CONTENTS

PERSONAL TAX 2
Health professionals and the annual allowance (Lecture P666 - 25.17 minutes) 2
Health professionals lifetime allowance (Lecture P667 – 12.15 minutes) 8
PAYE and termination payments (Lecture P668 – 8.11 minutes) 10
National insurance——provision of services through an intermediary 11
"Pay-day by pay-day tax relief" models—HMRC Statement on PAYE compliance 12
Mistake in PAYE coding 14
Remittance Basis Rule Changes (Lecture P669 – 14.21 minutes) 15

CAPITAL TAXES 16
Earn-out deals for genuine business sales (Lecture B667 – 15.23 minutes) 16
Capital losses claimed against interest 17
Grant of future underlease 18

ADMINISTRATION 20
HMRC Litigation and Settlements Strategy Relaunched 20
HMRC's new single compliance process (Lecture P670 – 9.39 minutes) 20
Revised legislation for handling misconduct 22
Tax fraudsters offered disclosure facility 22
Disclosure facility criticized by legal experts 23
Corporation tax online—reasonable excuse claims guidance 24
Companies House postpones mandatory online filing 25
Business records checks by HMRC—consultation response and brief 25
COP9 (2011) Civil Investigation of Fraud 27
The Agent View (Lecture B666 – 10.09 minutes) 29

BUSINESS TAXES 32
Completeness of income 32
Resurfacing partnership farm drive – capital or revenue? 32
Construction subcontractor – recognising income 33
Taking on a corporate partner? (Lecture B669 – 17.32 minutes) 34
Close company loan written offs (Lecture B668 – 12.02 minutes) 35
Companies acquiring businesses carried on prior to 1 April 2002 by a related party 36

VALUE ADDED TAX 37
HMRC Position following the Tribunal Decision in Paymex Ltd 37
VAT and sporting services (Lecture B670 – 12.59 minutes) 37
DIY housebuilder—was building a dwelling? Appeal dismissed 40
DIY housebuilder—was building a dwelling? Appeal allowed 41
Default surcharge when one day late 41
HMRC targets London's fast food outlets 42

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Personal Tax

Health professionals and the annual allowance (Lecture P666 - 25.17 minutes)

Annual Pension Allowance now £50,000

The Government announced on 14 October 2010 changes to the annual allowance for tax relief on pensions. From 2011/12 onwards, the annual allowance for tax relief on pension savings for individuals will be reduced from the old level of £255,000 to **£50,000**. In some circumstances, pensions savings made between 14 October and 5 April 2011 may also be affected.

If an individual's total pension savings are more than the annual allowance for the tax year they are liable for the annual allowance charge. However, they might still not have to pay the annual allowance charge as they can carry forward any annual allowance that they have not used from the previous three tax years to the current tax year.

From 2011/12 individuals can elect for their pension scheme to pay their annual allowance charge out of their pension benefits. The election is subject to certain qualifying conditions and exceptions, generally where the charge exceeds £2,000.

Doctors & Dentists - Who is likely to be affected?

NHS Pensions has considered all members of the Scheme and the likelihood that they will be affected by the annual allowance charge. They conclude:

Earnings	Affected by the charge?
Earnings under £45,000	Unlikely
Up to £100,000	Less than 1%
£100,000 - £150,000	About 1/3rd of members
£150,000+	90% plus

The changes are therefore more likely to affect GPs as a group than other Scheme members. In practice we believe that the reduction in the annual allowance is likely to affect:

- high earning GPs;
- particularly those in their early 50s; and
- those paying added years.

Carry forward of unused relief for three years

If an individual saves more than £50,000 in their pension they still might not have any annual allowance charge to pay. They can carry forward any annual allowance that they have not used from the previous three tax years to the current tax year. The amount of the unused annual allowance can then be added to this year's annual allowance. This gives you a higher amount of available annual allowance.

The annual allowance for 2008/09, 2009/10 and 2010/11 is deemed to be £50,000. So if your pension saving in a tax year was £20,000 you would have £30,000 unused annual allowance to carry forward. If your pension saving was £50,000 or more in a year you would not have any annual allowance left to carry forward from that tax year.

If the pension saving for the tax year is less than the available annual allowance there will be no annual allowance tax charge. If the pension saving is more than the available annual allowance the individual will have to pay the annual allowance charge - but only on the amount over the available annual allowance.

