CONTENTS

PERSONAL TAX 3
2010/11 Tax returns: the key changes *(Lecture P651 - 12.40 minutes)* **3**
Employment status - surgeon assisting consultant cardiac surgeon **5**
Disguised Remuneration **6**
Bosses offered EBT settlement opportunity **6**
Wholly and exclusive EBT contribution? **7**
Were shares received an emolument or a gift? **9**
Racehorses made available as benefit **9**
Class 1A refund re overseas holiday homes purchased through a company **10**
Junior ISAs **11**
Flexible Drawdown: Secondary Legislation **11**
Ordinary residence **12**
10 working days in the UK? **12**

CAPITAL TAXES 14
Main residence relief and inter-spouse transfers *(Lecture P652 - 8.50 minutes)* **14**
How should non-domiciles hold UK property? *(Lecture P653 - 13.42 minutes)* **15**
Topical IHT issues *(Lecture P654 - 10.01 minutes)* **16**

ADMINISTRATION 20
Finance Bill (No. 3) Bill 2011 **20**
Paying HMRC from 1 April **20**
Equitable liability and the new special relief *(Lecture P655 10.52 minutes)* **20**
Reasonable excuse when filing late Online Return **23**
PAYE Update **23**
HMRC toolkits—Company Losses and Chargeable Gains for Companies **24**
Supreme Court to judge on LPP extension **24**
Changes to agent authorisation and registering for SA **25**
Taxman apology over record checks pilot **25**
Employee responsible for PAYE **26**

BUSINESS TAXES 27
Income tax relief for capital losses on shares *(Lecture B651 - 16.19 minutes)* **27**
New style Enterprise Investment Scheme relief *(Lecture B652 - 14.32 minutes)* **28**
Incorporation – the changing tax burden *(Lecture B653 - 14.39 minutes)* **33**
Were losses on the stock market deductible as trading losses? **38**
Return of capital or assessable profits? **38**
Definition of goodwill **39**
Research and Development **39**
Corporation tax on gains *(Lecture B654 - 14.54 minutes)* **40**
Double tax relief **43**

VALUE ADDED TAX 44
VAT on hot food *(Lecture B655 - 23.18 minutes)* **44**
Compound interest claims **44**
Lennartz calculations on a yacht **45**

STAMP DUTIES 46
Residential Transactions: Chargeable Consideration Exceeds £1m **46**

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Personal Tax

2010/11 Tax returns: the key changes *(Lecture P651 - 12.40 minutes)*

For those doing personal tax compliance work, early summer is a time for making sure that they and any staff are aware of the main changes to the self-assessment forms. As expected this year, the main changes are in the area of Capital Gains Tax, although there are a number of other changes to be familiar with too. This article does not seek to discuss in any detail the underlying technical issues, merely to make readers aware of the revised forms.

Before dealing with specific boxes, there is one general point to mention. References to 'surcharge' have been changed to 'late payment penalty', reflecting the change in penalty regime which has now taken effect.

SA100 (Main tax return)

TR4

There are new boxes 11 and 12. These deal with the new rules introduced whereby gifts to charities in certain non-UK states can qualify for Gift Aid. **Box 11** deals with the value of qualifying investments gifted to non-UK charities and **box 12** with Gift Aid payments to non-UK charities.

The box 11 amounts also have to be included in either box 9 (Gifts of qualifying shares and securities) or box 10 (Gifts of qualifying land and buildings). The box 12 amount also has to be included in box 5 (Gift Aid payments made during the year). Details of payments to qualifying non-UK bodies should be included in Box 19 (Additional information).

There is a re-numbering of the subsequent boxes, so that the old boxes 11 to 14 dealing with Blind Person's Allowance become boxes 13 to 16.

SA101 (Additional information pages)

Box 9, like last year, deals with the Special Annual Allowance Charge (SAAC) relating to pension contributions. This results from the anti-forestalling legislation that discouraged high income pension investors from investing an amount above the 'Special Annual Allowance' (SAA). (Broadly, the SAA is the higher of normal pension inputs or £20,000). **Such excess contributions have relief restricted to basic rate tax (20%)**.

Where payments are made that are in excess of the SAA, the SAAC becomes chargeable. With the introduction of the 50% rate, this charge can be at 20% or 30%.

Box 9 is now specifically for amounts chargeable at 20%; a new **box 10** entitled 'Amount saved towards your pension in excess of the Special Annual Allowance taxed at 30%' has been introduced, where the excess contribution falls in the additional rate band.

The introduction of the new box 10 causes the old boxes 10 to 21 to be renumbered as 11 to 22, with appropriate amendments to referencing.

SA103S (Self-employed – short)

SES1

The turnover limit below which a total, rather than detailed, figure for expenses can be given is increased to £70,000. The same figure also appears on the SA103F (self-employed – full) form on page SEF2.

SA108 (CGT pages)

Not surprisingly, in view of the reform of CGT part-way through 2010/11, these pages show the biggest changes this year. Thankfully, they seem to provide a fairly logical way of presenting the year's information so that it can be dealt with properly.

The key boxes on **CG1** are now

- Box 3 – total gains before 23.6.10, when the flat 18% rate applied.
- Box 4 – gains from 23.6.10 and eligible for Entrepreneurs' Relief are taxed at a flat 10%.
- Box 5 – other gains from 23.6.10; these can be taxed at either 18% or 28%, depending on the taxpayer's available basic rate band.
- Box 6 – total losses for the year, which can be allocated as the taxpayer wishes; generally, it will be against post 22.6.10 gains that may be subject to 28% tax.
- Box 15 – gains before 23.6.10 qualifying for Entrepreneurs' Relief; these gains are shown *before* the 4/9 reduction which applied until 22.6.10. Remember that the lifetime limit on qualifying gains is £2m from 6.4.10 to 22.6.10 and then £5m until 5.4.10.

The main changes to **CG2** are

- Box 32 – this deals with attributed gains where personal losses cannot be set off; for this year only, include those attributed pre-23 June 2010.
- Box 33 – into this new box put attributed gains post 22.6.10.

SA109 (Residence, remittance basis, etc.)

RR2

Box 16 The instructions have been amended as follows:

If you are entitled to claim personal allowances as a non-resident on some other basis, ***or as a dual resident remittance basis user under the terms of certain Double Taxation Agreements (see notes)***, put 'X' in the box.

SA800 (Partnership return)

Pages 3, 4 The green writing is revised to the new 3-line account turnover figure of £70,000.

SA900 (Trust and estate return)

Page 3, Q 8.15, 8.16 The wording now reflects the higher tax rates introduced in April 2010, namely 50% and 42.5% (rather than 40% and 32.5% respectively).

Page 6, Q 10C This is a new question: **'Employee Benefit Trusts – do you want to claim relief in respect of discretionary employment income payments?'**.

Box 10C.1 then asks for the amount of relief claimed. This change reflects the enactment of the previous ESC A68, whereby trustees can get some tax relief for tax paid on income that is subsequently distributed as employment income to a beneficiary.

SA904 (Trust and estate foreign pages)

TF2 **Box 4.5** The wording has been changed to '***Disposals of holdings in*** offshore funds, ...' rather than '*Income from* offshore funds, ...'.

SA905 (Trust and estate capital gains)

TC2 contains several changes, similar to those for the individual's CGT pages, which reflect the changes introduced w.e.f. 23 June 2010.

TC4 Question 5.22 ('Are you claiming Entrepreneurs' Relief?') now has two boxes for entries, one for gains post 22.6.10 and one for pre-23.6.10 gains.

In summary, the most important compliance issues for the new returns will be:

1. For high earning clients who could be subject to the pension SAAC, making sure that all relevant details of their pension provision is received; and
2. For those with many CGT disposals, making sure that all dates are correct, so that gains can be allocated to the correct part of the tax year.

Contributed by Kevin Read

Employment status - surgeon assisting consultant cardiac surgeon

Introduction

Mr Mitchell is a consultant cardiac surgeon. He appealed against a decision and determinations for the purposes of, respectively, national insurance contributions ("NICs") and PAYE that Dr Bhimagunta -- who assists Mr Mitchell in operations on Mr Mitchell's private patients -- is Mr Mitchell's employee (or employed earner for NIC purposes).

The facts

Mr Mitchell is a cardiac surgeon and is employed by an NHS trust.

As well as his NHS practice, Mr Mitchell also has a private practice. Where surgery is required by Mr Mitchell's private patients he performs operations at two available hospitals in Nottingham for which he makes all of the arrangements including booking the theatre and medical team including Dr Bhimagunta.

It was clear from the evidence that Mr Mitchell took great care in assembling his surgical team. He made sure that the team was made up of individuals with whom he had worked before and with whose work he felt comfortable.

A contract was entered into between Mr Mitchell and Dr Bhimagunta on 1 February 2005. It is headed "Self-Employed Contract for Services". There was no commitment by Mr Mitchell to use only Dr Bhimagunta as his surgical assistant. Equally, there was no commitment from Dr Bhimagunta to work only with Mr Mitchell, although in practice he only assisted Dr Mitchell. There was no commitment by Mr Mitchell to provide work to Dr Bhimagunta – the work was ad hoc.

Looking at the "whole picture"

As is the norm in status cases there were a number of cases that were considered:

(1) the well-known threefold test set out by MacKenna J in *Ready Mixed Concrete (South East) Ltd v. Minister of Pensions and National Insurance* [1968] 1 All ER 433;

(2) whether the worker is in business on his own account: see in particular the judgment of Cooke J in *Market Investigations Ltd v Minister of Social Security* [1969] 2 QB 173;

(3) the "mutuality of obligation" test: see the judgment of Park J in *Usetech Ltd v. Young (HMIT)* [2004] STC 1671 and *Cornwall County Council v Prater* [2006] EW CA Civ 102;

(4) the "substitution issue": see the decision of the Court of Appeal in *Express & Echo Publications Ltd v Tanton [1999] EWCA Civ 949,* the decision of Park J in *Usetech* (see above) and the decision of Henderson J in *Dragonfly Consultancy Ltd v The Commissioners for Her Majesty's Revenue & Customs* [2008] EWHC 2013 (Ch);

(5) the influence of the surrounding terms; and

(6) the intentions of the parties.

Finding

Overall, the Tribunal considered that none of the tests set forth in the authorities provided a compelling answer in this appeal.

On balance, the Tribunal concluded that the very limited nature of the engagements, their ad hoc and sporadic occurrence, the fixed-price paid per operation, when taken together with the very skilled professional services which Dr Bhimagunta was required to supply indicates a contract for services rather than a contract of employment.

In a borderline case such as this, they believed that they could take into account the fact that both parties specifically intended that Dr Bhimagunta would be self-employed. Usually, the intention of the parties will not be determinative, but in cases of doubt such as this we believe that the intention of Mr Mitchell and Dr Bhimagunta can properly be taken into account.

Accordingly, the Tribunal considered that Dr Bhimagunta was self-employed as regards private operations in which he assisted Mr Mitchell during the relevant periods.

Appeal allowed

Ian Mitchell, 15 March 2011

Disguised Remuneration

Legislation on disguised remuneration is included in the Finance Bill. There are substantial changes, mainly to provide for exemptions for bona fide remuneration arrangements.

HMRC has published a revised version of the FAQs. HMRC confirm that even if the only circumstances that would result in the specified conditions failing to be met are that the employee departs from the employment as a 'bad leaver', the test will be met. But this will only apply if there is no possibility of the employee receiving the reward if the conditions for forfeiture are triggered.

To address the concern that share plans could give rise to charges under the disguised remuneration measure, the legislation now provides that arrangements which have certain characteristics will not give rise to a charge on earmarking at the time that the shares are earmarked.

Loans made by a company in the same group as the employer at the time the loan is made will not be within the scope of Part 7A provided they are not made in connection with a tax-avoidance arrangement. However, there is still no provision for credit to be given for the repayment of any loan made by a third party on or after 6 April 2011, except in the case of certain short-term loans used to exercise employee share options and loans made under an Employee Car Ownership Scheme (ECOS) arrangement.

(www.hmrc.gov.uk/budget-updates/march2011/index.htm)

Bosses offered EBT settlement opportunity

HMRC are offering firms that have used employee benefit trusts (EBTs) and similar arrangements the opportunity to resolve outstanding enquiries without recourse to litigation.

According to the Revenue, employers and companies who are concerned with how their arrangements will be affected by the new disguised remuneration legislation in schedule 2 to the Finance Bill can use the EBT opportunity to obtain certainty about tax liabilities.

Businesses willing to reach a financial settlement with the taxman will be invited to discuss how it might be achieved. Arrangements will depend on the facts of the case.

Where there is a link to the employment, if the settlement is reached before a relevant step under the disguised remuneration legislation is taken:

- recovery of outstanding PAYE and Class 1 National Insurance (NI) contributions (Earnings Basis) on contributions to the trust, with a corresponding corporation tax deduction where permitted;
- the settlement will be an agreement for the purposes of para 58 of the Finance (No 3) Bill 2011 and the employee will be entitled to a corresponding credit against the value of a subsequent relevant step under part 7A of ITEPA;
- where a benefit-in-kind charge has arisen in connection with the amount that has been contributed – for example, on a beneficial loan – credit will be given for the charge.

If a relevant step under the disguised remuneration legislation is taken before a settlement has been reached:

- where tax and NI arise as a consequence of a relevant step which relates to an amount contributed to the trust before 6 April 2011, HMRC will not pursue recovery of PAYE and NI on that same amount for the earlier period;
- where the relevant step does not account for the whole of the amount contributed to the trust before 6 April 2011, the Revenue will be willing to settle the outstanding amount on the basis described above, giving rise to a corresponding settlement credit under part 7A for subsequent relevant steps
- no credit will be given for a benefit-in-kind charge which has arisen on amounts for periods before the charge under part 7A arises.

