gains which might otherwise be taxed at 28%.

For this purpose, the basic rate band limit is increased by the grossed up amount of:

(i) any Gift Aid payments (S414(2) ITA 2007); and

(ii) any pension contributions paid net (S192(4) FA 2004).

Illustration 1

For 2010/11, Bob has income of £33,700 after deducting his personal allowance. On 3 December 2010, he sold some quoted shares and realised a gain of £18,650.

Bob made a Gift Aid payment of £800 on 24 December 2010.

What is the tax charge on Bob's gain?

Bob's taxable income for 2010/11 is £33,700. His basic rate band of £37,400 must be increased by the grossed up amount of his Gift Aid payment (£800 x 100/80 = £1,000) – therefore, his limit becomes £37,400 + £1,000 = £38,400.

Bob's chargeable gain is:

		£
Gain on sale of quoted shares		18,650
Less:	Annual CGT exemption	10,100
		£8,550

Bob's unused basic rate band is £38,400 – £33,700 = £4,700. His CGT liability for 2010/11 is:

	£
4,700 @ 18%	846
3,850 @ 28%	1,078
	£1,924

Capital losses

An individual can now offset his capital losses in the manner most beneficial to his tax position. This provision is, however, subject to any other part of the CGT code restricting the use of losses (eg. the 'connected persons' anti-avoidance legislation in S18(3) TCGA 1992).

There are no changes to the rules which require gains and losses accruing in the same tax year to be set off against each other. Similarly, where there are capital losses brought forward, they are only deductible against the current year's gains to the extent that they exceed the annual CGT exemption. Where the current year's gains are taxable at different rates, the brought forward losses can of course be deducted from the gains chargeable at the highest rate first.

A transitional problem

Another matter to note is a transitional problem. Where a taxpayer has made an entrepreneurs' relief claim in respect of a takeover disposal before 23 June 2010 but has not yet encashed his resulting QCB loan notes, he will not be entitled to the 10% tax rate which he would have enjoyed had the QCBs been redeemed prior to 23 June 2010. This is because the subsequent encashment will be liable to a 28% charge (in virtually every case) on 5/9ths of the gain, thereby producing an effective 15.56% rate. Curiously (and unfortunately), there is no transitional relief.

Remittance basis users

Para 20 Sch 1 F(No2)A 2010 sets out the position for non-UK domiciliaries who are taxed on the remittance basis. The main aspect of this regime is that gains on the disposal of assets situated outside the UK are chargeable only when they are brought into the UK. Therefore, gains remitted before 23 June 2010 are charged at the old 18% rate, while gains remitted on or after that date will usually be charged at the new 28% rate.

The fact that a disposal took place before 23 June 2010 is insufficient to lock in the 18% fixed rate – it is the date of remittance which is the key (Para 20(1) Sch 1 F(No2)A 2010).

In summary, therefore, the position for 2010/11 is as follows:

(i) All remittance basis users pay CGT at the 18% rate:

- on gains from UK-situated assets disposed of prior to 23 June 2010; and
- on foreign chargeable gains remitted prior to 23 June 2010.

(ii) Remittance basis users not liable to the remittance basis charge of £30,000 pay CGT at 18% or 28%:

- on gains from UK-situated assets disposed of on or after 23 June 2010; and
- on foreign chargeable gains remitted on or after 23 June 2010.

The special position of remittance basis users paying the remittance basis charge is examined below.

Illustration 2

Max is a foreign domiciliary who will be making a remittance basis claim for 2010/11. He is a top rate taxpayer and has been resident in the UK for the last five years.

The following capital transactions occurred during the tax year:

(i) On 17 June 2010, he sold a UK asset, realising a gain of £640,000.

(ii) On 20 June 2010, he remitted proceeds of £2,500,000 from the disposal of foreign shares sold two years earlier (the gain was £860,000 and his acquisition had been funded out of clean capital).

(iii) On 21 June 2010, he disposed of another foreign asset for £490,000, realising a gain of £235,000 (again the asset had been acquired out of clean capital).

(iv) On 29 June 2010, he remitted the proceeds from the sale of the asset eight days earlier.

(v) On 14 January 2011, he sold another UK asset, realising a gain of £18,000.

As a top rate taxpayer for 2010/11, Max will pay CGT at 28% on gains accruing or remitted on or after 23 June 2010. He will be taxed as follows:

(i) UK gain of £640,000 – disposal before 23 June 2010 and so taxed at 18% fixed rate.

(ii) Remittance of foreign gain – gain remitted before 23 June 2010 and so taxed at 18% fixed rate on £860,000.

(iii) Remittance basis user – no tax charge on disposal of foreign asset.

(iv) Remittance of foreign gain – gain remitted after 22 June 2010 and so taxed at 28% on £235,000.

(v) UK gain of £18,000 – disposal after 22 June 2010 and so taxed at 28% rate.