There is a strict order in which the annual allowance is used. You use the annual allowance in the current tax year first. You then use your unused annual allowance from earlier years, using the earliest tax year first (FIFO).

Example 1 (HMRC)

Sybille has total pension savings of £65,000 for the 2011/12 tax year.

In the previous three tax years her pension savings were:

2010/11 -	£35,000
2009/10 -	£30,000
2008/09 -	£25,000

If the annual allowance for each of those years was £50,000 Sybille has unused annual allowance of £25,000, £20,000 and £15,000 from those three tax years:

2010/11 -	£15,000
2009/10 -	£20,000
2008/09 -	£25,000
	£60,000

This means Sybille has £60,000 unused annual allowance to carry forward. Together with the £50,000 annual allowance for the 2011/12 tax year Sybille can have pension saving of £110,000 without the annual allowance charge being due.

Sybille's pension saving for the 2011/12 tax year is less than her available annual allowance. She does not have to pay the annual allowance charge.

Sybille has used up the £50,000 annual allowance for the current tax year and £15,000 unused annual allowance from three years ago. Although she still has £10,000 unused annual allowance from three years ago she cannot carry this forward to the next tax year.

You can only carry forward unused annual allowance from the last three years and next year the £10,000 unused amount will be from four years ago and so will be out of time and not available.

Sybille has £35,000 unused annual allowance that she can carry forward to next tax year. If the annual allowance in the next tax year is still £50,000 she will be able to making pension saving of £85,000 and still not have any annual allowance charge.

This three year carry forward rule allows you to make occasional large amount of pension savings without having to pay the annual allowance charge. For example if you are self-employed and in one year make a large profit, you might be able to make a contribution to your pension scheme that is larger than normal and is above the standard annual allowance level. This depends, of course, on the amount of contributions that you have been paying over the previous three tax years and the amount of unused annual allowance that you can carry forward.

If the individual's pension saving is more than their available annual allowance they have to pay the annual allowance charge - but only on the amount over the available annual allowance.

Example 2 (HMRC)

Bob has total pension savings of £85,000 for the tax year. This is more than the £50,000 annual allowance for the year.

However, in the three previous tax years his pension saving was £30,000 below the annual allowance for each tax year. This means Bob has £90,000 unused annual allowance to carry forward.

Together with the £50,000 annual allowance for the tax year Bob can have pension savings of £140,000 without an annual allowance charge arising.

As Bob's £85,000 pension saving is less than his available annual allowance there is no annual allowance charge for that tax year. However if his pension savings were £150,000 the excess of £10,000 would be taxed at 20%, 40% or 50% depending upon his marginal rate of tax. If his taxable income (after all reliefs) was £148,000 then the charge would be:

£2,000 @ 40% = £800
£8,000 @ 50% = £4,000
Payable £4,800

Pension savings under a defined benefits arrangement

The amount of an individual's pension savings under a defined benefits arrangement is the increase in the value of the promised benefits over the PIP. This is the difference between the value of the benefits at the start of the PIP (the opening value) and the value of the benefits at the end of the PIP (the closing value). If the difference is a negative amount then the pension savings for the arrangement is nil.

How to find the opening value

The opening value of pension benefits can be thought of as the amount of money that might be needed to provide the expected benefit. It is a notional 'capital' value and is determined as follows.

1. Find the amount of your annual pension. (This is the amount of pension that you would be paid if you retired now at normal pension age and without any extra benefits for ill health. So, if you took your benefits today, what would you get without any adjustment for early payment?)

2. Multiply the annual amount of your pension by 16.

3. If your scheme also gives you a separate lump sum in addition to your pension, for example many public sector schemes provide a lump sum without having to give up pension, add the amount of the promised lump sum to the amount found after step 2.

4. Increase the total after step 3 by the 12 month increase in the Consumer Price Index (CPI) to the September before the start of the tax year which you are calculating annual allowance for.

Example 3 (HMRC)

Fiona is a member of a scheme (say the post 2008 NHS Officer scheme) that gives her a pension of 1/60th pensionable pay for each year of being a scheme member. Although she can take a lump sum from her scheme, Fiona can only do this by giving up (commuting) pension to provide the lump sum unlike the old scheme which accrued pensions at a lower rate but added a lump sum to the end result. At the start of the PIP (Pension Input Period – the NHS Scheme has PIP which is effectively the same as the Financial year but personal pensions started after 2006 will have a period which runs from the anniversary of the first payment) Fiona's pensionable pay is £50,000. She has 15 years 214 days service at the start of her PIP.