Where there is no link with employment, HMRC will refuse a corporation tax deduction and amounts will not be subject to PAYE and NI at the point at which the Revenue denies the deduction.

This will not prevent a subsequent tax charge under ITEPA 2003, s 62 of or new part 7A from applying in future, if a later taxable event occurs. If a subsequent tax charge arises, a corporation tax deduction will be permitted.

Interest will be charged on duties in the normal way, and all relevant duties will be taken into account.

HMRC intend to write before the end of August to all employers and companies with open EBT enquiries, to invite discussion about potential settlements. The department says arrangements are in place to ensure a consistent approach is taken.

If firms do not respond to the opportunity by 31 December, the taxman will deal with enquiries formally.

Where HMRC are unable to agree settlement proposals, they will, as appropriate, progress cases within the terms of the litigation and settlement strategy; the new legislation will apply to continuing employee benefit trusts and funds held in them.

‘There seems to be no obvious carrot to take part in this initiative,’ said PKF partner John Cassidy. ‘A company could save litigation costs, but only if it reaches agreement with HMRC. The Revenue is, however, retaining the option to take matters further if no settlement can be reached.’

Taxation, 27 April 2011

Wholly and exclusive EBT contribution?

The appellant company was founded by the D family. In 1954 one of the members of the family, HD, set up a pensions trust company (PTC) and transferred his shares in the appellant to the PTC, as did two minority shareholders. The PTC provided an additional pension to the appellant's employees who were members of its occupational pension scheme. The PTC, which was run by an independent trustee council, supervised the appellant's board to ensure that the business was run in accordance with the philanthropic principles set out in the Blue Book. Those arrangements remained in place

until early 1997 when a change in the law meant that the PTC had to divest itself of its shares in the appellant. Accordingly in order to make sure that the shares continued to be run in accordance with the Blue Book, the pension fund was merged with the appellant's main scheme and the combined scheme was administered by the PTC. Then on 28 January 1997 the appellant paid £3 million to a trustee company (TC) so that TC could purchase the appellant's shares from the PTC. On 29 January 1997 the employee benefit trust (EBT) was established, under a trust deed, for the benefit of former and present employees and family members. Under cl 5 of the trust deed, the trustees could in their absolute discretion pay or apply or transfer to the benefit of any beneficiary, including the employees of the appellant, the whole or any part of the trust fund. Clause 9 limited such transfers to two circumstances: (i) under cl 9.1.1, to any agreement entered into by the trustees with the appellant under cl 5.3; and (ii) where they were sanctioned, under cl 9.1.2, by all of the trustees, directors of the appellant and employees. Also on 29 January 1997, the appellant's shares were purchased by the TC pursuant to a share sale agreement and settled by it on the terms of the EBT. The EBT thus held the appellant's shares for the benefit of all the appellant's employees while the pension scheme was now held separately. In its corporation tax return for the period ending 31 December 1997 the appellant deducted the £3 million payment against its taxable profits. HMRC disallowed the claim and the appellant appealed. The issue arose as to whether the payment was: (i) made wholly and exclusively for the purposes of the appellant's trade within the meaning of TA 1988 s 74(1)(a); (ii) a revenue, or a capital, payment; and (iii) a "potential emolument"—as defined in FA 1989 s 43(11)(a) to be "amounts or benefits reserved in the accounts of an employer, or held by an intermediary, with a view to their becoming relevant emoluments"—it being common ground that the TC was an intermediary for the purpose of s 43(11).

A payment by a company intended, at least in part, to prevent outsiders becoming shareholders could amount to a payment made wholly and exclusively for the purposes of a trade within the meaning of TA 1988 s 74(1)(a) where, as in the instant case, it was the means to an end, or purpose, which was to perpetuate principles established to ensure efficient or harmonious management and working practices. That conclusion was not based on the mere connection of the new structure with the appellant's trade, but the fact that the structure was put in place to secure the goodwill and cooperation of its workforce and that expenditure was for the purpose of earning profits in the appellant. Nor was it material that that was sought to be achieved by retaining the appellant's shares in an EBT, rather than by transferring shares to employees, or the fact that the benefits were made available to a wide range of employees of varying degrees of qualification. It was the purpose of the payment that was the relevant factor. The fact that it resulted in an accounting loss in the accounting period of payment did not preclude the payment from being generally for the purpose of earning potential profits in the trade. Thus the payment to the TC was wholly and exclusively for the purposes of the appellant's trade.

In considering whether, as a matter of law, a payment was a capital or revenue payment where, as in the present case, no asset was brought into existence, it was necessary to look at whether what had been brought into existence was an advantage for the enduring benefit of the trade, according to the legal meaning of the phrase. That could not be determined by reference to the long-term nature of the advantage alone. What was important was whether there was an identifiable asset, or an advantage or benefit that endured in the way that fixed capital endured. On the facts, the advantage to the appellant was not one that endured in the way that a fixed asset endured. On that basis the payment by the appellant to the TC was a revenue, and not a capital, payment.

Whether payments were held "with a view to their becoming relevant emoluments" for the purposes of FA 1989 s 43(11)(a), in circumstances where the payments depended on the exercise of a discretion, depended on the nature of that discretion and consequently the extent of the contingency affecting the payment of emoluments. What had to ascertained was the extent to which the discretion was qualified or fettered in order to determine whether the possibility of the funds being used to pay relevant emoluments was a realistic one. Cl 9.1.1 of the trust deed effectively disapplied the fetter in cl 9.1.2. The background to the establishment of the EBT could not affect the construction of the plain words of cll 5.3 and 9.1.1. That absolute and unfettered discretion to enter into an agreement with the appellant and to transfer shares to employees was one in a range of realistic possibilities available to the trustees. Therefore the payment made by the appellant to the TC to acquire the shares were amounts or benefits held by the trustees "with a view to" their becoming relevant emoluments within the meaning of FA 1989 s 43(11) and were thus "potential emoluments". It followed that the appeal would be dismissed.

JT Dove Limited v Revenue and Customs Comrs [2010] UKFTT 16 (TC)

Were shares received an emolument or a gift?

The taxpayer appealed against an income tax assessment for the tax year ended 5 April 2002.

The assessment in question concerned his receipt of company shares which HMRC believed to be emolument and therefore liable for income tax, as well as PAYE deductions.

An in-depth history of earlier proceedings as well as the relationship between the taxpayer and his employer was presented to the tribunal.

Within this, the judge heard that the company, from which the shares originated, was part founded by the appellant and, over the years, a friendship grew between the appellant and the owner. In 2001, the owner died, leaving shares to the appellant.

The issue was whether or not the appellant had received an emolument from his employment. The tribunal were referred to TA 1988, s 131(1) where the term ‘emolument’ is defined as ‘all salaries, fees, wages, perquisites, and profits whatsoever’.

Thus the appellant’s liability to the income tax charges depended on whether the shares represented a benefit or profit from his employment.

The appellant contended that the evidence showed that the transfer was a gift from his late employer and friend, which was designed to reflect his gratitude towards the appellant for the role he had played in founding, as well as developing the business of the business.

As regards TA 1988, s 203F(2)(e) the tribunal accepted it was sufficiently unlikely that, when the appellant received the shares in 2001, he would be eligible for cash in respect of them.

The tribunal concluded that the transfer to the appellant was not an emolument from his employment within the meaning of TA 1988, s 19.

The taxpayer’s appeal was allowed.

Kieran Anthony Rogers

Racehorses made available as benefit

The taxpayer company appealed against HMRC’s decision that it was liable to pay Class 1A National Insurance in respect of racehorses made available as a benefit to the employee (H).

The employee subsequently appealed against an assessment charging him tax on the benefit of the racehorse being made available to him for his personal use.

The First-tier Tribunal directed that the appeals be heard together.

It was accepted that H and his wife were 90% shareholders of the company which dealt in the sale and hire of heavy plant to the construction industry.

The company also acquired racehorses, although H had no interest in racing and rarely attended race meetings. H said he received no personal benefit from the company’s ownership of the horses, although it did provide a useful talking point with some of the company’s customers who followed racing.

Although the horses were registered in H’s name, the acquisition and training costs were met by the company and any prize money belonged to the company.

HMRC claimed that the horses were at H’s disposal and were a taxable benefit.

The tribunal, after going through the evidence, concluded that the appellant had no interest in horses or horse racing and therefore did not receive any taxable benefit by having the racehorses registered in his name.

Both H’s and the company’s appeals were allowed.

Chepstow Plant International Ltd and Edward Hayward (TC1035)

Class 1A refund re overseas holiday homes purchased through a company

The Finance Act (FA) 2008 introduced new provisions to the Income Tax (Earnings and Pensions) Act 2003 (ITEPA): sections 100A and 100B. These provisions effectively provide an exemption from the living accommodation tax charge where living accommodation outside the UK is provided by a company for a director or other officer of the company (D) or a member of D's family or household where all of the following apply:

- the company is wholly owned by D or D and other individuals (and no interest in the company is partnership property),
- the company's main or only asset is a relevant interest in the property
- its only activities are ones that are incidental to its ownership of that interest

The new legislation was treated as having always had effect. In other words, the new legislation meant that since the coming into force of these provisions in the Finance Act 2008 a charge to Income Tax on the benefit provided through a qualifying overseas holiday home has never existed. As a consequence any liability to Class 1A National Insurance contributions, which was due on an amount equivalent to the general earnings charge in ITEPA, was also removed from 21 July 2008. At that time HM Revenue & Customs (HMRC) advised that refunds of tax could be claimed on the basis that the living accommodation tax charge was never intended to apply in these circumstances and the new legislation is treated as always having had effect.

However the same wasn't the case for Class 1A National Insurance contributions (employer only). In the case of overseas holiday homes, it remained the case that for the years prior to the enactment of Finance Act 2008, Class 1A National Insurance contributions remained due on the benefit in kind chargeable to Income Tax. HMRC published Regulations on 17 March 2011 that align the National Insurance contributions position with that for Income Tax - The Social Security (Contributions) (Amendment No. 3) Regulations 2011 (SI 2011/797). This means that it is now possible to claim a refund of Class 1A National Insurance contributions in the same way as it was possible for Income Tax. A refund of Class 1A National Insurance contributions can be claimed where contributions have been paid and an officer of HMRC is satisfied that the contribution was paid on the same amount treated as earnings that are now exempt under the relevant legislation in ITEPA.

Refunds

Any individual who can show that they have paid Class 1A National Insurance contributions for any year before 2008-09 on the benefit of living accommodation which qualifies for exemption in accordance with sections 100A and 100B of ITEPA should write to HMRC giving the information listed below:

1. name, address, National Insurance number and/or Unique Taxpayer's Reference

2. if agent acting - agent's name and address

3. details of the living accommodation outside the UK - address, type of property, uses made of the property

4. details of the company through which living accommodation outside the UK is provided including name, address, nature of company/entity, place of incorporation, ownership and activities

5. an explanation of why they consider that the exemption applies

6. the years for which Class 1A National Insurance contributions have been paid on the benefit of this accommodation

7. evidence that the benefit of the accommodation in question has been taxed - acceptable evidence would include for each year copies of one or more of the following documents which clearly show the benefit as taken into account as taxable income:

- assessments/self-assessments
- P11Ds and P11D(b)
- correspondence with HMRC or the former Inland Revenue

Note that the above list is not intended to be exhaustive. HMRC will consider any other documentary evidence in the individual's possession that the individual believes can show that the benefit has been taxed as earnings and Class1A National Insurance contributions has been paid on the same amount treated as earnings.

Time limit for making a refund claim

Any application for a refund in these cases must be made in writing on or before 6 April 2015.

HMRC will take action to identify those customers who have previously claimed refunds of tax and Class 1A National Insurance contributions and arrange to refund the Class 1A National Insurance contributions already paid. However, if you wish to submit details of your original claim again please quote any reference number that you were given previously and send it to the above address.

Junior ISAs

HMRC has published details of the new Junior ISAs. These are in the form of draft regulations for consultation.

- All UK resident children under 18 who do not have a Child Trust Fund will be eligible
- Anyone with parental responsibility for an eligible child will be able to open Junior ISAs
- Until the child reaches 16, accounts will be managed on their behalf by a person with parental responsibility for that child.
- At age 16, the child assumes management responsibility for their account.
- Both ‘cash’ and ‘stocks and shares’ Junior ISAs will be available.
- Children will be able to hold up to one ‘cash’ and one ‘stocks and shares’ Junior ISA at a time.
- Each eligible child will be able to receive contributions of up to £3,000 each year
- Withdrawals from Junior ISAs will not be permitted by account holders until the child reaches 18, except in cases of terminal illness or death.
- At the age of 18, the Junior ISA will by default become a normal adult ISA.

Flexible Drawdown: Secondary Legislation

HMRC has published draft secondary legislation on the flexible drawdown rules which apply from 6 April 2011.

The Finance Bill includes primary legislation enabling individuals with a lifetime pension income of at least £20,000 a year to access the whole of their drawdown funds without being subject to any annual limits.

The Regulations prescribe three categories of payment that are not to be regarded as ‘relevant pension income’ for the purposes of satisfying the ‘minimum income requirement’, including defined benefit arrangements where there are fewer than 20 pensioner members and money purchase arrangements where the pension scheme has less than 20 pensioner members entitled to such pensions.

(www.hmrc.gov.uk/budget-updates/march2011/pensions-annuitise.pdf)

Ordinary residence

In *Tuczka v Revenue and Customs Comrs*, in 1997 the Austrian taxpayer began to work in London. He later bought property in London and his partner moved from Austria to join him in London. In 2002 he accepted a new job which allowed him to divide his time between London and Vienna.