In some cases, where there were no remittances of foreign gains prior to 23 June 2010, it may make sense for an individual who is normally a remittance basis user to be taxed on the arising basis for 2010/11 so that he or she will be charged at 18% on any foreign gains made between 6 April 2010 and 22 June 2010 (inclusive). The decision to adopt this course of action will depend on a number of factors. It is essential to work through the figures in order to ascertain the most tax-efficient strategy, taking into account both the position in 2010/11 and the likely need for remittances in later years.

HMRC have stated that individuals who pay the remittance basis charge of £30,000 will be taxed on their capital gains at 28%, regardless of the level of their income. There is no specific legislative provision in F(No2)A 2010 fixing the CGT rate at 28% in such cases. The rationale for imposing an automatic 28% tax charge would seem to be that the nomination of income or gains, which is necessary where the remittance basis charge is paid, is deemed to use up the taxpayer's entire basic rate band for the year. It is not at all clear that the existing legislation achieves this result and both the CIOT and the Tax Faculty have asked HMRC to explain their reasoning.

<u>Temporary non-UK residents</u>

Under S10A TCGA 1992, an individual who makes gains during a period of temporary non-UK residence (where this is less than the five-year period specified) and then returns to the UK is treated as if those gains accrued in the tax year of his return. For a taxpayer in such circumstances who returns to the UK in 2010/11, his gains will be treated as accruing before 23 June 2010 and are therefore taxable at the old 18% rate even if he returns on or after 23 June 2010 (Para 19 Sch 1 F(No2)A 2010).

It should be noted that S10A TCGA 1992 only applies to gains accruing during the intervening period, ie. the tax years between the year of departure and the year of return. Gains realised in the year of return are taxable on an arising basis under the normal rules.

Illustration 3

John, who is UK-domiciled and who has always been UK-resident, left the UK on 1 October 2007 for a three-year secondment to France. He returned to the UK on 1 February 2011, having realised the following gains during his period of non-UK residence:

(i) £150,000 in 2008/09;

(ii) £430,000 in 2009/10; and

(iii) £770,000 in 2010/11 (of which £690,000 relates to gains accruing after 22 June 2010).

S10A TCGA 1992 catches the gains of the intervening years, ie. 2008/09 and 2009/10. John's aggregate gains of £150,000 + £430,000 = £580,000 are treated as accruing in 2010/11 (but prior to 23 June 2010, even though he returned in early 2011). They are therefore taxed at the old 18% rate.

The gains of £770,000 in 2010/11 are taxed under normal CGT principles. Thus £80,000 will be charged at the old 18% rate, but the remaining £690,000, which accrued after 22 June 2010, will be dealt with under the new rules, ie. at 28% (unless John has any unused basic rate band).

Someone returning to the UK in 2011/12, having been caught by S10A TCGA 1992, will find that all his 'intervening year' gains are brought into charge at 28% (unless there is any unused basic rate band). This is the case even for gains which arose prior to 23 June 2010.

Contributed by Robert Jamieson

CGT and foreign currency (Lecture P649 – 20.41 minutes)

This article examines the CGT rules that apply to foreign currency held by individuals. Foreign currency transactions of companies are subject to special rules based on accounting treatment, and the basic rule for foreign currency transactions of individuals is widely known – but the practical application of it to someone who has a fair number of transactions is worth examining, because it is not obvious how the rules work.

Basic principles

The rule in Bentley v Pike; Where assets are bought and sold in a foreign currency, any UK gains and losses are measured by converting:

- proceeds into sterling at the rate ruling on the date of disposal;
- costs into sterling at the rate or rates ruling on the date they were incurred.

It is not possible to compute a gain or loss in the foreign currency and convert that into sterling at a single rate.

Example

Alvodar invests in Utopian shares, but is domiciled and resident in the UK. In 1996 he bought some shares on the Erewhon Stock Exhange for 1,000,000 Utopian dollars at a time when the rate of exchange was U$ 10.5/UK £1. He transferred the funds out of a Utopian dollar bank account.

In 2011, he sells the shares for U$ 900,000, when the rate of exchange is U$ 7.4/UK £1. He puts the proceeds into his Utopian bank account.

Alvodar thinks he has lost U$ 100,000. HMRC would look at it like this:

Proceeds 2011: 900,000/7.4	121,621
Acquisition cost 1996: 1,000,000/10.5	– 95,238
Chargeable gain	£26,383

Currency as a chargeable asset

Note that foreign currency itself is a chargeable asset for CGT (unless it is for personal use, e.g. on a holiday). If one foreign currency holding is converted into a different foreign currency:

the sterling base cost of the first currency holding…

…is compared with the spot sterling value of the first currency at the date of conversion…

…to compute a sterling capital gain at that date…

…and the spot value becomes the acquisition cost of the new currency.

If there are regular transfers between currencies, the identification rules for shares apply to the units of money – which could be very complicated.

Foreign mortgage

Suppose an individual borrowed €500,000 in order to buy a French property for €500,000. At the time, the exchange rate was €1.40/£1. Later the property is sold for €490,000 and the borrowing is paid off – the individual has to find further funds to settle the debt, which is now standing at €1.10/£1.