1. Find annual of pension entitlement at the start of the input period. This is calculated as (15 + 214/365)/60 x £50,000 = £12,988.58

2. Multiply result by 16: £12,988.58 x 16 = £207,817.28

3. Add on any separate lump sum: Fiona's scheme does not give her a separate lump sum, so the running total is still £207,817.28

4. Increase amount for CPI: The calculation is being done for the tax year 2011-12. Let us assume the annual increase in CPI to September 2010 is 3%. A 3% increase brings the opening value to £214,051.79

How to find the closing value

The closing value is the notional 'capital' value of the expected benefits at the end of the PIP in the same way as you find your opening value, but missing out the final step. So:

1. Find the amount of your annual pension.

2. Multiply that amount of your pension by 16.

3. If your scheme also gives you a separate lump sum in addition to your pension, for example many public sector schemes provide a lump sum without having to give up pension, add the amount of the promised lump sum to amount found after step 2.

Certain events can cause the closing value of your benefits to be bigger or smaller than they would otherwise be. These events include where a transfer payment has been made or received by the pension scheme in relation to you or, following a pension share (on divorce there is a pension debit or credit attached to your benefits), or a Benefit Crystallisation Event (BCE) has occurred. In these circumstances you will need to adjust the amount of your closing value as shown below. (The most likely BCE is where you start to take some or all of your benefits from your pension scheme.)

If there has been a transfer into the arrangement in the PIP

Deduct the amount of the transfer in from the closing value.

If there has been a transfer out of the arrangement in the PIP

If the transfer is to another registered pension scheme or an overseas scheme that is a Qualifying Recognised Overseas Pension Scheme (QROPS) add the amount of the transfer out to the closing value.

If the transfer is to a non-registered scheme that is not a QROPS there is no need to add back the transfer out to the closing value. The transfer out is an unauthorised payment.

If there has been a pension debit in the PIP

Add the amount of the pension debit to the closing value
If there has been a pension credit in the PIP

Deduct the amount of the pension credit from the closing value.

If there has been a BCE during the PIP

Add the value of the BCE to the closing value. For example, for a defined benefits arrangement, this will be based on the pension paid multiplied by 16. You do not need to do this if the BCE is a BCE 8 (transfer to a QROPS) as you should already have adjusted the closing value for the transfer out.

Example 3 continued (HMRC)

At the end of the PIP Fiona's pensionable pay has increased by 10 per cent to £55,000 and her pensionable service is now 16 years 214 days.

1. Find annual rate of pension
   This is calculated as (16 + 214/365)/60 x £55,000 = £15,204.11

2. Multiply result by 16
   £15,204.11 x 16 = £243,265.76

3. Add on any separate lump sum
   Fiona's scheme does not give her a separate lump sum, so the running total is still £243,265.76.

No adjustments need to be made to Fiona's closing value as she has not had any transfers in or out, BCEs, pension debits or credits.

Fiona's pension saving for this arrangement is the difference between her opening value and her closing value. This is £**29,223.52** (£243,264.76 - £214,042.24 - 11a above).

There are significant administrative problems thrown up by the new regime. For example NHS Pensions have stated that they will provide a certificate of opening and closing benefits only if you get pay and service details to them by 5 July following the end of the year. This applies to doctors, dentists … what chance?

More Complex GP Example

Dr B has worked as a practitioner for 26 years and has pre-practitioner service of 4 years. His accountants have contacted NHS Pensions and it has been confirmed that on 5 April 2011 Dr B has dynamised career earnings of £1,800,000. His pension entitlement at that date is calculated by applying the accrual rate of 1.4% to his dynamised career earnings, as follows:

£1,800,000 x 1.4% = £25,200

This figure is adjusted to uplift his practitioner earnings for pre-practitioner service using the fraction:

$$\frac{\text{Total career service}}{\text{Practitioner service}}$$

This is known as the Regulation 72 uplift and applying this to Dr B:

£25,200 x 30/26 = £29,077

The value of Dr B's pension benefits at 5 April 2011 is therefore:

16 x pension of £29,077	= £465,232
Lump sum 3 x £29,077	= £ 87,231
Total	= £552,463

Uplift this by CPI (say 3%) = £569,037

Dr B's earnings in the year ended 5 April 2012 are £125,000. Assuming a dynamisation factor for 2011/12 of 4.6% his dynamised career earnings become:

£1,800,000 x 1.046	= £1,882,800
2011/12 earnings	= £ 125,000
Total	= £2,007,800

Revised annual pension entitlement:

£2,007,800 x 1.4% = £28,109

Regulation 72 uplift £28,109 x 31/27 = £32,273

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The value of Dr B's pension benefits at 5 April 2012 is therefore:

16 x pension £32,273	= £516,376
Lump sum 3 x £32,273	= £ 96,820
Total	= £613,196

This increase in pension benefits is therefore £613,196 - £569,037 = £44,159.

Accordingly, Dr B has, on the face of it, does not have an annual allowance charge. If there were one, this will be taxed at his highest marginal rate of tax which is likely to be 40%.

Brought forward unused relief

The regulations, as explained above, allow unused relief to be brought forward for 3 years. In Dr B's case it would be wise to review the benefits position in the 3 prior tax years, 2008/09, 2009/10 and 2010/11 as only small contributions to a personal pension say could lead to him going over the AA. Indeed, added years would be very likely to make him burst his allowance. To the extent that the increase in his benefits in any of those years was less than £50,000, the balance is available to offset against any excess in 2011/12.

How is the annual allowance charge paid?

The charge will be reported in the self assessment tax return. If the tax on the charge is less than £2,000 the tax will be paid by the taxpayer. If the tax on the charge exceeds £2,000 it will be paid by NHS Pensions, with a corresponding reduction in benefits in the future.

Obtaining information about CARE etc

NHS Pensions will provide information to enable an assessment of the change in the value of a medical professional's NHS pension benefits for the purposes of the annual allowance charge.

To obtain that information NHS Pensions have asked that all information in connection with GPs pensionable earnings is submitted to them by **6 July** following the end of the tax year. On the basis of receiving the earnings information NHS Pensions will provide annual allowance information by **6 October** following the end of the tax year.

These deadlines have been extended for the 2011/12 and 2012/13 years to **6 July 2013** and **6 October 2013** respectively. Accordingly for 2013/14 and tax years thereafter a practice with a March year end would be required to finalise its accounts within 3 months of its year end, together with each partner's personal expenses claim and superannuation certificate. This is clearly an impossible deadline. We understand that discussions are taking place between the accountancy profession, NHS Pensions and HMRC to consider ways of arriving at an estimate of earnings which will be acceptable to HMRC.

Changes to Pension Drawdown Arrangements

Currently most members of defined contribution (DC) schemes secure a retirement income by buying an annuity. Up until now, the options for members of DC schemes who do not wish to buy an annuity have been limited to:

- before age 75, an unsecured pension arrangement (USP) which enables individuals to leave their pension fund invested while drawing down an income; and
- after age 75, an alternatively secured pension arrangement (ASP) which is similar to USP but with a lower maximum drawdown limit.

Under the new rules, from 6 April 2011, the concepts of USP and ASP will disappear and there will be a single alternative to an annuity, a drawdown pension. The maximum withdrawal of income that an individual may make from most drawdown funds will be capped at 100 per cent of the equivalent annuity that could have been bought with the fund value.

In addition, “Flexible Drawdown” will be available for some people. Individuals able to demonstrate that they have a secure pension income for life of at least £20,000 a year will have full access to their drawdown funds without any annual cap. All withdrawals from drawdown funds will be subject to tax as pension income. An individual making a withdrawal from a drawdown pension fund during a period when they are resident outside the UK for a period of less than five full tax years will be liable for UK income tax on that withdrawal for the tax year in which they become UK resident again.

Any new pension savings by an individual after he or she has demonstrated that their secure lifetime pension income is at least £20,000 a year will be liable to the annual allowance charge on all pension input amounts. Most of the rules preventing registered pension schemes from paying lump sum benefits after the member has reached the age of 75 are being removed. The tax rate for all lump sum death benefits is set at 55 per cent, apart from death benefits for those who die before age 75 without having taken a pension, which will remain tax free.