Questions arose as to whether he was ordinarily resident in the UK for the relevant period.

The taxpayer contended that, to be ordinarily resident in the UK, he had to have the intention of staying in the UK permanently or at least for an indefinite period.

Dismissing the taxpayer's appeal, the Upper Tribunal held that, for an individual to be classed as "ordinarily resident" in a country, there was no requirement that he intended to stay there permanently or for an indefinite period.

10 working days in the UK?

Recently there has been inaccurate commentary in the national press which suggested that HMRC had recently indicated that it would challenge the non-UK residence of those individuals who spend more than ten working days in the UK in a tax year.

This mis-conception arose from a proposed revision to HMRC6 on 'non-residence and full-time work abroad' and what HMRC would regard as 'incidental duties' carried out in the UK. This is an important point as HMRC accepts that an individual can break UK residence if they leave the UK under a full-time overseas contract which spans a complete tax year. HMRC6 states that it is not necessary to sever links with the UK in a more thorough fashion as long as the individual does not return to the UK for an average of 91 days or more per tax year or more than 183 days in any one tax year.

HMRC has given us permission to reproduce the draft guidance in full to allay these concerns. The guidance is as follows and will be included in the proposed revision to HMRC6:

'Non-residence and–full time work abroad
You can become non-UK resident if you make a break with the UK through working full time abroad.

'Full time work abroad' means a genuine, full time, foreign employment. This could be either a contract with a foreign employer or a formal secondment to a non-UK position by a UK employer.

If you claim that you have left the UK to work full time abroad we will expect you to be able to demonstrate that you are working equivalent hours to full time foreign employees, at the same level in the same line of business, in the country concerned. It is expected that this will normally be a minimum of 35 hours a week.

If you are working abroad you may still have to physically return to the UK sometimes to do some work here. You will be expected to show that the amount and nature of any work carried out in the UK do not prevent the overseas work from satisfying the criteria required for it to be considered to be full time.

The evidence required to demonstrate that you are in full time work abroad may include the following:

- A description of the nature of your work and responsibilities
- The results of your work
- Timetables of activities, including time spent and nature of work done in the UK
- Reports that you made to your employer on your performance
- A record of the annual leave you took

Duties in the UK
HMRC accept that it has a practice whereby non residence can be demonstrated by working abroad full time even though some of the duties carried on in the UK are substantive. Although this is not in accordance with the definition of full time work at section 830 Income Tax Act 2007, HMRC's guidance on ceasing to be UK resident covers a wider range of issues than that section.

How much work can be carried on in the UK depends upon the facts and circumstances relevant to each individual. However HMRC will generally accept that working in the UK for fewer than 10 days in a year will not by itself prevent an individual claiming they have made a break with the UK because they are working full time abroad. If more days than this are worked in the UK, whether an individual is working full time abroad will depend upon their particular circumstances.

Given that

a. Residence is a long term issue affecting the entirety of a tax year and individuals and companies will have planned actions on the basis of HMRC guidance, and
b. The government has announced that it will consult on a statutory residence test to codify the rules on residence

HMRC can confirm that for 2011/12 this practice will continue. It will however, be reviewed for future years having regard to the outcome of the consultation on a statutory residence test'

This guidance gives some clarity in this area and helps address the question of the acceptable frequency of business visits to the UK by an individual working full-time abroad. As a general rule if the UK work is for less than ten days per annum HMRC will accept that UK duties are 'incidental' without further investigation. If more than ten days are spent in the UK this does not mean that HMRC will automatically argue that there is no full-time contract of employment abroad, it will depend on the facts. Where the full-time contract of employment overseas is not in point in considering whether an individual has broken their UK residence status this new guidance is irrelevant.

HMRC has also updated its Employment Income Manual (EIM) in respect of 'incidental duties' and this can be found at EIM40204.

ICAEW Tax Faculty, April 2011

Capital Taxes

Main residence relief and inter-spouse transfers *(Lecture P652 - 8.50 minutes)*

The basic CGT provision is that an inter-spouse transfer takes place on a no gain no loss basis (S58 TCGA 1992). The transferee spouse acquires their interest in the property on the date of the transaction, but at the transferor spouse's base cost.

Sole or main residence twist

Where there is an inter-spouse transfer of an interest in a sole or main residence, the principle outlined above applies, but with an added twist.

By virtue of S222(7) TCGA 1992, the recipient spouse's period of ownership is deemed to commence not at the date of the transfer but instead at the date of the original acquisition by the transferor spouse.

Furthermore, any period during which the property was the sole or main residence of the transferor spouse will also be deemed to be that of the transferee spouse. In other words, the transferee spouse effectively stands in the shoes of their other half (ie. the transaction is backdated).

Conditions

However, in order for the backdating regime to apply, there are two conditions which must be satisfied. At the date of the transfer of the interest in the property:

1. the spouses must be married and living together; and
2. the property in which the interest is being transferred must be the couple's sole or main residence.

Although this backdating rule will not always be desirable, with a little careful planning it may be possible to turn the situation to the couple's advantage.

Illustration

Nigel has been living overseas for many years, but, in 10 years' time when he retires, he plans to return to the UK with his wife.

While they are still abroad, Nigel and his wife arrange to buy a house in London in their joint names which they intend to let out prior to their return to the UK.

Following their return, any subsequent sale of the London house is likely to precipitate a CGT charge for each spouse, given that, for the 10 years prior to their return to the UK, the property had not been either spouse's sole or main residence.

One option is for Nigel to purchase the house in his own name and let the property out as planned. Shortly before returning to the UK, Nigel transfers his entire interest in the property to his wife.

This transaction is deemed to take place at the date of the transfer and is done on the normal no gain no loss basis. However, there is no backdating because, at the time of the transfer, the London house was not the couple's sole or main residence. On any future sale by Nigel's wife, the entire capital gain is exempt because the house qualifies as the wife's sole or main residence throughout her period of ownership (Nigel's period of ownership, when the property was let, is irrelevant).

Letting the property

This issue may also be in point where a married couple purchase a sole or main residence but it is known that, at a later date, the property is likely to be let out. In such circumstances, it will be preferable for one spouse initially to own the property with a view to a transfer to the other spouse prior to the couple returning to live in the house or flat.

Advice needed

Although inter-spouse transfers of property interests are widely believed to be tax-neutral, they can give rise – often unknowingly – to both planning opportunities and pitfalls. Sound advice is essential before making any such transfers.

Contributed by Robert Jamieson

How should non-domiciles hold UK property? *(Lecture P653 - 13.42 minutes)*

From time to time advice is sought about the best way for a UK-resident but foreign-domiciled client to hold residential property here in the UK. The house or flat is invariably valuable and, because it is situated in the UK, it will be liable to an IHT charge when the client dies. Even non-UK domiciled individuals are subject to IHT on UK-situated assets. The value of a comparatively modest freehold house in Central London can create a very substantial IHT exposure which most non-UK domiciled clients find undesirable.

A traditional answer to this dilemma is to ensure that the UK property is purchased by an offshore company. The individual then owns shares in an overseas company which represents foreign property for IHT purposes and so is excluded from the scope of the tax – problem solved!

Unfortunately, it is not quite as simple as that. There are a number of other issues which arise and which need to be considered.

One of these is the possibility of a charge to income tax under the benefit in kind legislation on the basis that the client is an employee of the company and is receiving the benefit of company-owned living accommodation. If so, he is chargeable to income tax on the annual value of the property in the normal way plus the supplementary charge under S106 ITEPA 2003, which is calculated at 4% of the cost of the property over £75,000. For a house costing £2,500,000, this currently equates to an annual benefit in kind of £97,000. HMRC's argument is deceptively simple. The client is a person in accordance with whose instructions the real directors are accustomed to act. He is therefore a shadow director. A shadow director is in the same position as any other director and is regarded as an employee. Accordingly, he is an employee who has living accommodation provided for him by the company which, by definition, is provided by reason of his employment. As one commentator has said:

'All the building blocks are in place for the benefit in kind charge to arise.'

It is therefore necessary to ensure that the purchase is structured so as to eliminate this charge.

There is also the question of the company's residence position. HMRC could easily argue that the company was resident in the UK on account of the overwhelming influence of the client on its operations so that the central management and control of the company would take place where the client lived. Accordingly, in the event of a sale, any capital gain on the property would be fully chargeable to corporation tax. No principal private residence relief would be available given that the house or flat was owned by the company and not by the individual personally.

For all these reasons, the client is likely to establish a non-UK resident trust to purchase the property and the trustees will arrange for the property to be held by an offshore company under their control (they will do this in order to protect the trust fund from any unnecessary IHT charge). This structure should also be helpful in connection with both the benefit in kind and the corporate residence arguments.

There is still one difficulty. The UK-resident but non-UK domiciled client may be protected from IHT and benefit in kind charges, but he is now exposed to a charge to CGT when the property is sold. If the company makes a gain, that gain is attributable to the trustees and the trust gain will then be taxed on the client to the extent that he has received benefits from the trust (which of course he has, given that he has occupied the property for a number of years). The full gain might not be chargeable – the computation will depend on the length of time for which he has lived in the property and the precise calculation of the benefit which he has enjoyed from it. But a substantial gain will still arise. If members of his family also occupy the house or flat, they could have part of the gain attributed to them as well.

In the words of one tax expert:
'One might ask why, with this serious CGT disadvantage, has it been traditional for this structure to be used. And the answer is that, until 6 April 2008, a trust established by a foreign-domiciled individual did not give rise to any capital gains being attributed to the beneficiaries. Unfortunately,

that exemption has been removed and the beneficiaries are liable to CGT by reference to capital payments under S87 TCGA 1992 in the traditional way. The foreign-domiciled beneficiary can still be advantaged by the remittance basis so that benefits received outside the UK and not remitted to the UK are protected, but, in these circumstances, the benefit is received in the UK and no advantage is therefore derived for the individual by reason of his foreign domicile. Companies have no equivalent of S225 TCGA 1992 whereby trustees can be allowed the main residence exemption if the property is occupied as the main residence of a beneficiary.'

Although the use of a company is a clear answer to the IHT problem and the implications regarding most of the other taxes can perhaps be managed, one has to ask the question 'Why are we doing all this?' In other words, what is the real problem? It is of course IHT. But how real is that liability and is it worth all these complications and costs, perhaps running over several decades?

In fact, IHT may not be a problem at all, because the client might simply leave the property to his wife on his death and full exemption under S18 IHTA 1984 will then be available. She would have the rest of her life to decide what to do with the property, having regard to her own tax position. In many cases, the property will be sold as it may be too large for the widow in her new circumstances. If so, the problem disappears.

There is of course a risk that both spouses could die in an accident, in which case there would be no spouse exemption and the full value of the property would be immediately chargeable. However, depending on the age of the client, this is a matter which can probably be most simply and effectively covered by a life assurance policy which pays out on the second death.

Contributed by Robert Jamieson

Topical IHT issues *(Lecture P654 - 10.01 minutes)*

Budget 2011 and rates and allowances

The nil rate band (NRB) for the tax year ending 5 April 2012 will remain at £325,000 and is currently set to remain at that level until April 2015. IHT is payable at a rate of 40% on transfers of value in excess of the NRB, while some lifetime gifts can attract a 20% IHT charge. A frozen nil rate band will drag more people into IHT over time.

The Chancellor announced in the Budget 2011 that, from April 2012, the rate of IHT will be reduced to 36% for estates leaving 10% or more to charity.

Specifically, **from 6 April 2012**, where 10% or more of an estate is left to charity, the balance of the estate in excess of the nil rate band will be taxed at 36% rather than 40%. The way the relief is expected to work effectively removes the gifted assets from the charge to IHT, but any estates which give more than 10% will find their relief limited to 10%.

For example, the taxpayer has £1 million and wants to give £100,000 to his favourite charity on death. This leaves £900,000 which after tax at 36% will leave an estate of £576,000. It's of course not that exciting as currently an estate of £1 million subject to 40% tax would leave £600,000.

Business Property Relief (BPR)

HMRC v Brander [2010] UK UT 300

A First-Tier Tax Tribunal case (the *Fourth Earl of Balfour v HMRC* TC69) looked at entitlement to Business Property Relief (BPR) for IHT. This was a Scottish case involving Scots law but there were some interesting and useful factors for other parts of the UK. It has since gone on appeal to the Upper-Tier Tribunal and the taxpayer has won again.

Lord Balfour had an interest in a farming partnership and was the proprietor of a landed estate of approximately 2,000 acres that consisted of two in-hand farms, three let farms, 26 let houses and two sets of business premises. There were also some parks, which were let on a seasonal basis.

Lord Balfour died in June 2003 and subsequently HMRC sought to deny BPR on the Earl's estate on the grounds that it was not relevant business property. Lord Balfour made no distinction between the partnership and the estate. He seemed to take the view that everything was run as a single business. The total trading turnover regularly exceeded the letting income for the years under review, but not

always by very much. The tribunal concluded that the whole of the activities represented a single business. This is interesting because arguable the farming partnership could be regarded as a separate activity from the letting of residential and commercial premises.

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

The Upper-tier Tribunal has now upheld the First-tier Tribunal decision on the basis that it had not acted perversely on the facts. The question of whether a business consisted wholly or mainly of making or holding investments was a question of fact for the decision-maker. The decision-maker was required to look at the business in the round and, in the light of the overall picture, to form a view as to the relative importance to the business as a whole of the investment and non-investment activities in that business. On the evidence, the tribunal had been entitled to conclude that the deceased had operated the estate as one business.

Nil rate band

House prices have fallen and may still fall further. House prices were often the main reason that people fell into the IHT net. Does this mean that IHT planning is no longer necessary?