To add insult to injury, HMRC will regard this as a capital gain (490,000/1.1 – 500,000/1.4 = £88,311) and an exempt capital loss (a mortgage is not an asset and cannot therefore create an allowable loss). There is no way of offsetting them.

Personal use

An intriguing suggestion arose in a recent e-mail:

I have a client who received a pension pay out of £80k (tax free lump sum) last year and shortly after, he converted it to US Dollars. The plan was to buy a second home in the US for his eventual retirement and having the dollars available would help the buying process. At the same time, he was looking to buy a main home in the UK as they had sold their main residence 2 years back and were living in rented accommodation short term.

As things panned out, they did not find anything they wanted in the US and despite falling prices in the UK, they ended up spending more here than was originally planned. The extra needed to be funded by the US Dollars.

These were cashed in last month and my client received back £120k which is quite a good return in the current economic climate. He is expecting to pay CGT on the gain but I am not so sure.

There seems to be an exemption on the purchase of foreign currency for personal use outside the UK – this is clearly what this was and there was certainly never an intention to make a profit or to hold as an investment. However, does the fact that we actually made use of the profit to fund something in the UK scupper this exemption?

I am fairly sure I would struggle to claim a capital loss if the figures had gone the other way so I think we do meet the exemption.

HMRC manual says this:

> 78315. Personal expenditure of individuals
>
> A gain on the disposal of currency acquired by INDIVIDUALS for the personal expenditure outside the United Kingdom of themselves and their family or dependents is not a chargeable gain. This includes expenditure on the provision or maintenance of a residence outside the United Kingdom.

TCGA 1992 s.269 applies only to currency which was specifically acquired for personal expenditure of this kind. If remuneration, interest, dividends or other sums are received in foreign currency, that currency was not acquired for the purposes specified in s.269. On the disposal of such currency, there will be a chargeable gain (or allowable loss) calculated in the normal way. The allowable costs being the sterling value of the currency on the date it is acquired. The receipts may have suffered Income Tax, but TCGA 1992 s.37(1) (exclusion of sums chargeable to Income Tax, see CG14300+) will not operate to reduce the disposal consideration.

The key expression is "on the provision of a residence" – on the face of it, the client could qualify under that because it was his intention to use the money for that purpose. Also, it appears that the money was specifically acquired for that purpose – it was pounds and he converted it into dollars with the intention of acquiring a residence. The possible problem is that he then did something else with the money – and there is nothing in the very brief statutory provision to cover that situation.

In this situation, I would write to HMRC and ask for a ruling – setting out the case for exemption as clearly as possible and asking them to agree with it. There doesn't seem to be any case law so it looks like the best line is to argue that the expression "for the personal expenditure..." implies the purpose for which the currency was obtained, not the eventual use of it. You could compare it with

the situation where you changed some currency in order to go on holiday and then the holiday was cancelled (swine flu?) so you changed it back again - you never spent the money abroad, but it would surely be exempt under s.269.

Note that the s.269 exemption for currency (i.e. notes and coins) is extended to foreign currency bank accounts which contain money for personal expenditure by s.252(2) TCGA 1992.

Contributed by Mike Thexton

Earn outs – a current perspective (Lecture B647 – 13.12 minutes)

In the past, whenever a private company was sold on an earn-out basis, it was relatively common for the deal to be structured so that the earn-out payment was satisfied by an issue of shares or loan notes in the purchasing company which fell to be dealt with under S138A TCGA 1992.

With business asset taper relief of 75%, this arrangement had a number of beneficial tax consequences:

- the gain which would have arisen on that part of the original shares attributable to the earn-out right under the rule in *Marren v Ingles (1980)* was deferred;
- the subsequent issue of shares or loan notes by the purchasing company was treated as the conversion of a non-qualifying corporate bond security so that the capital gains charge was postponed still further; and
- a gain, computed by reference to an appropriate part of the vendor's shares, came into charge when the shares / loan notes in the purchasing company were eventually disposed of.

The impact of this was that all the vendor's gains would typically attract business asset taper.

Note that, with a cash-based earn-out, taper was only available to reduce the gain on the original disposal and never on the subsequent ones (an earn-out right not being a qualifying business asset).

With the replacement of business asset taper by entrepreneurs' relief and the recent increase in both the entrepreneurs' relief limit and the CGT rate, it is thought that future corporate disposals involving earn-outs will more often take the form of cash deals.

The main reason is that, where S138A TCGA 1992 applies, entrepreneurs' relief is virtually never available on the earn-out element and so it will make sense to maximise the vendor's initial gain, given that this is the one time when the 10% rate can be claimed.

Since the remaining gains are likely to be charged at 28%, a higher upfront gain and a lower deferred charge will normally represent good tax and cash flow planning.

Illustration 1

Shannon formed Runaway Ltd in April 1991, subscribing for the entire share capital of 10,000 ordinary shares of £1 each at par.

On 1 July 2010, he sold his shareholding to Larry plc. The sale contract provided for:

- an initial cash consideration of £2,800,000 to be paid on completion; and
- a deferred earn-out consideration based on defined profits for the 12 months ended 30 June 2011 which was to be satisfied in the form of Larry plc loan notes (the maximum earn-out consideration was set at £2,250,000).