With effect from 6 April 2011, inheritance tax (IHT) will not typically apply to drawdown pension funds remaining under a registered pension scheme, including when the individual dies after reaching the age of 75. Also with effect from 6 April 2011, IHT anti-avoidance charges that apply to registered pension schemes and Qualifying Non UK Pension (QNUP) Schemes where the scheme member omits to take their retirement entitlements (e.g. a failure to buy an annuity) will be removed. These changes will also apply to superannuation funds that are occupational pension schemes by virtue of section 615(3) of the Income and Corporation Taxes Act 1988 (ICTA).

Contributed by Bob Trunchion, MacIntyre Hudson Advisory Services LLP

Health professionals lifetime allowance (Lecture P667 – 12.15 minutes)

As announced on 14 October 2010 the level of the lifetime allowance for determining whether the lifetime allowance charge is applicable is lowered to £1,500,000 from 2012/13 onwards. Schedule 18 to Finance Bill 2011 introduces transitional provisions which provide protection from the lifetime allowance for those who may already have built up pension savings on the expectation that the lifetime allowance would remain at the current level of £1,800,000

Pension benefits with a value in excess of the standard lifetime allowance (SLA) will be subject to a tax charge known as the lifetime allowance charge.

The current lifetime allowance is £1.8 million but this will reduce to £1.5 million on 6 April 2012. However, the £1.8 million limit can be retained on application to HMRC, though no further contributions can be made. This will be called 'fixed protection'.

- Primary and enhanced elections already made will continue to protect funds of over £1,800,000

Transitional Rules

Where fund likely to exceed £1,500,000 on 6 April 2012, or are likely to at a future benefit crystallisation event will be able to elect for a £1,800,000 lifetime limit but must cease either contributions (DC) or accruing benefits (DB) by that date. i.e. election and cessation both by 6 April 2012 for transitional protection

Lifetime allowance charge

The SLA creates a ceiling on the benefits value that can be built up by an individual in registered pension schemes whilst continuing to benefit from tax relief. If the benefits at retirement exceed the SLA the difference between the two is subject to the lifetime allowance charge (LAC).

The LAC can be applied in either of two ways or a combination of both depending on how the excess benefits value above the SLA is taken.

The charge is:
- 55% if taken as a lump sum, or
- 25% if taken as income.

Dr Jones has been a high earner (over £100,000 pa) – he has contributed for 40 years.

- He has a personal pension fund with a value of £290,000 to help with the acquisition of the pharmacy at the back of the surgery that was built five years ago
- CARE established giving
  - Pension of £63,000
  - Lump sum = £189,000
- Capitalise Pension X 20 = £1,260K
- Lump Sum = £189K
- PP Fund = £290K
- Total = £1,739K

Has Dr Jones got a problem? The answer is that today, he does not but before he gets to April 2012, he has some urgent action to take. Whilst it is unlikely that he had registered for primary or enhanced protection before April 2009 as his fund was not big enough then, if he had, that would continue to protect amounts over £1.8 Million, he needs to consider the Transitional Relief of fixed protection. Can he do it? The answer is to consult an IFA. Why, if he does not register for protection and stop all contributions by 5 April 2012 **(on all pensions – not just the NHS)** there will be the high tax charge on the excess. If he does register then the funds will not grow further other than through investment growth effectively which could have other ramifications. Definitely need to advise on future caution on contributions and review Medics before 6 April 2012.

Trap for the unwary – taking benefits in drifts and drabs

If the Benefits started before A Day, the Standard valuation factor of 25:1 is used for pre A Day income rather than the factor of 20 used above e.g.£10,000 pension = £250,000 of LTA

The factor is applied to the annual payment in force when the first benefit crystallisation event after A Day occurs but is more complicated where the doctor is in income drawdown. For income drawdown, the factor is applied to the maximum permitted withdrawal (max GAD) at last review.