If only it were that easy. What if house prices don't fall far enough to take clients out of the IHT net? What happens if/when house prices increase again? What about other assets that they might have such as savings or potential lump sum payouts from death-in-service cover? This is where knowing your client and the inheritance rates, reliefs and exemptions is invaluable. Overall it is unlikely that the market conditions alone will remove the need for IHT planning.

The IHT nil rate band is being frozen at £325,000 and that may be until 2015. However, one of latest planning opportunities is the transferable nil rate band between spouses or civil partners. As discussed later, not only does this offer an opportunity for some clients to keep their Wills very simple, but some couples may be able to utilise four nil rate band allowances between them! This could actually remove the IHT liability for some couples.

There are therefore many different areas of estate planning to discuss with clients and by putting this onto an annual review basis with clients you will have the opportunity to discuss a range of tax issues.

Wills

The importance of having a valid Will is of course well known to most. For example, avoiding intestacy rules, tax planning, flexibility (or ironically control) are amongst the main advantages. But as client's circumstances change, their Wills should be kept under review. For example, is their choice of executors/trustees still appropriate, do any of the beneficiaries need to be added (or removed!), has the client got married, or has the first grandchild just arrived?

All these events give the opportunity for advisers to talk to their clients about their Wills and general estate planning issues.

Regularly review client's Wills to ensure their terms meet the client's **current** circumstances and wishes. It is also a good way to open discussion about wealth planning in general and can lead to other work and planning opportunities.

Transferable nil rate bands

The Pre-Budget Report in October 2007 announced the introduction of transferable nil rate bands between spouses and civil partners. This rule was backdated to include those couples where the second death was on or after 9 October 2007.

This provision will benefit couples where not all the nil rate band allowance was utilised on the first death, as the nil rate band available on the second death will be increased accordingly. Surprisingly

the rule changes were set up so that they apply even if a widow or widower lost their spouse many years before 9 October 2007.

Example - a transferable nil rate band

Mr Smith died leaving a legacy to a Will trust, which used 25% of his nil rate band (say £200,000 nil rate band allowance at date of death). The balance passed to his widow absolutely so the spouse exemption applied. On the widow 's death, she will be entitled to an extra 75% of the nil rate band allowance at the rate then in force on her own death (say 75% of £325,000). This is in addition to widow's own nil rate band, so she would be entitled to a total of £325,000 plus 75% of £325,000 = £568,750.

It should be noted that even if an individual has survived more than one spouse or civil partner, they will not be able to claim more than two nil rate band allowances on their own death, but this does lead to some interesting planning points.

For example, where a widow has remarried, it can be beneficial to utilise her two nil rate bands (one inherited from her already deceased husband and her own entitlement) on the first death. This leaves the surviving husband to use his own nil rate band later on. In this type of case, the couple will have utilised three nil rate bands. However, say a widower marries a widow, then it would be possible for two nil rate bands to be used on each of their deaths, hence using **four allowances** between them! Utilising the two nil rate bands on the first death could be achieved by passing assets into a discretionary trust or absolutely to other family members on the first death.

A word of warning is appropriate here. In order to claim the unused nil rate band of the deceased on the death of the survivor, Her Majesty's Revenue & Customs (HMRC) Form IHT 216 will need completing and submitting within 24 months from the end of the month in which the second death occurred. This is therefore effectively something you need to elect for and you will risk a PI claim and an irate client if you miss the deadline.

In addition a substantial amount of information is required, which may be difficult to obtain if the first death was many years ago.

From now on, a record of all the required information to make a claim for the transferable nil rate band could be collected after the first death in order to assist the executors of the surviving partner. The types of information and documents HMRC will expect to see are:

- a copy of the IHT forms or full written details of the assets in the estate and their values
- death certificate
- marriage or civil partnership certificate for the couple
- copy of the grant of representation (Confirmation in Scotland)
- copy of the Will, if there was one
- a note of how the estate passed if there was no Will
- a copy of any Deed of Variation or other similar document if one was executed to change the people who inherited the estate
- any valuation(s) of assets that pass under Will or intestacy other than to the surviving spouse or civil partner
- the value of any other assets that also passed on the death of the first spouse or civil partner, for example jointly owned assets, assets held in trust and gifts made in the 7 years prior to death
- any evidence to support the availability of relief (such as agricultural or business relief) where the relievable assets pass to someone other than to the surviving spouse or civil partner.

The widow, widower or surviving civil partner may wish to keep these documents with their own Will, if they have made one, or with other important documents, to ensure that a claim can be made for the transfer of unused nil rate band on their death.

Deed of Variation

There are few areas of tax where planning can be carried out after the occasion, but fortunately death is such an event. Even if someone dies intestate, it may be possible to vary the distribution of the estate using a Deed of Variation (s142, IHTA 1984), as it allows the original recipient to redirect assets to someone else as though they had never inherited under the will.

For IHT, the deceased is treated as making the gift of assets subject to the deed of variation to the new beneficiary as at the date of death. If assets are varied into trust, the deceased will be the settlor for IHT purposes and where relevant, 10 year charges are calculated from the date of death.

The main rules are that deed of variation must be made within two years of death, only the free estate (as opposed to the settled estate) can be varied, no consideration is given and the person making the variation has the capacity to do so. This makes it extremely difficult to vary the inheritance of a minor child or assets left on trust.

It should be noted that different rules apply for capital gains tax and income tax and these will also need to be considered.

A deed of variation can be used to redistribute the deceased's estate but the consent of the original recipient will be required. The signatory must be at least 18 years old and of sound mind.

Contributed by Francesca Lagerberg

Administration

Finance Bill (No. 3) Bill 2011

Finance (No 3) Bill 2011 was published on 31 March 2011. The Bill is the third Finance Bill of the Parliamentary session but, once enacted, will become Finance Act 2011.

The Bill runs to 93 clauses and 26 Schedules.

Paying HMRC from 1 April

HMRC have reminded taxpayers of a number of changes that came into play from 1 April 2011:

- Company tax returns must be filed online
- All corporation tax and related payments including interest and penalties must be made electronically
- Payments of Class 2 NICs become due on 31 July and 31 January.
- HMRC now issuing late payment penalty notices to taxpayers who paid their PAYE late in the 2010/11 tax year.
- Penalties will apply for VAT returns not submitted online for accounting periods ending on or after 31 March 2011.

Equitable liability and the new special relief *(Lecture P655 10.52 minutes)*

Introduction and background

Equitable liability for income tax and corporation tax was a practice whereby HMRC accepted the evidence of time-barred returns, accounts, claims etc where there was a tax debt but no longer any legal right to adjust the liability. The amount of the legal liability was not actually amended, but HMRC agreed not to pursue the difference between the original liability and the revised amount.

The practice was introduced in the days when the old Inland Revenue had Crown preference for debts in insolvency, and including an inflated claim based on estimated assessments could be unfair to other creditors. It could also have been used to ensure fair treatment of the taxpayer in appropriate cases, and used in cases not involving insolvency. Controversially, details of the practice were not made public until 1995, and the admission of the existence of the practice was largely due to pressure from *TaxAid* and other organisations who saw how valuable, right and proper the practice actually was.

Equitable liability was one of a number of non-statutory practices which HMRC felt they had no option but to review following the *Wilkinson* decision which indicated that HMRC's administrative discretion is more limited than had been thought, and basically all ESCs should either be legislated for or dropped.

HMRC decided to withdraw equitable liability from April 2010 because circumstances had changed and they no longer had Crown preference. Furthermore, under self-assessment there is now a much longer period in which an assessment can be amended or a determination displaced. HMRC also considered that equitable liability no longer fell within its discretionary power.

Summary of the new position

Following consultation, equitable liability has been replaced from 1 April 2011 by a new and statutory special relief. Previously if a taxpayer had no statutory remedy to adjust an excessive assessment or displace a determination because the time limit for submitting a return had passed, HMRC would in some cases be prepared not to pursue their legal right to recover the full amount due as explained above. The stated purpose of the equitable liability concession was to provide a 'relief of last resort' for certain taxpayers, particularly those vulnerable taxpayers who were unable to fully engage with the tax system, for a number of different reasons.

Details of the special relief

In HMRC Brief 17/11 it is explained that previously, where a taxpayer had no statutory remedy to adjust an excessive assessment or displace a determination because the time limit for submitting a return had passed, HMRC would in some cases be prepared not to pursue their legal right to recover the full amount due – specifically if, in their view, it would be *unconscionable* to pursue recovery of the full amount based on evidence provided. That is said to mean *completely unreasonable* or *unreasonably excessive.*

From 1 April 2011 equitable liability was replaced by a new, statutory, "special relief". As a result HMRC will no longer accept new requests for equitable liability but will still continue to consider those claims for equitable liability received before then

There is of course still the machinery by which a taxpayer can make a late appeal against an amendment or assessment if they have a reasonable excuse for not having appealed within time, or if they apply to the tribunal.

There is no right of appeal against an HMRC determination where a taxpayer has not submitted a self-assessment return. Instead taxpayers who disagree with the determination should displace it by submitting a self-assessment return. If out of time to make a self-assessment to displace a determination, and if unable to claim overpayment relief, the taxpayer may be able to claim special relief which is accordingly a form of overpayment relief applying to amounts charged in HMRC determinations for income tax self-assessment or corporation tax self-assessment where no other statutory remedy is available.

A person who has received a notice to make a return must do so by the filing date. When a person fails to meet this obligation, HMRC has the power to raise a determination of the liability due and unpaid to the best of their knowledge and based on the information available to them. Where HMRC issues such a determination the sum on it becomes the amount that is legally due to be paid. There is no right of appeal against a determination, but submission of the return displaces the determination and the determined amount of tax is automatically amended to the return amount, provided the return is received within the time allowed.

If these time limits are passed a person may, subject to what follows, claim special relief, if HMRC have made a determination in the absence of a return for a year of assessment or accounting period and the person is out of time to make a return to displace the determination, and they are unable to claim overpayment relief.

Unlike claims to overpayment relief, there is no time limit for claiming special relief. Furthermore, also unlike overpayment relief claims, special relief is not automatically excluded whenever (a) a person knew, or ought reasonably to have known, that they had some other means of correcting an overpayment or over-assessment, but they failed to use those other means within the relevant time limit; or (b) HMRC has already taken court action to recover amounts due under a determination, unless the person was present or was legally represented during the proceedings, or an agreement was reached to settle the proceedings.

In addition to all of the above points the person making a claim for special relief must satisfy both the remaining requirements for overpayment relief and must meet three further conditions A, B and C below which reflect HMRC's former practice regarding equitable liability:

A. In the opinion of the Commissioners it would be unconscionable for HMRC to seek to recover the amount which has been charged by a determination, or refuse to repay it if it has already been paid.
B. The person's tax affairs are otherwise up to date or arrangements have been made to the satisfaction of the Commissioners, to bring them up to date as far as possible.
C. The person has not previously claimed special relief or sought equitable liability – whether or not relief was given (this condition may be disregarded in exceptional circumstances).

Any claim for special relief must include such information and documentation as is reasonably required to determine whether these conditions are met. Enforcement Insolvency Service (EIS) are responsible for determining whether a claim to special relief can be accepted and in particular whether these three conditions are met. Therefore, as soon as a claim is received in a local office and is identified as potentially a claim to special relief, any relevant papers should be referred to EIS (Special Relief) Worthing for a claimant in England and Wales and overseas, or EIS (Edinburgh) for

any claimant in Scotland or Northern Ireland. However, local offices will be involved in considering evidence of the correct tax liability and whether the person's other tax affairs are up to date before forwarding the papers to EIS.

Condition A - unconscionable to recover or not to repay an amount

It is a condition of special relief (Condition A) that in the opinion of the Commissioners it would be unconscionable for HMRC to seek to recover the amount which is the subject of a special relief claim, (if it is charged in a determination) or to withhold repayment of it, (if it has already been paid).

Special relief is intended as a final and exceptional remedy where it would be unconscionable for HMRC to pursue tax that is legally due. HMRC has a duty to both Parliament and customers generally to collect the tax due under relevant tax law and to ensure the tax system is operated fairly and clearly HMRC are trying to emphasise that a claim for the special relief will often fail. In particular, HMRC say that they cannot simply disregard the time limits for making a self-assessment if it appears a determination might be excessive. There must be further circumstances which make it unconscionable to recover the full amount due under the determination or not to repay an amount already paid.

Such circumstances, say HMRC, might be where the taxpayer is:

- suffering from a temporary or sporadic illness, including mental illness, and consequently finds it particularly difficult to engage with the tax system
- has not received HMRC notices or other communications for reasons outside his or her control, or
- is insolvent

Where the debt is based on determined sums, and the late submitted evidence (or returns) prove that a different amount would have been due if returns had been made in time, HMRC will consider using this relief. It would be considered where doing so is fair to other creditors - so the unconscionable element would be that pursuing the amount in the determination would be to the detriment of other creditors.