Shannon continued to be the managing director of Runaway Ltd during the earn-out period. Shannon's earn-out right has been valued at £1,200,000 as at 1 July 2010.

On the assumptions that the actual earn-out consideration turns out to be £1,650,000 for the 12 months ended 30 June 2011, that the loan notes were received by Shannon on 1 November 2011 and that the loan notes were redeemed on 1 May 2012, Shannon's CGT computations are as follows:

2010/11	£
Sale proceeds	2,800,000
Less: Cost	
$\frac{2,800,000}{2,800,000 + 1,200,000} \times 10,000$	7,000
	2,793,000
Less: Annual CGT exemption	10,100
	£2,782,900
CGT @ 10%	£278,290

2012/13	£
Earn-out proceeds	1,650,000
Less: Cost (10,000 – 7,000)	3,000
	1,647,000
Less: Annual CGT exemption (say)	11,000
	£1,636,000
CGT @ 28%	£458,080

Shannon's aggregate CGT liability for this transaction amounts to £278,290 + £458,080 = £736,370.

If, however, Shannon's earn-out deal had been structured in cash so that the payment of £1,650,000 was made on 1 May 2012, the tax position changes dramatically:

2010/11	£
Sale proceeds (2,800,000 + 1,200,000)	4,000,000
Less: Cost	10,000
	3,990,000
Less: Annual CGT exemption	10,100
	£3,979,900
CGT @ 10%	£397,990

2012/13	£
Earn-out proceeds	1,650,000
Less: Cost	1,200,000
	450,000
Less: Annual CGT exemption (say)	11,000
	£439,000
CGT @ 28%	£122,920

Shannon's aggregate CGT liability is now only £397,990 + £122,920 = £520,910, a saving of £215,460. Even though Shannon has paid more tax initially, the overall saving will certainly be worth having.

Contributed by Robert Jamieson

Valuing shares for CGT

The taxpayer appealed against capital gains tax assessments issued on the basis that the value of shares held at 31 March 1982 had been £1.23 each. E argued that their value had been £4 each.

The First-tier Tribunal reviewed the evidence and decided that a price to earnings ratio of 14 should apply, valuing the shares at £4.04 each.

However, as the taxpayer owned less than 2% of the shares in the company, this value was to be discounted by 40%, resulting in a capital gains tax valuation of £2.42 each.

The tribunal held that it was not 'worthwhile or appropriate to trawl the cases comparing discounts in share valuation cases. Each case must depend on its own particular facts and circumstances; these circumstances would then have to be compared with the company in question and appropriate adjustments made, none of which could be carried out scientifically. The range seems to be between 25% and 75%'.

The taxpayer's appeal was allowed in part.

SP Erdal (TC964)

Voidable dispositions

The Court of Appeal Civil Division allowed appeals by HMRC, that the rule known as 'the Hastings-Bass rule' was not correct and a new rule, having regard to void and voidable cases, was promulgated.

The court further gave guidance on the legal test to be applied if a donor sought to have a voluntary disposition set aside as having been made under a mistake.

Cases considered here

HMRC appealed against two decisions:

1. *Pitt v Holt:* held that a special needs trust set up in such a way as to attract inheritance tax was to be set aside on the basis of the declarations sought by the claimants.
2. *Futter v Futter:* trustees' declaration that advancements made under the trust were void and of no effect, was allowed, in order to ensure that beneficiaries did not suffer by an invalid exercise of a power by trustees.

The issues

The issues were:

- the nature and extent of the duties owed by trustees in relation to their dispositive discretionary
- distinction between a trust being void and voidable

Nature and extend of trustees duties

The duty to act impartially was no more than the ordinary duty which the law imposed on a person who was entrusted with the exercise of a discretionary power: that he exercised the power for the purpose for which it was given, giving proper consideration to the matters which were relevant and excluding from consideration matters which were irrelevant.

Trustees were also under a duty of care, obliging them to exercise such skill and care as was reasonable in the circumstances.

Void and voidable

Where acts were within the powers of the trustees but were said to be vitiated by the failure of the trustees to take into account a relevant factor to which they should have had regard, the trustees' act would be voidable if it could be shown to have been done in breach of fiduciary duty on the part of the trustees.

If it was voidable, then it might be capable of being set aside at the suit of a beneficiary, but that would be subject to equitable defences and to the court's discretion.

Futter: The trustees had relied on advice from suitable professional advisers and so the enlargement and the advancements were not void, because they were within the relevant powers of the trustees, but they are also not voidable, because no breach of fiduciary duty had been committed in the process of making them.

Pitt: It could be seen that the claimants had fulfilled any duty of skill and care necessary and therefore the settlement and the assignment were not voidable.

Setting aside a voluntary disposition on the grounds of mistake

To set aside a disposition, there had be a mistake on the part of the donor either as to the legal effect of the disposition or as to an existing fact which was basic to the transaction.