Example – Hospital Consultant

Client (semi retired consultant) has following pension income:

- NHS pension (index linked) £30,000
- Annuities (level) £23,000
- Drawdown on balance £25,000

Notes

1. All were started pre A Day
2. Current max GAD entitlement on Drawdown is £36,000
3. Doesn't like the way medicine is going - retiring
4. He has a deferred final salary pension with an accrued pension of £5,000 p.a. as at A Day

5. He has a small S226 RAC worth £50,000 with 10% GAR not yet crystallised

If client now crystallises his RAC or deferred pension, his benefits are valued as follows:

6. NHS pension x 25 £750,000
7. Annuities x 25 £575,000
8. Drawdown – max GAD x 25 £900,000
9. Deferred £5,000 x 20 £100,000 or
10. S226 Fund Value £50,000

Taking either of his undrawn benefits would trigger a lifetime charge unless protected by Primary or Enhanced Registration (which should have been registered by 5 April 2009

11. NB Level and indexed pensions valued identically

New GAD Tables

- Came out Mid February
- Effect on income drawdown
- Combine with 120% to 100% reduction?
- Effect on lifetime limit – probably good

Contributed by Bob Truncheon, MacIntyre Hudson Advisory Services LLP

PAYE and termination payments (Lecture P668 – 8.11 minutes)

Where an employer makes a termination payment to a member of staff, there is a requirement to deduct tax at source in respect of any amount which does not fall within the tax-free exempt limit provided by S403 ITEPA 2003. As is well known, this exemption only applies to the first £30,000 of a qualifying termination payment and so tax is withheld from any excess over £30,000.

Hitherto, employers were permitted to deduct basic rate tax only from non-exempt payments made after the issue of the employee's P45, using the 'BR' code. This provided a cash flow advantage to employees who were higher or additional rate taxpayers, given that the further tax due was not payable until after they had filed their tax returns with HMRC.

HMRC recently published new PAYE Regulations which came into force on 6 April 2011 and which now require employers to use a non-cumulative 'OT' code to calculate and deduct tax in these circumstances. The effect of this reverses the cash flow benefit to HMRC's advantage and involves a potential requirement to deduct tax at 20%, 40% and 50%.

By way of illustration, the PAYE withholdings which would have applied to a post-P45 cash payment made during the first month of 2011/12 are:

(i) the first £2,917 (1/12 x £35,000) is taxed at 20%;

(ii) the next £9,583 (1/12 x £115,000) is taxed at 40%; and

(iii) any amount above £12,500 (1/12 x £150,000) is taxed at 50%.

The PAYE treatment of payments made prior to the issue of the P45 remains unchanged. Employers are obliged to withhold tax on any non-exempt termination payment at the rates which would have applied had that payment been additional salary.

Employers who wish to limit the impact of this change for employees should consider either making the termination payment before the P45 is issued or alternatively staging the payments over several months after the P45 has been given to the employee.

Contributed by Robert Jamieson

National insurance——provision of services through an intermediary

R, a highly skilled IT worker specialising in software development, was the sole director and shareholder of the appellant company. She was approached by an agency company (B) to provide computer services to another company, V. She was not interviewed for the position and assumed V had checked her website which contained her CV. There was no direct contract between R and V; but there were agreements between V and B and between B and the appellant, all of which allowed for substitution. Between 2002 and 2005 the appellant entered into a series of contracts with B for R's services; firstly at a rate of £600 per day and then £350 per day. In December 2007 HMRC issued a decision that the appellant was liable to pay National Insurance Contributions (NICs) for the period 6 April 2002 to 27 March 2005 under the Social Security Contributions (Intermediaries) Regulations 2000, SI 2000/727. They also issued a determination that the appellant was liable to pay PAYE income tax for the years 2002/2003, 2003/04 and 2004/05, pursuant to the Income Tax (Pay As You Earn) Regulations 2003, SI 2003/2682. The appellant appealed. It was common ground that the appellant was an “intermediary” for the purposes of the 2000 Regulations.

The issue arose as to whether the hypothetical contract between R and V was a contract of employment or a contract for services.