For a claim to special relief to be successful, it must, among other things, explain why the taxpayer considers that it would be unconscionable for HMRC to recover the full amount charged by a determination. In considering whether something is within that, HMRC will look at what behaviour is expected from any reasonable person in a similar situation. So, for example special relief will not normally apply where the person:

- registers as self-employed and never gets any business but remains in the SA system (HMRC would reasonably expect the person to tell them that the business has ceased and file a nil return); or
- ceases self-employment, winds up their affairs (incompletely or incorrectly) but moves on without providing a forwarding address as HMRC expect all taxpayers to act reasonably so they should be aware that HMRC has 12 months to enquire into any return; in this situation say HMRC, the taxpayer should ensure HMRC has an up to date address or that arrangements are put in place to forward post; or
- is a subcontractor who suffers deductions under the construction industry scheme and believes he has nothing further to pay, so does not respond to determinations and other contacts (he/she must take responsibility for their own affairs, or engage an agent to do so; they must not simply ignore HMRC communications in ignorance or in anticipation of later relief; wherever a taxpayer is unsure whether or how to respond to HMRC communications he should get in contact with HMRC to find out more.); or
- moves abroad and fails to respond to HMRC communications to the point of facing enforcement action for unpaid debt (HMRC expect taxpayers to act reasonably and take responsibility for their tax affairs; where there is a debt on record, self-assessment statements are issued every 6 weeks, so there can be no excuse for not responding to HMRC they say); or

- is negligent and, although aware of their responsibilities to pay tax and to file returns on time, fail to act appropriately in relation to their tax affairs and ignore all communications sent to them (again taxpayers must take responsibility for their own affairs, or engage an agent to do so; they must not simply ignore HMRC communications in ignorance or in anticipation of later relief - wherever a person is unsure whether or how to respond to HMRC communications they should contact them to find out more.

Contributed by Gerry Hart

Reasonable excuse when filing late Online Return

HMRC has issued guidance on what may generally be considered a reasonable excuse for filing an online return late.

They will not accept an excuse where it considers that the taxpayer has not made a reasonable effort to meet the deadline. Taxpayer:

- found the online system too complicated to follow; or
- was let down by an accountant; or
- forgot about the deadline; or
- did not try to re-submit return on time once a problem with IT system was put right.

They advise that a record be kept of any error messages which are produced during an abortive attempt to file online. They have said that they do not want to penalise taxpayers who would have filed on time but were prevented from doing so by events beyond their control.

PAYE Update

Centralising PAYE Employer Work In Newcastle

From 1 April 2011 all employer work previously dealt with by 30 offices nationwide will be dealt with by the National Insurance Contributions and Employer Office (NIC&EO) in Newcastle. The contact number for Employer Helpline is 08457 143 143.

Withdrawal of National Insurance Number Cards

HMRC has stopped sending out plastic cards to people who request a replacement to their original card. When an individual asks for confirmation of their National Insurance number, HMRC will send a letter.

From summer 2011, HMRC will stop sending National Insurance number cards to adults who apply for a National Insurance number via the Department of Work and Pensions (DWP). Individuals will receive their National Insurance number in a notification letter from DWP.

From the autumn HMRC will stop sending National Insurance number cards altogether.

(www.att.org.uk/technical/newsdesk/HMRCPAYEUpdate56)

HMRC toolkits—Company Losses and Chargeable Gains for Companies

HMRC has published two new toolkits to help tax agents and their clients reduce errors when completing tax returns.

The twin additions to HMRC's toolkit family set out the steps that can be taken to minimise mistakes when dealing with Company Losses and Chargeable Gains for Companies.

Company Losses Toolkit: www.hmrc.gov.uk/agents/toolkits/ct-losses.pdf

Chargeable Gains for Companies Toolkit: www.hmrc.gov.uk/agents/toolkits/cg-for-companies.pdf

Agents are under no obligation to use the toolkits, but they have proved very popular since their launch last year, with more than 90,000 downloaded to date.

There are now 19 toolkits available in total, covering a wide range of tax issues affecting individuals, businesses and corporations, as well as trusts and estates. All the toolkits can be downloaded free by visiting www.hmrc.gov.uk/agents/prereturn-support-agents.htm.

Brian Redford, Deputy Director of HMRC's Business Customer and Strategy Unit, said:

> “HMRC now offers a comprehensive range of agent toolkits which highlight the common risks and errors that we find in returns in a number of key tax areas.
>
> “They are a real success story for HMRC, and a really good example of joint working between ourselves and the agent community. I would urge all agents to take advantage of these free resources.”

Supreme Court to judge on LPP extension

The question as to whether legal professional privilege (LPP) should be extended to non-legally qualified advisers is to be decided in the Supreme Court.

It has granted leave for Prudential to contest the Court of Appeal judgment of 13 October 2010, which unanimously confirmed that LPP does not apply to any professionals other than qualified lawyers.

The Law Society plans to intervene in the appeal before the Supreme Court so that it has the society’s views on LPP, as it did before the Court of Appeal.

Law Society president Linda Lee said her organisation will ‘ensure that the scope of LPP remains clear and certain, so that it remains an important safeguard for clients who seek and obtain legal advice’.

The issue as to how far LPP should extend is not confined to the UK. Last week, the Australian government issued a discussion paper entitled *Privilege in Relation to Tax Advice*, to consider whether LPP should be extended to tax advisers who are not legally qualified.

Taxation 21 April 2011

Changes to agent authorisation and registering for SA

The way that HMRC deals with Self Assessment registrations and agent authorisations has changed, so that, from 1 April 2011, letters sent to agents explaining that authorisation form 64–8 must be accompanied by the correct registration form are no longer issued.

The way that HM Revenue & Customs (HMRC) deals with Self Assessment registrations and agent authorisations has changed.

In December 2009, the Central Agent Authorisation Team (CAAT) stopped their informal practice that allowed tax agents and advisers to register a client for Self Assessment using form 64–8 alone. Instead, agents must use the correct Self Assessment registration form and send it to CAAT along with agent authorisation form 64–8.

Up until 31 March 2011, if a form 64-8 was received without the appropriate Self Assessment registration form, CAAT issued a letter telling agents and their clients that the 64–8 must be accompanied by the correct registration form. From 1 April 2011, these letters are no longer issued.

It's important that all forms are sent to HMRC at the same time. Once you have completed all appropriate forms for a client, staple them together and send them to:

> HM Revenue & Customs
> Central Agent Authorisation Team
> Benton Park View
> Longbenton
> Newcastle upon Tyne
> NE98 1ZZ

View and download Self-Assessment registration forms: http://search2.hmrc.gov.uk/kb5/hmrc/forms/selfassessmentforms.page#2020.

What happens if HMRC receives form 64-8 before your client is registered for Self-Assessment

If you send form 64–8 to HMRC before your client is registered for Self-Assessment, HMRC won't be able to set up and update your client's Self-Assessment record to include your agent details. This means you won't be able to view your client on your online client list.

In these circumstances you must do one of the following—

- complete a Self-Assessment registration form and a new form 64–8 so that HMRC can add your details
- call the Self-Assessment Helpline or the Newly Self-Employed Helpline to register your client for Self-Assessment - if HMRC can verify your details securely and has evidence that your client has authorised you, a further form 64-8 will not be required
- call the HMRC Online Services Helpdesk if you think that you have correctly registered your client and been authorised by them, but you still can't see them on your online client list

Taxman apology over record checks pilot

A pilot scheme of checks of small and medium-sized firms' business records has been launched, HMRC have confirmed, following complaints that the department had begun proceedings prematurely.

The recent consultation on the matter suggested a trial period and indicated that such an undertaking would need to be publicised. The letters sent out recently by the Revenue to firms did not indicate that they were part of the tester scheme only. The department has agreed to provide clearer information in future correspondence.

HMRC have apologised to the professional accountancy bodies for not providing clarity before launching the trial record checks. The taxman has also confirmed that no penalties will be charged

for record keeping failures during the pilot, the results of which will be considered alongside feedback from the consultation before a full programme of work begins.

In a briefing sent to the pro bodies, the Revenue said, ‘The purpose of HMRC's BRC [business record checks] initiative is to improve the record-keeping procedures of small and medium business customers and thereby develop those customers' ability to comply with their statutory record-keeping obligations.

‘Following a recent consultation document period, ending in March 2011, HMRC is testing BRC in a limited way between 4 April and 15 July 2011. HMRC confirm that no BRC activity took place during the consultation period.’

The briefing continued: ‘The test of BRC involves 30 HMRC staff in eight locations (Edinburgh, Irvine, Manchester, Liverpool, Stockport, Sunderland, Sheffield and Portsmouth). It is estimated that up to 1,200 BRC visits will be undertaken in this period depending on the outcomes of the early stages of the trial. BRC cases will be selected using HMRC’s existing risk engines and procedures.

‘HMRC would like to clarify that the BRC initiative does not insist on a specified format for business records, but checks whether the records of all business income and outgoings are recorded in a way appropriate for the size and nature of the trade.’

The Revenue acknowledged concerns about the additional time and cost burdens placed on firms by the checks, but said it expected them to be outweighed by the long-term benefits of having good record-keeping routines in place.

‘HMRC would also like to confirm that it has no intention of charging any penalties for record keeping failures during the current phase of testing and continues to review its long-term planning around the introduction of such charge in the future,’ said the briefing sent to accountancy bodies.

Taxation, 14 April 2011

Employee responsible for PAYE

The taxpayer appealed against an HMRC notice issued under IT (PAYE) Regulations 2003, reg 72(5), to pass the responsibility for paying outstanding PAYE tax from his employer, DriveHire Nationwide, to him.

The problem arose after the taxpayer returned to the company following employment with another firm. His P45 showed a tax code of 489, for which DriveHire used when handling the taxpayer’s earnings.

In May, HMRC sent a new notice of coding to both the taxpayer and his employer showing code BR.

However, the employer continued to deduct tax on the basis of previous information, which resulted in insufficient tax being deducted.

A new payroll system had been installed in the company around the time of the code error. HMRC accepted that the business had taken reasonable care to deduct the correct amounts but had made an error resulting from lack of familiarity with the new system.

The department therefore approached the taxpayer for the outstanding tax.

The taxpayer appealed, saying the company had not taken reasonable care in dealing with his PAYE liability. He accepted that each payslip issued displayed the incorrect code, but claimed to have checked none, relying on his wife for the purpose.

The First-tier Tribunal agreed with HMRC’s decision, saying the employer had acted in good faith.

The taxpayer’s appeal was dismissed.

Thomas James Blanche

Business Taxes

Income tax relief for capital losses on shares *(Lecture B651 - 16.19 minutes)*

This relief applies where an individual incurs a capital loss on shares in a trading company, enabling that loss to be offset against the individual's income either in the year of the loss or in the previous year.

The loss is computed on capital gains tax principles, so long as the loss arises as a result of a bargain at arm's length, on dissolution in the course of winding up the company, or as a result of a negligible value claim.

The individual must make a claim within one year of the normal filing date for the year of the loss, and can specify whether the loss is to be offset against the current year, the previous year, or both. If the loss is to be offset against both years the individual can specify which year is to be used first.

The shares must be qualifying shares which includes any shares on which EIS relief has been claimed, or shares in a company which is a qualifying trading company. A qualifying trading company is defined principally in section 134 ITA 2007, which sets out a number of requirements set out as Conditions A to D.

In essence, the company must be a trading company, cannot be controlled by another company, and must not control any other company that is not a qualifying company.

These conditions must be met for a continuous period of six years, and if the company has ceased to meet the requirements within three years of disposal of the shares relief would not be prejudiced so long as the company met the conditions for six years up to the date the requirements ceased to be met and the company has not been an excluded company, an investment company or a trading company.

If the company met the requirements for less than six years relief is not prejudiced if, before the beginning of that period it was not an excluded company, an investment company or a trading company. This allows relief for a company that has been in existence for less than six years, but prevents an individual claiming relief for a company that started as an investment company and starts a trade simply to claim the relief.

Excluded company is defined in section 151 ITA 2007 as a company which:

(a) "has a trade which consists wholly or mainly of dealing in land, in commodities or futures or in shares, securities or other financial instruments,

(b) has a trade which is not carried on on a commercial basis and in such a way that profits in the trade can reasonably be expected to be realised…"

The gross assets of the company or group must be less than £7m immediately before the issue of the shares on which relief is being claimed and £8m immediately after the relevant issue of shares.

The company must be unquoted when the shares are issued, and there must be no arrangements for the company to become quoted at that time.

The company must have carried on its business wholly or mainly in the UK for the period from 12 months before the issue of the relevant shares to the date of disposal.

The claimant must have acquired the shares by subscription. Where there is a bonus issue of shares, those additional shares will be treated as if they had been subscribed for if the original shares in respect of which the bonus issue arises were subscribed for by the shareholder. It is possible, however, for shares to be transferred between spouses or civil partners in order to maximise the relief. Section 135 ITA 2007 treats the transferee spouse or civil partner as if they had subscribed for the shares, so that the transferee can claim income tax relief on the loss.

The timing of negligible value claims needs to be kept in mind. Section 24 TCGA 1992 treats an asset as having been sold and immediately reacquired at market value, so triggering a capital loss at the date of the claim. It is possible to treat the disposal as having taken place at an earlier time, not earlier than two years before the beginning of the year of assessment in which the claim is made, so long as the shares had become of negligible value at that earlier time.

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However, the time limit for making the claim to offset the loss against income is one year after the normal filing date. This means that the two time limits have to be looked at together to ensure that a negligible value loss set back can be offset against other income.

Contributed by Paul Howard

New style Enterprise Investment Scheme relief *(Lecture B652 - 14.32 minutes)*

Introduction and overview

EIS relief is available at a fixed rate of 30% (20% to 5 April 2011) on a maximum of £1 million per tax year (£500,000 to 5 April 2011) in respect of new equity investment in unquoted trading companies.

The aim is to provide a targeted incentive, with the tax attractions also including the right to CGT deferral if a chargeable gain is reinvested in a company which qualifies for EIS relief.