The fact that the transaction gave rise to unforeseen fiscal liabilities was a consequence, not an effect, for that purpose, and was not sufficient to bring the jurisdiction into play.

Pitt and another v Holt and another, Futter v Futter

[2011] EWCA Civ 197

Administration

Validity of assessments on royalty payments

The case

In a letter dated 5 May 2005 to the taxpayer HMRC stated “I will shortly therefore be arranging for the issue of assessments for the years 1999/2000 and 2000/2001 tax years on the following amounts for Schedule D income. This should be treated as either Case I or II or Case VI Schedule D.” There followed a statement of income for each of those years. The last paragraph of the letter stated that the assessments were to be made pursuant to s 29(1) of the TMA 1970 (the Act).

HMRC subsequently sent the taxpayer notices of assessment dated 16 September 2005. They were accompanied by a letter of the same date from the HMRC Special Civil Investigations which, having referred to HMRC’s letter of 5 May 2005, set out the assessments for the relevant years, and added that the issue of the assessment had been delayed to allow for responses to be made to letters received from the taxpayer's wife in respect of the Revenue's enquiry. The calculation which followed showed the amount of income tax which was payable in respect of that amount of income from self-employment and the income tax calculated was the amount shown in the notice of assessment.

The appeal

The taxpayer appealed against the assessments to the First-tier Tribunal (the FTT), challenging their validity on the basis that they did not meet the conditions of s 114 of the Act, which referred to “an assessment ... which purports to be made in pursuance of any provision of the Taxes Acts ...”.

The taxpayer submitted that the assessments were invalid on the basis that:

(i) they were not made on a form prescribed by the Board in accordance with s 113(3) of the Act;

(ii) they failed to state that they were made under s 29 of the Act and that they were Case I (or II or VI) assessments

(iii) the letter of 5 May 2005 could not cure the defect of not referring to s 29 of the Act because the inspector could state in advance that an assessment would be made under one provision and then make it under a different one.

HMRC’s position

The Revenue contended that there was no statutory provision which required that a notice of assessment had to state the statutory provision under which the assessment in question had been made. In any event, the letter of 5 May 2005 had told the taxpayer that the assessments would be made pursuant to s 29 of the Act.

Finding

In the instant case, if there was any requirement to specify in the notice of assessment the provision of the Act under which the assessment had been made, then it had been satisfied in the taxpayer's case. The letter of 5 May 2005 (which clearly specified both that the assessments were to be made pursuant to s 29 of the Act and that the charge to tax was under Case I or II or VI of Sch D, and also included the amount of income which then featured in the respective notices of assessment) had been incorporated by reference into the letter of 16 September 2005 accompanying the notices of assessment so there had been no possibility that the inspector had changed his mind about the basis for the assessments between the two letters.

Further, the words relied on by the taxpayer in s 114 of the Act could not contain an implication that the provisions of the Act had to be stated in either the assessment itself or the notice of assessment.

In respect of s 113(3) of the Act, there was no evidence about whether the form of the notice of assessment used in the taxpayer's case had been prescribed by the Board. As the burden of proof was on the taxpayer to show that it was not in a prescribed form, the tribunal could not make any finding

on that. Furthermore, in accordance with s 114 of the Act, the notices of assessment had been “in substance and effect in conformity with the Act”. It followed that the assessments were valid

Gunn v Revenue and Customs Comrs [2011] UKUT 59 (TCC)

Increased penalties (Lecture P650 – 6.15 minutes)

Penalties for late filing of SA income tax returns

Prospective amendments relating to the penalties for the failure to make returns etc were included in Finance Act 2009. HMRC has now published a draft order for external comment which will bring into effect the new late filing and late payment penalties from 6 April 2011 (in relation to tax years ending after 5 April 2010) for personal, trust and partnership returns.

The rule stating that the personal/trust late filing penalty was the lower of £100 and the balance of tax due will be replaced. That is hardly a surprise, but the good news is that the level of the basic £100 penalty remains.

The penalties for **late filing** will include:

- £100 penalty immediately after the due date for filing (whether or not the tax has been paid)
- daily penalties of £10 per day for returns that are more than 3 months late, running for a maximum of 90 days
- penalties of 5% of tax due for the return period (or £300 if greater) for prolonged failures, which arise after 6 months and again after 12 months
- higher penalty of 70% of tax due where a person fails to file for over 12 months and has deliberately withheld information necessary for HMRC to assess the tax; (this is 100% if deliberate with concealment)

The penalties and surcharges for **late payment of tax** will be:

- penalty of 5% of the amount of tax unpaid, generally 1 month after the payment due date (or at the filing date of the relevant return)
- further penalties of 5% of any amounts still unpaid at 6 months and 12 months
- suspension of late payment penalties where the taxpayer agrees a time to pay arrangement with HMRC

Increased penalties for offshore tax evasion

We knew that the sanctions available to HMRC for tackling offshore non-compliance were to be increased under Section 35 and Schedule 10 FA2010.

We now know when and how this will happen:

1. As normal, penalties will be calculated by looking at the behaviour of the taxpayer, the degree of disclosure and the amount of tax lost. However, the level of the tax-geared penalty will be determined by the tax transparency of the jurisdiction in which the non-compliance arises. Where a jurisdiction only exchanges information with HMRC on request, inaccuracies arising offshore will be subject to penalties at 1.5 times the existing rate. Where a jurisdiction shares no information with HMRC, penalties will be at twice the current rate.
2. This means that deliberate failures to report income or gains from the most opaque tax jurisdictions could be met with penalties of up to 200% of the tax.
3. This new penalty framework for offshore non-compliance will apply to income tax and capital gains tax from 6 April 2011.
4. The first Self Assessment returns affected will be for the 2011/12 tax year, with paper returns due to be filed by 31 October 2012, and electronic returns by 31 January 2013.
5. The new penalty is an enhancement of the penalties for:
    - failure to notify

- inaccuracy on a return
- failure to file a return on time

6. Where the income or gain arises in a territory in ***category 1***, the penalty rate will be the same as under existing legislation. Where the income or gain arises in a territory in ***category 2*** the penalty rate will be 1.5 times that in existing legislation - up to 150 per cent of tax. Where the income or gain arises in a territory in ***category 3***, the penalty rate will be double that in existing legislation - up to 200 per cent of tax.

   Category 1: This includes all EU territories; USA; IoM; Australia; New Zealand.

   Category 2: These are simply all territories (other than the UK) not in Category 1 or Category 3.

   Category 3: These territories with a potential penalty of 200% include Brazil; Cuba; Monaco; UAE.

7. All existing safeguards will still apply. There will be no penalty if a person can demonstrate they have taken reasonable care to get their tax right or have a reasonable excuse for a failure to notify taxable income.

Contributed by Gerry Hart

© Reed Elsevier (UK) Limited

Business Taxes

Drawings and unrecorded expenditure claimed as wages

Drawings

The Appellant's accounts for the year 2002/03 included a debit for drawings of £5,200 in 'cost of sales'. Drawings are not an expense of a business. In the absence of evidence of wages paid, HMRC disallowed the £5,200 claimed.

Drawings are not expended for the purpose of the trade, but capital withdrawn and therefore is not allowable as a deduction under s 74.

Wages

The Appellant's accounts for 2002/03 also showed a wages debit of £41,600 but following a review of the payroll records only £39,478 had been recorded. HMRC therefore adjusted the accounts in the sum of £2,122.

Discovery assessment

The HMRC assessment in respect of 2004/05 was a discovery assessment under the provisions of s 29 TMA 1970. The Appellant had not substantiated 'employee costs' claimed at £70,400. The total recorded employee costs taken from the payroll records were £46,391 resulting in a difference of unrecorded costs of £24,009.

The Appellant said that the discrepancy may have been because payments had been made to subcontractors. There was however no evidence that the Appellant was contracting within the CIS scheme and no records to indicate that payments had been made to subcontractors. In the absence of any evidence that the sum of £24,009 represented wages or payments to subcontractors that sum was disallowed by HMRC.

Lack of Evidence

At the hearing the Appellant was unable to provide any evidence or persuasive argument as to why the adjustments should not be made to the 2002/03 and 2004/05 accounts.

The Tribunal dismissed the appeal

TC001011: J A Draper Joinery

Whose money is it?

The taxpayer company carried on business as a recruitment agency, providing temporary and permanent workers to customers who were invoiced on a regular basis. All payments, including unreconciled ones, were made to the same bank account.

Customers occasionally overpaid and, where they remained unresolved, the overpayments were shown as a liability owed to customers, until released into the profit and loss account.

The taxpayer claimed that such payments were not trading receipts because they had been made in error. HMRC said the payments were trading income and liable to corporation tax.

The First-tier Tribunal supported HMRC; the taxpayer appealed to the Upper Tribunal (Tax and Chancery Chamber), contending that the First-tier Tribunal had erred in law.

The company argued that its circumstances fell within those in *Morley v Tattersall* 22 TC 51: a payment could not be a trading receipt unless the trader had a legal entitlement to receive it at that time.

The Upper Tribunal did not accept the taxpayer's arguments. First, nothing in TA 1988, s 18(1)(a)(ii) required a taxpayer to be legally entitled to receipts making up the profits, nor had it been stated in Morley that such a requirement existed.

Furthermore, the fact a customer had made an overpayment, and therefore had a restitutionary claim to repayment of that sum, did not mean the taxpayer was not legally entitled to receive it.

On the contrary, the taxpayer was legally entitled to receive and keep the money unless a claim for repayment was made. That was why the taxpayer had done nothing wrong in keeping the money mistakenly paid by its customers.

The payments were trading receipts, and the taxpayer company's appeal was dismissed.

Pertemps Recruitment Partnership Ltd v CRC, Upper Tribunal (Tax and Chancery Chamber)

Thin capitalisation—legislation compatible with European law

The case

The claimants were UK resident subsidiaries of multinational groups which had invested in those subsidiaries by means of loan finance. The proceedings were part of a group litigation challenging the compatibility of the UK rules on "thin capitalisation" with European Community law and consisted of a number of claims for restitution and/or compensation brought by the claimants against the Revenue and Customs Commissioners.