The tax advantages are clear as under, but the risk and lack of control over the company's activities must be given prime consideration:

- EIS income tax relief at 30%
- After 3 years no claw-back of the EIS relief
- After 3 years a sale at a profit is tax-free
- After 3 years a sale at a loss gives rise to an income tax relief claim against income of the same tax year or preceding tax year, with the loss being net of the EIS relief
- After 2 years the shares qualify for IHT business property relief
- Possible deferral of a CGT liability arising on disposal of any chargeable asset

The investor must be a ***qualifying investor*** subscribing wholly in cash for fully paid-up ***eligible shares*** issued by a ***qualifying company***. A carry-back election can be made so as to treat the claim as relating to the preceding tax year.

Queries from companies are dealt with by The Small Enterprise Centre, but the company's own tax district handles applications and the claimants of tax relief make claims to their own tax district.

No tax relief is available on interest on a loan used to acquire an EIS investment, even though it might ordinarily be a qualifying loan.

Qualifying investor

This is an individual liable to income tax who is not ***connected with the company*** at any time in the period from two years prior to the share issue to the third anniversary of the share issue. If the company was not trading when the shares were issued, the three year requirement starts when trading starts.

To be not connected involves not directly or indirectly possessing over 30% of any of the following:

- the issued ordinary share capital of the company or any subsidiary
- the loan capital and issued share capital
- the voting power

If the investor held one or more of the subscriber shares before it commenced trading and before any other shares were issued, he is not regarded as connected with the company solely because of this.

An individual is also connected with the company at any time when he or any ***associate*** of his is:

- an employee or director of the company or subsidiary; or
- a partner in any partnership of which the company or subsidiary is a member, or an employee of such a partner

If the investor (as a Business Angel) either wants to become a director or the company wants him to, he is therefore connected with the company. However, the EIS rules do not automatically debar entitlement to EIS relief provided that (a) the director's remuneration is "not excessively high" (HMRC expression) for the services performed; and (b) when issued with the shares the investor was not and had not previously been connected with the company (e.g. as an employee, paid director or partner of the company or subsidiary).

A director is not connected with the company simply because he (or an associate or partner) receives any of the following:

- payment or reimbursement of allowable expenditure as employment income
- interest at a commercial rate on money lent
- dividends etc., representing no more then a normal return on investment
- payment for supply of goods at no more than market value
- rent at no more than a reasonable and commercial amount for property occupied
- any reasonable and necessary remuneration for services rendered (other than secretarial / managerial services, or those rendered by the payer) which is taxable as a trading receipt

Under 4 above, ***associates*** for EIS purposes are parents; grandparents etc; spouse; children; grandchildren etc; partners in a business; trustees of trusts in which the person has an interest.

Eligible shares

These are new ordinary shares which do not carry any preferential right to dividends or asset distributions on a winding-up, or any redemption rights, for three years from the share issue (or three years from when trading starts if later).

No other type of share or security qualifies for EIS relief.

No EIS relief is claimable on a share issue if arrangements already exist involving disposal of the shares; disposal of the company's assets; cessation of trade; or guaranteeing the investment.

Qualifying company

This requires all of the following conditions to be met:

- unquoted (AIM listing is unquoted for this purpose) when shares issued, and no arrangements exist to cease to be unquoted; if on issue arrangements exist for the company to become a wholly-owned subsidiary of a new holding company by way of a share exchange, that is acceptable provided no arrangements exist for the new company to cease to be unquoted
- carrying on a ***qualifying business activity*** for at least three years
- all the funds raised must be wholly used within two years of the share issue (or, if later, within two years of the commencement of a qualifying activity)
- gross assets of no more than £15 million immediately before the EIS issue (£7 million to 5 April 2012) and no more than £25 million afterwards by looking at the whole group (£8 million to 5 April 2012)
- the company cannot raise more than £10 million (£2 million to 5 April 2012) in any EIS scheme in the 12 months up to the date of the investment
- the company (or group) must have fewer than 250 full-time equivalent employees (50 to 5 April 2012)
- the company must have a permanent establishment in the UK
- where the EIS funds raised are used by a subsidiary it must be a 90% subsidiary carrying on a qualifying activity or holding or managing property for the group; or has no profits

for corporation tax purposes and does not make investments – an indirect subsidiary of the parent company also qualifies, but the 90% test still has to be met

- any subsidiary of an EIS company can be only 51% owned, rather than 90%, other than subsidiaries whose activities benefit from the EIS money and property management subsidiaries

Qualifying business activity

All trades qualify unless they come within any of the following at any time within the three years from share issue (or, if later, three years from trading commencing).

There is no problem, however, if the company carries on any outlawed activity to an extent which is less than 20% and is therefore insubstantial.

- dealing in land; commodities; futures; securities; other financial instruments
- dealing in goods otherwise than in the course of an ordinary trade of wholesale or retail distribution
- banking; insurance; money-lending; debt-factoring; HP financing or other financial activities
- leasing; letting ships on charter (other than oil rigs or pleasure craft); letting other assets on hire; receiving royalties or licence fees (other than by reference to film production or R & D activities)
- providing legal or accountancy services
- property development
- farming; market gardening
- woodlands (holding, managing or occupying); any other forestry activities; timber production
- operating or managing hotels etc; or managing property used as such
- operating or managing nursing homes or residential care homes; or managing property used as such
- shipbuilding, coal production, steel production
- providing services or facilities for any trade etc substantially falling within any of the above heads, which is carried on by another person (other than a parent company) where one person has a controlling interest in both trades

Other qualifying activities are R & D or oil exploration which is intended to lead to a qualifying trade carried on by the company or subsidiary.

EIS investment funds

EIS investment can be made through an investment fund rather than as a direct investment. This allows money pooled by several investors to be subscribed for in a range of companies selected by the fund manager. The fund could be one approved by HMRC (=AIF) or an unapproved one.

For an AIF investment, the manager issues a form EIS 5 to the investor who uses it instead of EIS 3. The former can be used to report investments in several EIS companies. For an unapproved fund the manager issues separate forms EIS 3 for each company in which the fund invests.

To determine the tax year for which EIS relief is claimable, all shares acquired via an AIF are treated as issued on the date when the fund closed.

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Given the improvements to EIS the following could be an attractive arrangement:

Illustration

1. *on 1/5/11 Jan, a 40% taxpayer, invests £10,000 into an EIS company or EIS fund*
2. *on 1/5/14 she contributes £10,000 gross into her pension plan*
3. *on 2/5/14 the pension plan buys the EIS investment from Jan at market value (say £10,000, the same as the original cost)*

Effective costs:

1. *£7,000 net of 30% tax relief*
2. *£6,000 net of 40% tax relief*
3. *return of £10,000*

Jan has therefore effectively paid £3,000 for a £10,000 EIS investment, which means tax relief at 70%.

Claiming the income tax relief

The company issues the shares and within two years from the end of the tax year of issue (or two years from the end of the initial four months of trading if not started to trade at the time the shares were issued) it submits form EIS 1 to the company's tax office.

If the tax office is satisfied that the conditions for qualifying investors to claim EIS relief are met, it sends the company form EIS 2 which authorises it to issue certificates EIS 3 to the investors. This cannot take place until the qualifying activity has been carried on for at least four months.

The investor must claim the relief within five years after the 31 January following the tax year to which the claim relates.

Ordinarily the claim is made in the tax return. If the return has already been filed the claim can be made by completing the claim section of EIS 3 and sending it to the tax office of the investor. A claim prior to filing the return can be made, and it then serves to increase the code number for an employee or to reduce payments on account.

Advance EIS clearance

Prior to an intended EIS share issue, the company can apply for assurance that the company will be eligible. This facility does not apply to the eligibility of individual investors.

All relevant information should be sent, so that HMRC could not at a later stage successfully argue that not everything was divulged and that consequently the assurance of eligibility is not valid.

The following should be included in the application:

- the latest accounts for the company and each of its subsidiaries
- the current memorandum and articles of association for each company in the group, and details of any proposed changes
- the draft of any document to be issued to potential investors, if available
- confirmation that company expects to be able to complete declaration on form EIS 1
- details of any subscription or similar agreement to be entered into by the shareholders
- details of all trading or other activities carried on (or to be carried on) by the company and its subsidiaries
- approximate sum company intends to raise via share issue and how it intends to use money

Disposal of EIS shares

A disposal within three years via a non-arm's length bargain results in the EIS relief being withdrawn. Where the disposal is at arm's length the relief is withdrawn but taking into account any loss on the disposal.

A disposal after the three year period results in no CGT on a gain, but if a loss arises this is allowable and can normally be set against income under Section 574 TA1988. This requires the shares to be unquoted at issue but not necessarily on disposal. The loss is determined by reducing the cost by the amount of EIS tax relief obtained.

Illustration

1/7/11 EIS relief claimed on £300,000 @ 30% = £90,000

1/1/13 shares sold for £100,000 at arm's length

As loss of £200,000 arises the EIS relief is reduced by £100,000 @ 30% = £30,000

CGT loss claimable in 2012/13 against income of 2012/13 or 2011/12; loss of £200,000 is reduced by £60,000, actual EIS relief obtained, to £140,000

EIS shares can be transferred between spouses with no tax consequences as the income tax relief continues to be attributable to the shares. The tax treatment on disposal by the new owner is the same as if he/she had been the investor.

EIS relief is not available if any arrangements under which the shares were issued, or in connection with the share issue before then, include provision for disposal. The inclusion of standard provisions in the company's articles of association requiring a shareholder to sell the shares if the majority accept an offer from a third party to purchase the entire share capital is disregarded in this context.

On a part disposal there are special identification rules, which also take into account the situation where some of the shares do not qualify for EIS relief. Basically FIFO initially applies. Then any shares not qualifying for relief but acquired on the same day as shares which do qualify have to be identified by treating shares as being disposed of in the following order:

- shares with no EIS relief or CGT deferral relief
- shares with CGT deferral relief but no EIS relief
- shares with EIS relief but no CGT deferral relief
- shares with both EIS relief and CGT deferral relief

Withdrawal of EIS relief

Quite apart from a disposal of the shares, where value is received during the period one year before the share issue to three years afterwards (or to three years from commencement of trade if later) the EIS relief is wholly or partly withdrawn on those shares.

The definition of receiving value includes providing a benefit, loan or advance; releasing a liability of his to the company; repayment of a debt to him made before the EIS share issue; an individual connected with him purchases any shares of the company from him. The repayment of a loan does not preclude claiming EIS relief on a subsequent investment in shares in the company. This is subject to the proviso that the repayment of any loan before the shares are issued is not made in connection with any arrangements for their acquisition.

No value is treated as received for EIS relief purposes on the provision of a benefit or facility as part of an investor's remuneration package provided the package is reasonable as a whole.

Contributed by Gerry Hart

Incorporation – the changing tax burden *(Lecture B653 - 14.39 minutes)*

The declining amount of tax differential between unincorporated businesses and limited companies calls into question both advice about incorporation, and the status of very small limited companies.

The tax savings achieved through running a small business through a limited company have varied over the last few years, with the steady increase in the small profits rate of corporation tax eroding the benefit of incorporation. The decision to reverse this trend and revert to a small profits rate of 20%, at the same time as the NIC rate borne on modest profits increases to 9% has reversed this trend quite noticeably.

The anticipated tax savings achieved through incorporation will depend on the precise facts of the case, and on how the business owner decides to extract his profits from the company. However, using the following assumptions, the table below gives the maximum potential savings without involving a spouse or civil partner in the structure. :

- All calculations are performed for a single person aged under 65 operating as a sole trader. The tax and NIC burden includes income tax and Classes 2 and 4 NIC payable. No account of any potential tax savings is taken for involving a spouse or civil partner, either through the payment of salary, partnership or as a shareholder or director in the limited company.
- Incorporated business excludes any potential benefit from including a value for goodwill on incorporation, assumes that the taxpayer takes the most aggressive view about distribution of profits and draws a salary equal to the lower earnings threshold, incurring no National Insurance liability either personally or in the company. Since 2009/10 this has meant a small amount of unused personal allowances for tax purposes. Any additional drawings are taken by way of dividends.
- A 100% profit distribution route has been considered, which puts maximum disposable income in the hands of the taxpayer. If profits are retained in a company over and above the personal higher rate threshold, this will produce further tax savings.
- These examples exclude any other differential arising from operating in the particular business structures; in particular, there will be differences in the cost of business motoring arising from the tax treatment, and the administrative costs borne by the business operating through a limited company. The treatment of goodwill on incorporation may be of interest to substantial businesses, whether through the favourable tax treatment on disposal into the company, or the availability of intangibles relief to the company (for businesses which commenced on or after 1 April 2002).

Table 1 : Tax & NIC burden self employed to limited company 2011/12

Profit	Sole trader	Company	Saving
£10,000	£885	£586	£ 299
£15,000	£2,335	£1,586	£ 749
£20,000	£3,785	£2,586	£1,199
£30,000	£6,685	£4,586	£2,099
£40,000	£9,585	£6,586	£2,999
£50,000	£13,463	£9,206	£4,257
£75,000	£23,963	£19,206	£4,757

Marginal rates of tax

Where profits are such that a taxpayer is paying both income tax and class 4 National Insurance contributions, (profits in excess of £7,475) the marginal rate of tax is 20% + 9% = 29% for income tax, and only 20% for a limited company, as profits which are drawn by a basic rate taxpayer as dividends are not subject to additional tax.

When the taxpayer is a higher rate taxpayer, the rate borne as self-employed increases to 40% + 2% = 42%, whereas for corporation tax the total rate borne is only 40% (20% in corporation tax and 25% of the remaining 80% as additional income tax – effective rate 40%).

So whether the taxpayer is a basic rate or higher rate taxpayer, the effective rate is lower through a limited company than it is as a sole trader – this ignores the additional burden of Class 2 NIC contributions for the sole trader, but also the slight loss of personal allowances to the company owner.

It is therefore not surprising that the tax savings through incorporation have increased once again.