Thin cap rules

Thin cap legislation sought to address what the Revenue considered to be transfers of profits, and therefore transfers of tax bases, from the UK jurisdiction to another.

There were two principal means of corporate finance:

1. Debt finance, companies were generally permitted to deduct interest payments on loans for the purpose of calculating their taxable profits, on the basis that that constituted current expenditure incurred for the pursuit of the business activities.
2. Equity finance, however, companies were not permitted to deduct distributions paid to shareholders from their pre-tax profits; rather, dividends were paid from taxed earnings.

Equity as debt

What was in substance an equity investment might be presented in the form of debt in order to obtain a more favourable tax treatment. The tax incentive to do so was particularly evident if the subsidiary was located in a relatively "high-tax" jurisdiction, while the parent company was located in a lower-tax jurisdiction.

By manipulating the manner in which capital was provided, a parent company could effectively choose where it wished profits to be taxed.

Excessive interest rate

By setting and paying an excessive interest rate, the profits of a subsidiary would be excessively reduced. The aim of thin cap legislation was to treat the interest as if it were payable at a reasonable rate, and to disallow the excess as a deduction from the gross profits of the subsidiary.

Article 9 of the OECD Model Convention with respect of Taxes on Income and Capital applied an "arm's length test" to deal with abusive transactions. The UK legislation adopted a proportionality test which was an arm's length test. Under that test, interest payable by a UK resident group borrower to an non-resident group lender was treated as deductible in the computation of the borrower's taxable profits so long as it did not exceed what would have been payable under a loan transaction negotiated at arm's length. Interest in excess of what would have been so payable was treated as a non-deductible distribution.

Thin cap rules compatible with art 43 of the EC Treaty?

The judge held that the UK thin cap provisions were consistent with arm's length test, but were not proportionate to achieve the purpose of preventing abusive tax avoidance, because they did not allow for a separate defence of commercial justification and so breached art 43 EC.

On appeal

Did the failure to permit a commercial justification of transactions that were not arm's length terms infringe the claimants' rights under art 43 EC?

Legislation that involved the application of the arm's length test did not unlawfully interfere with art 43 EC, if the taxpayer was given an adequate opportunity to present his case to the tax authority that the transaction was on arm's length terms, and could challenge the decision of the tax authority before the national court, and, secondly that the effect of the legislation was limited to those aspects of the advantage conferred by the taxpayer company did not satisfy that test.

There was no doubt that the UK legislation satisfied all of those requirements. It applied the arm's length test, it did not disallow any interest that would have been payable under a transaction on arm's length terms; the taxpayer was given an adequate opportunity to present its case, and it had recourse to the courts if dissatisfied with the decision of the Revenue.

Test Claimants in the Thin Cap Group Litigation v Revenue and Customs Comrs [2011] EWCA Civ 127

Deduction for amortised goodwill

The facts

Martyn Holmes, Nigel Pole and Gilbert Scoular carried on in partnership a business of independent financial advisers for a number of years prior to 30 January 2004.

On 22 July 2003 the Appellant was incorporated and on 16 October 2003 the sole subscriber share of £1 was transferred to an employee of the partnership who was appointed the sole director. On 12 January 2004 a further 999 £1 shares were allotted to the employee and the authorised capital was increased to 10,000 £1 ordinary shares.

On 30 January 2004:

- the partners and the Appellant entered into a written agreement for the sale and purchase of the partnership business as a going concern together with the goodwill and certain assets for a consideration, part of which was to be satisfied by the allotment of 3,000 fully paid shares to each partner on the date of the Sale Agreement. The balance of the consideration, which consisted of the goodwill valued at £1,251,565 and the net book value of the other Sale Assets as defined less the £9,000 attributable to the shares, was left outstanding as a debt.
- the Appellant allotted 3,000 ordinary shares to each of the partners and each partner was appointed a director.

The acquisition of the goodwill was shown as an addition to intangible assets in the Appellant's accounts to 31 March 2004 and a charge of £13,906 amortisation was included in the profit and loss account and the calculation of profits for corporation tax.

This appeal was against an amendment to the Appellant's corporation tax return for the period to 31 March 2004 disallowing a deduction for amortisation of goodwill on the ground that the goodwill did not fall within paragraph 118 of Schedule 29 to the Finance Act 2002.

The issue

"At the time of the acquisition" by the Appellant of the goodwill were the partners related parties in relation to the Appellant? If they were, then a deduction for amortised goodwill would be disallowed under paragraph 118(1)(b) of Schedule 29 FA 2002?

HMRC contended that on acquisition the partners became entitled to acquire the shares and were therefore participators and related parties in relation to the Appellant. The Appellant contended that the partners became entitled to the shares once the goodwill had been transferred.

Findings

The Sale Agreement gave rise to mutual obligations all of which arose at the same time when it was concluded in January 2004. On the Sale Agreement being made, the partners became entitled to the shares and thereby became participators. What mattered was the entitlement to have the shares allotted and issued not when the allotment or issue occurred.