Comparison with recent years

Fluctuating rates of both personal tax and corporate tax have made the picture quite complex over the last few years. The tax savings based on the same assumptions for various levels of profit are shown in Table 2 below.

Table 2 : Tax savings on incorporation 2008 - 2012

Profit	2008/09	2009/10 & 2010/11	2011/12
£10,000	£324	£274	£ 299
£15,000	£674	£624	£ 749
£20,000	£1,024	£974	£1,199
£30,000	£1,724	£1,674	£2,099
£40,000	£2,424	£2,374	£2,999
£50,000	£3,423	£3,710	£4,257
£75,000	£3,485	£3,772	£4,757

Disadvantages

Clearly, incorporation offers some quite substantial savings in tax for all businesses, but it is worth re-iterating the main disadvantages for the taxpayer before recommending incorporation.

Business motoring

Where the business motoring costs are substantial, and the business relies heavily on significant journeys in cars, there may be significant extra costs to account for when running the business though a limited company. Company cars are not tax efficient to purchase, now that they must be pooled with other plant. From 2012/13 the writing down allowance on cars will be only 18% on a reducing balance basis for those emitting more than 160 g/km of CO_2. Above this emissions figure, the rate which is currently 10% will reduce to 8%. As the car cannot be de-pooled, no balancing adjustment is available on sale, and therefore purchase of a car to use in the business is very tax inefficient.

Leasing the car is an alternative, but many companies will find the cost of leasing prohibitive if they need to rack up significant mileage. Where the business mileage is lower this is not a particular issue.

Putting the car into the company is also an issue for the owner, as benefit in kind tax becomes ever more aggressive. The gradual increases in the rates of company car tax benefit are really starting to bite now, and drivers are finding it difficult to keep their tax bill down by buying ever more fuel efficient cars.

The alternative for the company owner is to retain the car outside the company. Again where business motoring is low, the 45p per mile the driver can claim (on up to 10,000 miles a year) will partially reimburse the costs of running the car for business, provided he has chosen a relatively fuel efficient model. However, as mileage increases, the rate drops to 20p per mile, and these rates

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become wholly inadequate when the depreciation caused by significant mileage is taken into account.

Tax planning opportunity

Those drivers who are able to buy a very fuel efficient car – with less than 110g/km emissions can currently obtain 100% first year allowances on the purchase (whether through the company or sole trader) and will also be subject to only 10% benefit in kind in the current year. However, these benefit in kind rates will increase in April 2012 and 2013, so the benefit in kind advantage will soon be eroded. Note that for a sole trader, the capital allowances will be restricted to the business proportion, and specifically for a sole trader, sale of the car will produce a substantial balancing allowance (as it will be de-pooled due to private use).

Administrative burden

It is assumed that the client will need the support of an adviser to complete company accounts and corporation tax returns. While this has always been the case, and the need for support with company secretarial matters (dividend vouchers and minutes of the necessary meetings) this burden has increased quite significantly with the introduction of XBRL filing. There is no doubt that the client would not be able to complete these formalities himself, and that this extra administrative burden will carry extra costs. This should not be overlooked when advising about the benefits of incorporation.

Bank lending

The current position with small business lending is very difficult indeed, and if a sole trader seeking advice about incorporation is already in debt to the bank, this fact may make incorporation impossible. The bank may be unwilling to lend to the same business as a limited liability entity – even with the personal guarantee of the directors. The bank may also seek to increase lending rates for the client as a limited company, and this itself may prove unsustainable.

High Income

The importance of the use of a limited company to protect high earners from the effect of the 50% tax rate (and the small band of marginal 60% rate) has been widely discussed in the tax press. The basic computations will depend largely on how much an individual draws, but the following assumptions have been used to test the benefit of incorporation.

In Table 3, all of the post tax profits have been withdrawn by way of dividend. A salary equal to the employer earnings threshold has also been paid.

Table 3 : Tax burden self employed to limited company 2011/12 – no retained profits

Profit	Sole trader	Company	Saving
£125,000	47,953	42,544	7,409
£150,000	58,453	50,887	7,566
£200,000	84,453	73,744	10,709
£250,000	110,453	98,188	12,265
£300,000	136,453	122,633	13,820

In Table 4 varying levels of retained profits have been considered. The resultant savings against sole trader structure is shown in the indicated columns.

Table 4 : Tax burden limited company 2011/12 – retained profits as shown (saving as against self employment)

Profit	Retain £25,000		Retain £50,000		Retain £75,000	
	Total tax	Saving	Total tax	Saving	Total tax	Saving
£150,000	45,669	14,784	36,705	21,748	30,455	27,998
£200,000	64,716	19,737	58,387	26,066	50,455	33,998
£250,000	89,160	21,293	80,133	30,321	72,137	38,316
£300,000	113,605	22,848	104,577	31,876	95,549	40,904

Extracting profits from a small company – profits under £50,000

For a small company the decision as to how to extract profits is a relatively simple one – when the company is paying small company rates of corporation tax, the profit will be extracted in general by payment of a dividend as this produces the cheapest tax outcome for the owner manager. The computations are as follows:

		£
Profit		49,188
Salary		(7,072)
Taxable profit		42,116
Corporation tax		8,423
Net profit		33,693
Dividend (net)	33,693	
Gross dividend income		37,437
Tax liability on dividends		£620

This computation holds up to the profits shown – every additional £1 distributed costs 25p in tax, so the net marginal tax rate is 40% on profits earned.

Total tax liability on £50,000 profit £9,206 (18.4%)

Although a very modest saving at this level compared to the liability on a sole trader (at 42%), the corporate structure has benefitted from the saving of 9% Class 4 National Insurance contributions on the basic rate band of income.

The cost of extracting all of the profits as salary is considerably higher:

	£	
Profit	50,000	
Salary	(44,794)	
NIC	(5,206)	
Taxable profit	NIL	
Corporation tax	NIL	
PAYE on salary	7,928	
Employee NIC on salary	4,276	
Employer NIC (as above)	5,206	
Total tax and NIC liability	£17,410	(34.8%)

So at this level, clearly dividend is preferable, and the best outcome is obtained when a salary equal to the secondary earnings threshold is paid (see above) to maximise the use of personal allowances.

Increasing the salary to the personal allowance will trigger an NIC charge, which erodes the tax benefit and adds complexity so this is normally the preferred route.

Increasing the salary

Although payment of salary carries quite a significant NIC cost, many businesses prefer to pay a modest salary so the costs of this are detailed below, continuing with the profits of £50,000 for illustrative purposes :

(a) Salary of £10,000 – roughly minimum wage

		£	
Profit		50,000	
Salary		(10,000)	
Employer NIC	(404)		
Taxable profit	39,596		
Corporation tax	7,919		
Net profit		31,677	
Dividend (net)	31,677		
Gross dividend income		35,197	
Tax liability on dividends		681	
PAYE on salary	505		
Employee NIC on salary		333	
Total tax liability on £50,000		£9,842	(19.7%)

(b) Salary of £20,000

		£	
Profit		50,000	
Salary		(20,000)	
Employer NIC	(1,784)		
Taxable profit	28,216		
Corporation tax	5,643		
Net profit		22,573	
Dividend (net)	22,573		
Gross dividend income		25,081	
Tax liability on dividends		652	
PAYE on salary	2,505		
Employee NIC on salary		1,533	
Total tax liability on £50,000		£12,117	(24.2%)

So clearly, the salary increases erode the benefits of incorporation quite significantly, and this should also be taken into account when making recommendations about business structure.

Contributed by Rebecca Benneyworth

Were losses on the stock market deductible as trading losses?

The taxpayer, a retired surgeon, used capital he accumulated over years to play the stock market. He took advice from a broker but was in control of his portfolio of shares. For the years ended 5 April 2007 and 2008, he made losses of £28,289 and £26,520 respectively, which he sought to offset against his general income.

He argued that the share transactions constituted a trade for the purposes of TA 1988, s 380(1), now ITA 2007, s 64(1). HMRC did not allow the claim, saying the transactions were not those of a trade.

The taxpayer appealed.

The First-tier Tribunal concluded that the taxpayer decided to trade in shares to augment his retirement income. This activity related to the management of a share portfolio and the transactions were in the nature of investments.

A business would conduct its dealings in a fundamentally different way, acting as wholesalers and retailers in trading stock, as well as usually being regulated by a financial regulatory authority. The taxpayer's activity was an investment, not a trade.

The taxpayer's appeal was dismissed.

Manzur TC 830

Return of capital or assessable profits?

Under a partnership agreement, the appellant received £55,000 from the partnership on his retirement.

HMRC said that £20,000 of the settlement represented the return of the appellant's capital from the partnership, and the remaining £35,000 was additional shares of profits.

The department issued discovery assessments under TMA 1970, s 29 for the years 1996/97 to 2003/04, allotting one eighth of the £35,000 as additional income for each of the years concerned.

The appellant agreed that £20,000 was the return of capital, but said the balance was a capital sum paid in respect of the disposal of his share in the partnership. He said therefore the discovery assessments were invalid.

The First-tier Tribunal said that it was clear from the evidence that the business's partnership returns for the years in question were complete and correct.

Likewise, the partners' returns for those years were correct.

There was therefore nothing in those returns for HMRC to discover. On this basis, the tribunal said that it would find the discovery assessments to be invalid.

The fact that the inspector was made aware of a payment received in 2006/07, which he considered to revenue income did not mean it was necessary to raise discovery assessments.

The supporting documents showed that the payment made to the taxpayer comprised the repayment of capital he put into the business and a further capital distribution.

The attempt by HMRC to assign the payment as income was misconceived.

The taxpayer's appeal was allowed.

David Howell TC 1048

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Definition of goodwill

The taxpayer company and Keyline were members of the same group.

In September 2003, Keyline sold its business to the taxpayer. In its accounts for the year ending 30 September 2003, the taxpayer company included an entry for goodwill and elected to write down the cost at an annual fixed rate under FA 2002, sch 29 paras 10 and 11.

HMRC disallowed the deduction on the ground that the goodwill had been created before the commencement date set out in FA 2002, sch 29: 1 April 2002.

The company appealed.

The First-tier Tribunal dismissed the appeal, ruling that the definition of goodwill in para 4(2) of sch 29 included internally generated goodwill.

The goodwill in this instance was created by Keyline and acquired by the taxpayer company, not created by the latter after commencement.

The company appealed to the Upper Tribunal (Tax and Chancery Chamber). It argued that the definition of goodwill in sch 29 para 4(2) did not include internally generated goodwill.

The Upper Tribunal said the taxpayer company's construction of goodwill would restrict the definition to purchased goodwill. Had this been the intention of Parliament, the draftsman would have made it clear in the legislation.

Paragraph 3(3) stated that the schedule applied to an intangible fixed asset whether or not it was capitalised in the company's accounts.

Paragraph 4(1) provided that the schedule applied to goodwill in the same way as to an intangible fixed asset, and this implied that the definition of goodwill in para 4(2) did not exclude goodwill not capitalised in the company's accounts: internally generated goodwill.

The Companies Act 1985, FRS10 and the expert evidence all supported the view.

The court concluded the company's contention that goodwill was created by the act of purchasing it was wrong.

It had been common ground that, immediately before the sale, Keyline had owned internally generated goodwill which had not been recognised in its accounts.

In September, Keyline had sold the goodwill to the taxpayer company and the latter correctly capitalised it in its accounts, in accordance with the accounting treatment of the goodwill under generally accepted accounting practice.

It did not mean that the goodwill had come into existence for the first time or that it had been a different asset to the goodwill owned by Keyline.

The taxpayer company's appeal was dismissed.

Greenbank Holidays Ltd v CRC, Chancery Division

Research and Development

The Finance Bill confirms the increase in the rate of the additional deduction for R&D for SMEs to 100%.

Not mentioned in the Budget but stated in Clause 43 of the Finance Bill, the rate at which losses may be surrendered for payable tax credit is reduced from 14% to 12.5% so that the value of the payable tax credit remains within limits set by the European Commission.

Corporation tax on gains *(Lecture B654 - 14.54 minutes)*

This article reviews the differences in computation between CGT – the tax on gains paid by individuals and trusts – and corporation tax on gains which is paid by companies.

Basic rules for companies

Companies pay corporation tax (CT), not CGT. Up to 1998, the computation of chargeable gains was nearly always exactly the same for companies and individuals, and it is common (but wrong) to refer to "CGT liabilities" in companies. These notes refer to "CT on gains" where relevant.

The 1998 Finance Act made the differences in computation fundamental: from April 1998 to 5 April 2008, indexation allowance was not available (or stopped increasing, for assets purchased before that) for individuals, who received taper relief instead; but IA continues to be given for companies, which have never enjoyed taper relief. New rules for identifying shares sold were introduced for individuals, but the pre-1998 rules remain in force for companies. Unfortunately, this means that the benefit of simplification (abolition of a complicated rule) is not felt by anyone who has to deal with companies as well as individuals.

From 6 April 2008, the differences changed again, but they remain significant: taper and indexation have disappeared altogether for individuals, but indexation still remains for companies; and the identification rules continue to be different.

There are also differences between the list of exempt assets for companies and those for individuals. Some are obvious (a company cannot have an "only or main residence", or be awarded a decoration for valour), but others are not – for example, companies and individuals are taxed in completely different ways on corporate and government debt instruments.

Note that foreign resident companies do not pay tax in the UK on gains, even if the assets are situated in the UK, unless the company is carrying on a trade through a branch in the UK. There are rules to charge the shareholders of a closely-controlled foreign company on the gains that the company makes, to prevent UK resident individuals "wrapping up" their investments in a tax-free "envelope".

Outline computation

The basic computation of a gain for CT looks like this:

	£
Proceeds	50,000
Costs of disposal –	(1,000)
	49,000
Acquisition cost	(20,000)
Indexation allowance (IA) 0.510 x 20,000	(10,200)
Chargeable gain	£18,800

Indexation allowance: general

Although indexation allowance was frozen for CGT at 6 April 1998 and was abolished altogether for CGT on 6 April 2008, it is still important for corporation tax, so it is still necessary to know the rules if you have to deal with corporate investors.

Indexation allowance (IA) gives some relief for the effect of inflation during the ownership of the asset. The indexation factor is the percentage rise in the retail prices index between the month of acquisition and the month of disposal. The idea was to charge the "real" gain arising on the asset, excluding the "apparent" gain from the change in the value of money.

Points to note about IA include:

- it is only allowed to reduce a gain to nothing – it cannot create a loss;
- if there are separate elements of acquisition and improvement costs, they are indexed separately from the month in which each was incurred;

- IA is given from March 1982 in respect of any assets acquired before that time, on the higher of original cost and market value on 31 March 1982;

Chargeable period: companies

Companies are chargeable on gains for their corporation tax accounting periods (CTAP), and simply add the net chargeable gains of the CTAP to other profits. CT rates vary depending on the level of other profits currently being earned by the company. The “small companies rate” (companies with total profits up to £300,000 in a year) is 21% (due to fall to 20% in April 2011). Companies with profits above £1.5m a year pay CT at a rate of 28% (which is supposed to be reducing by 1% a year over the next four years).

The rates of tax in the “marginal band” between £300,000 and £1.5m, and the effect on the tax rates of the existence of “associated companies”, are more complicated, but these complications are beyond the scope of a CGT lecture.

Payday

CT on all profits, including gains, is payable nine months and a day after the company’s AP if the company does not pay CT at the “full rate” (i.e. profits of £1.5m or more). For a 31 December 2010 year end, the company pays all its tax on 1 October 2011.

Large companies pay instalments of their liability starting 6.5 months after the start of the period; for a 12 month period the instalments are paid 6.5, 9.5, 12.5 and 15.5 months after the start of the period, and interest runs on amounts which subsequently turn out to have been underpaid or overpaid.

There is no distinction between CT on gains and CT on income as there is for income tax: the instalments are calculated on the total tax liability of the company, even if a large gain is made late in the AP after the first two instalments have been paid.

Identification rules

The acquisitions are analysed between:

- shares bought on the same day;
- shares bought in the nine calendar days before the disposal (acquisitions on different days being treated separately, and taking the earliest first where there is more than one);
- the s.104 holding or “1985 pool”, which is “open” and updated for purchases and acquisitions that were not disposed of within nine days;
- the 1982 pool, which was frozen;
- shares bought before 6 April 1965;
- shares bought after the disposal (e.g. where the shareholder has “sold short”).

Once the shares are allocated to holdings, the disposal is identified with acquisitions in the order of the above list – the most recent acquisitions go first, back to the oldest acquisitions; but acquisitions after the sale are identified last, and are only relevant if there are not enough prior purchases. This meant that such acquisitions are only identified with the sale if the seller is short of the stock, and there is no general rule against bed and breakfasting.

Example

Michelle Ltd sold 10,000 XYZ plc shares on 4 October 2010. The company held 20,000 at the time. They had been acquired as follows:

- 2,000 purchased by subscription on XYZ plc’s incorporation in 1964
- 4,000 bought in the market in 1980
- 1 for 2 bonus issue in 1985 – 3,000 shares
- 3,000 shares bought in the market in June 1994
- 5,000 bought in the market in February 1999
- 3,000 bought in the market on 30 September 2010

Which 10,000 has the company sold?

The shares are divided into:

- the "pre-1965 purchases" (2,000) and the bonus issue which related to them (1,000), total 3,000;
- a "1982 pool" which contains the shares bought after 5 April 1965 which were actually held on 31 March 1982 (4,000) and the bonus issue which related to them (2,000), total 6,000;
- a s.104 holding or "1985 pool" which contains the shares acquired since then but at least 10 days before the disposal, total 8,000;
- the acquisitions in the last 9 days, total 3,000.

As there are no acquisitions on the same day, that part of the rule does not apply.

The disposal is then identified "LIFO":

- 3,000 acquired on 30 September 2010 (no indexation allowance);
- 7/8 of the s.104 holding.

The 10,000 shares retained are 1/8 of the s.104 holding, the whole of the 1982 pool and the whole of the pre-1965 shares.

Changing the history

The procedure for dealing with share for share exchanges is now more significant for companies than it is for individuals, because companies do not pool everything together. It is possible for companies to have two pools of shares which have to be kept separate – those owned on 31 March 1982 and those acquired since. It is rare, but possible, for a pre-6 April 1965 acquisitions to exist, identified separately from these two pools.

In the simplest possible exchange – "one Z plc share for one Y plc share" – all that is required is to change the name of the company on the share history. All the dates, numbers and amounts stay exactly as they were before.

In the next simplest possible exchange – "one Z plc share for every two Y plc shares" – all that is necessary is to halve all the numbers of shares. There are no changes to dates or monetary amounts, but what used to be two Y plc shares is now one Z plc share. Even that creates a problem when individual acquisitions do not adjust to a round number. From the investee company's point of view, the shareholder may not have fractional entitlements, because the company is only concerned with the total number of shares – not the artificial division that the tax rules require. The computer system has to do something to deal with the rounding required. This is not very difficult with just two pools – it was much worse for individuals under taper relief.

In the next level of complexity, there is cash as well as shares (or some other form of consideration). The cost of the original holding has to be split up between what is carried forward as the cost of the new holding and the amount that is used up in calculating a gain on disposal. This is done in proportion to the value of the cash and the value of the share consideration received (see the slide for illustration, and more detail later).

Basic rules: bonus issues

Bonus (also called scrip, "cap" or capitalisation) issues are treated as an adjustment to the holding to which it relates, rather than a separate acquisition. This means that for identification purposes, bonus shares are added to each relevant part of an existing holding – usually s.104 holding, 1982 pool and pre-1965 acquisitions.

Basic rules: rights issues

Rights issues are treated in the same way as bonus issues for identification purposes, but there is a cost of the new shares.

This means that:

- for identification purposes, rights shares are added to each relevant part of an existing holding – usually s.104 holding, 1982 pool and pre-1965 acquisitions;

- for cost of acquisitions, the cost of rights shares is added to the cost of the relevant holding – it even increases the "frozen" base cost of the 1982 pool. However, it is separately indexed from the time at which the rights issue took place, not from March 1982.

Scrip dividends

A scrip dividend is charged to income tax when received by an individual; the amount so charged is then added to the CGT base cost. As dividend income from another UK company is not chargeable in the hands of a UK company, there is no taxable income and no addition to base cost.

Contributed by Mike Thexton

Double tax relief

BUKP and BUK were UK-resident companies which were wholly owned by a US company, BDE. BUK made a profit, while BUKP made a loss of the same amount.

There was no commercial purpose for this other than to produce a matching loss and profit. BUK's profit was taxed in the US under the 'check the box regulations', under which the profit was deemed to be BDE's profit if no election was made for BUK to be taxed separately.

BUK then claimed double tax relief in respect of that tax, and claimed that its liability to UK tax was thereby extinguished.

HMRC refused the claim, so the company appealed to the Special Commissioners. They dismissed the company's appeal, saying unilateral relief under TA 1988, s 790 was not available to BUK for the US tax paid by BDE and that relief was not available under the Double Taxation Relief (Taxes on Income) (the USA) Order 1980 SI 2002/2848 in respect of the same US tax paid by BDE.

The company appealed.

Allowing the appeal, the High Court said that the company was entitled to s 790 relief. HMRC appealed.

The Court of Appeal said that, under the treaty, HMRC had not been bound to give double tax relief to BUK. The US authorities were, however, obliged to give relief.

Furthermore, the UK was not required to allow unilateral relief under s 790. BDE could claim credit in the USA for the UK tax paid, and it was only to the extent that it could not do this, that BUK could claim s 790 relief.

HMRC's appeal was allowed.

Bayfine UK v CRC, Court of Appeal

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Value Added Tax

VAT on hot food *(Lecture B655 - 23.18 minutes)*

The CJEU has considered a series of cases from Germany in which the issue was whether the supply of prepared food constituted goods (eligible for a lower rate in Germany) or services. The court's answers were:

"the supply of food or meals freshly prepared for immediate consumption from snack stalls or mobile snack bars or in cinema foyers is a supply of goods within the meaning of Article 5 if a qualitative examination of the entire transaction shows that the elements of supply of services preceding and accompanying the supply of the food are not predominant" and

"except in cases in which a party catering service does no more than deliver standard meals without any additional elements of supply of services, or in which other special circumstances show that the supply of the food represents the predominant element of a transaction, the activities of a party catering service are supplies of services".

CJEU (Case C-497/09): Finanzamt Burgdorf v M Bog; (Case C-502/09): Fleischerei Nier GmbH & Co KG v Finanzamt Detmold

These cases attracted considerable interest. The CJEU itself issued press releases to draw attention to the issue and the decision. UK national papers speculated that UK traders could make claims for repayment of overpaid output tax.

HMRC issued a Brief to quell the enthusiasm. In their view, the decisions have no impact in the UK. The UK's zero-rating legislation is a specific legal framework which is operated by the UK within the derogations permitted by art.110 VAT Directive. The UK has discretion over what to include in the derogation, and exceptions to the standard rating of supplies are to be construed strictly. Therefore, in HMRC's view, the UK's exclusion of hot takeaway food from zero-rating is within the UK's rights and not susceptible to the application of the Bog decision.

R & C Brief 19/2011

In my view, HMRC are right about the CJEU decision, so anyone who is thinking of making a claim should consider carefully whether they want to expend the time and effort involved in doing so when HMRC appear to have a very solid basis for refusing to make any repayments.

Contributed by Mike Thexton

Compound interest claims

The claimant taxpayers appealed to the Court of Appeal from a decision of the Tax and Chancery Chamber of the Upper Tribunal that they were not entitled to recover compound interest on Value Added Tax (VAT) (see [2009] STC 2485). The defendant Revenue and Customs Commissioners (the Revenue) applied for a stay of the appeals until 56 days after the Court of Justice of the European Union (CJEU) had delivered its judgment on a reference made to it in November 2010 in *Littlewoods Retail Ltd v HMRC* [2010] All ER (D) 47 (Nov) (Littlewoods). The issues in the instant case arose out of overpayments of VAT to the revenue regarding "manufacturer's bonuses" paid to them and on sale by them of demonstrator vehicles. Littlewoodsrelated to overpayments of VAT arising out of the use of agents by catalogue-based home shopping businesses. The claimants appealed.

They submitted that the questions referred to the CJEU in Littlewoods were inadequate to enable their appeals to be properly determined and that, in any event, they were entitled to have their own reference to the CJEU on the grounds that they had their own claims to compound interest. They submitted further questions for referral.

It would not be appropriate for the court to direct a reference to the CJEU until the CJEU had ruled on the questions posed in the case of Littlewoods.

The request to refer the questions would therefore be refused. The proceedings would be stayed.

John Wilkins (Motor Engineers) Ltd

Lennartz calculations on a yacht

Kingfisher purchased a yacht and reclaimed the VAT it was charged as input tax.

The Tribunal sought to adjudge the proportions of private and business (that is, chartering the yacht) use of the yacht but whilst it was not convinced by the accuracy of the information from which HMRC had worked, neither did Kingfisher proffer any more credible evidence.

The Tribunal concluded that Kingfisher had failed to demonstrate that HMRC's information was incorrect, so HMRC's assessment had to stand, apart from minor corrections.

The Tribunal made the following specific findings—

- that travel to and from the Caribbean was not business use, since use while there was entirely private and business use, although intended when the journey began, had not in fact transpired
- however, a day each moving the boat to and from a UK location where it was chartered for a day were both business use, making three day's business use in all
- “reconnaissance” missions which did not result in any business use were not mixed private and business use but were purely private use.

The Tribunal then considered whether Kingfisher had reclaimed the original input tax under the *Lennartz* method, so that it should have charged and accounted for output tax in relation to the private use of the yacht. Kingfisher denied having operated the *Lennartz* method and argued instead that it had simply made an error in claiming too much input tax. If this argument had been upheld HMRC would have been out of time to correct that error by assessment. However, the Tribunal held that *Lennartz* had been applied, on the basis that Kingfisher would not prefer the alternatives—

- that the directors of Kingfisher had not acted in the company's interests by failing to turn their minds to the correct VAT treatment when it was known that there would be private use of the yacht or
- that the claim was fraudulent.

Finally, the Tribunal rejected Kingfisher's claim that private use of the yacht was the provision by Kingfisher of zero-rated or outside-the-scope transport services. This was a deemed supply and as such was not capable of being zero-rated or outside the scope of VAT.

The appeal was almost entirely dismissed (save for the effect of two more days' business use than HMRC had allowed).

Kingfisher Events Ltd TC 1014

Stamp duties

Residential Transactions: Chargeable Consideration Exceeds £1m

HMRC has issued a reminder that from 6 April 2011, the new 5% SDLT rate for residential property transactions where the chargeable consideration exceeds £1m applies.

Transitional arrangements apply to transactions where a contract was entered into before 25 March 2010 (Budget day) but was not completed before 6 April 2011. In most such cases the new rate will not apply.

The 5% rate applies to the following transactions:

- transactions which consist wholly of residential property and where the chargeable consideration exceeds £1m;
- linked transactions which consist wholly of residential property where the aggregate chargeable consideration exceeds £1m.

Non-residential and mixed use transactions are not affected.