In their judgment the words in paragraph 118(1)(b) "at the time of the acquisition is not a related party" did not apply to the situation in this case when the persons in question became related parties at the same moment in time as the time of the acquisition. The exclusion of related parties was not limited to persons who immediately before the acquisitions were related parties.

They accepted HMRC’s submission that the construction of paragraph 118(1)(b) as applying when a person became a participator at the same time as the acquisition is consistent with the purpose of the statute and with normal language.

Appeal dismissed

TC00982: HSP Financial Planning Ltd

Value Added Tax

Flat rate scheme (FRS) – what goes in BOX 6? (Lecture B650 – 26.29 minutes)

The starting point for deciding what should be included as turnover under the FRS is Notice 733.

Include

- VAT inclusive sales and takings for standard rate, zero rate and reduced rate supplies
- Exempt income, such as any rent, bank interest on a business account or lottery commission.
- Supplies of capital expenditure goods, unless they are supplies on which VAT has to be calculated outside the flat rate scheme and
- Value of any despatches to other Member States of the EC if you are making intra EC supplies.

As exempt and zero rate supplies are included in flat rate turnover, you apply the flat rate percentage to the exempt and zero rate turnover. As the Brief points out, you may pay more VAT by being in the scheme if these supplies are a larger proportion of your business turnover than the average for your trade sector.

Exclude

You exclude from your flat rate turnover:

- private income, for example income from shares
- the proceeds from the sale of goods you own but which have not been used in your business
- any sales of gold that are covered by the VAT Act
- non-business income and any supplies outside the scope of UK VAT,
- sales of capital expenditure goods on which you have claimed input tax.

Territorial scope

Supplies which are "in the UK, but zero-rated" (exports and despatches of goods to foreign business customers) are subject to FRS VAT. Notice 733 contains a warning at the end of para.6.2 to explain that a trader who has higher than an average proportion of such sales for the business sector will probably be disadvantaged by joining the scheme.

Supplies which are placed outside the UK by the place of supply rules (e.g. supplies of most services to foreign business customers) are not subject to FRS VAT.

Bank interest received

In the First Tier Tribunal cases, Fanfield Ltd v HMRC and Thexton Training Ltd v HMRC, it was held that certain bank deposit interest does not need to be reported ion BOX 6. The judge held that a small company is capable of receiving interest on its bank accounts (both deposit and current) as a passive investment activity which is outside the scope of VAT and is therefore not counted for FRS purposes.

HMRC's position had been that all interest received by a company is always:

- consideration for an exempt supply, rather than not consideration;
- received in the course or furtherance of a business, rather than outside the business.

The judge accepted HMRC's first argument but rejected their second. Interest should not be included in the FRS if the receipt of interest is no more than a "satellite activity" which is not a "direct, permanent and necessary extension" of the taxable business.

In the majority of cases, the receipt of interest will be completely passive and incidental, and should therefore be ignored. Any FRS trader who has accounted for FRS VAT on bank interest should be able to make a claim for repayment going back four years. This can almost certainly be made as an adjustment to the next VAT return, because it will probably be rather less than £10,000 (the error correction limit). Any FRS trader who has never thought of accounting for FRS VAT on bank interest can simply rest assured that there will not be a comeback.

© Reed Elsevier (UK) Limited

Applies only to buildings completed on or after 1 March

In *Revenue & Customs Brief 5/11*, HMRC announced a simplification in the change in use provisions. The department have confirmed that the simplified provisions will apply only to buildings completed on or after 1 March 2011, and whose use changes, from a qualifying one to a non-qualifying one, on or after 1 March 2011.

If the buildings were completed before 1 March 2011, the old 'change in use' provisions will apply.

VAT Information Sheet 04/11 has been amended to reflect this clarification and to make other minor clarifications.

Brief 16/11 covers interim application

HMRC intend to legislate to give statutory effect to extra-statutory concession 3.2.2, with a technical consultation taking place in May. *Revenue & Customs Brief 16/11* has been published to set out how the concession should be applied in the interim.

It affects UK VAT groups with an overseas member that buys services from persons outside the VAT group and uses them to make supplies to the UK members. Anti-avoidance legislation was enacted in 1997 requiring a tax charge to be declared on certain supplies by the overseas members to the UK members of the group.

The purpose of ESC 3.2.2 was to ensure that this provision was limited to removing the tax advantage from such structures. It works by restricting the tax charge to the value of reverse charge services bought in by the overseas member. These services were listed in VATA 1994, Sch 5.

However, as a result of a change to the place of supply of services rules in 2010, Sch 5 was repealed.

In the meantime, until the concession has been legislated, the reference to Sch 5 should be read as one to the new general rule for supplies to businesses in s 7A(2)(a).

The concession will continue to allow VAT groups to value the tax charge by reference to the services the overseas member has bought in that would now be treated as subject to UK VAT, if the UK group member bought them direct.

Evidence of the value of the services bought in, and that they have not been undervalued, will still be needed.

© Reed Elsevier (UK) Limited