The hypothetical contract would be one for services. Given the level of responsibility the worker, R, had taken over the years, it was prudent of her to operate under the protection of a limited company. Whilst that in itself would not prevent the hypothetical contract being a contract of services, considered in the round it was one for services for the following reasons:

(i) the terms of the formal contracts between V and B and between B and the appellant had to be imported into the hypothetical agreement between R and V;

(ii) V relied on B to provide the contractors and it was immaterial who was appointed, provided they had the necessary skills. The substitution clause was in no way fettered. On that basis the hypothetical contract would have to have a valid substitution clause which could only be found in a contract for services;

(iii) V were prepared to negotiate the best price at the time which was initially £600 and then almost half that amount in subsequent contracts. The hypothetical contract would have to have a clause which gave V the opportunity to fix the remuneration to be paid on their terms. It would not be possible to control an employee's pay in that manner and a contract of service would make no such provision;

(iv) on the evidence V had no real control over the way R worked. V accepted invoices showing the work for the week as being 37.5 hours when it was clear from R's records that the hours she worked varied from week to week. That was consistent with a contract an agreed price; a contract of service would specify the working week;

(v) the termination provisions made it clear that there was no obligation on either party to employ the other or work for the other and the hypothetical contract would have to make provision for that.

That was not a provision that would be found in a contract of services; and (v) in painting the picture, it was clear that the appellant was a genuine business and therefore not a target of the IR35 legislation. It followed that the appeal would be allowed.

Appeal allowed.

ECR Consulting v Revenue and Customs Comrs TC 1174

[2011] UKFTT 313 (TC)

"Pay-day by pay-day tax relief" models—HMRC Statement on PAYE compliance

HMRC has issued a statement of its view that a particular payroll model, which some umbrella companies and others employing temporary workers are operating, does not comply with tax and NICs legislation. The model involves employers giving relief for travelling expenses by reduction of the amount subjected to PAYE, rather than as a deduction from total income. HMRC consulted on travel expenses of temporary workers in 2008 and decided against new legislation at that stage.

Who should read this statement

- All umbrella companies, employment businesses, labour providers and employers engaging and paying temporary workers.
- Temporary workers engaged under employment contracts.
- Those in receipt of the services of temporary workers supplied by employment businesses and labour providers, particularly, but not exclusively, workers paid at or near the National Minimum Wage.

Background

HM Revenue & Customs (HMRC) understands that a number of umbrella companies, employment businesses and labour providers are proposing to operate a business model which applies tax, and in some case National Insurance contributions, "relief" on a pay-day by pay-day basis: a "pay-day by pay-day relief" model.

Under pay-day by pay-day relief models, temporary workers engaged under overarching employment contracts and who incur travelling and subsistence expenses which are eligible for a tax deduction under s 338 Income Tax (Earnings and Pensions) Act 2003 (ITEPA), are paid a gross pay which is intended to be compliant with the National Minimum Wage legislation. However, rather than then subjecting this gross pay to Income Tax and National Insurance, the employer applies tax and National Insurance contributions "relief" to the amount of expenses which the employee has incurred with the effect that only the balance is subjected to Income Tax and National Insurance. This tax and National Insurance contributions "relief" is applied each pay day.

Tax and Social Security legislation

The information obtained by HMRC thus far indicates that the model described above does not comply with the Taxes Acts or Social Security Acts and associated Regulations.

How tax relief is applied

An employer operating such a model is not accounting for the correct Income Tax (PAYE) due to HMRC.

Income Tax is an annual tax and is assessed in respect of a particular "year of assessment". Any deductions from Income Tax (for example as provided for under s 338 ITEPA) are made from the total income for the year of assessment.

There are various requirements which must be met in order to receive the benefit of the tax deduction at the end of the tax year. These include that the claim for the deduction by the employee must be made to HMRC - there is no statutory framework for employers to operate the reclaim process.

National Insurance disregards

An employer operating such a model would also not be accounting for the correct employers' and employees' National Insurance contributions due to HMRC.

For the purposes of calculating an employee's earnings, the Social Security Contributions and Benefits Act 1992 provides that "earnings" includes any remuneration or profit derived from the employment, including wages and salaries.

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The Social Security (Contributions) Regulations 2001 provide that payments made by the employer to the employee to cover certain travelling expenses incurred by an employee can be disregarded in the calculation of earnings for National Insurance purposes from the employed earner's employment for the purposes of earnings related contributions (ie where such payments are made, those payments will not count as "earnings" for the relevant earnings period). However, the relevant legislation does not provide for a deduction from the amount of that employee's earnings where the employee meets the travelling expenses out of total income/earnings.

Summary of position

HMRC have set out below the ways in which tax relief and/or a National Insurance contributions disregard can be given effect.

Separate and distinct expense payments / reimbursements made by employer covered by dispensation

- The employer pays an amount at least equal to or greater than the National Minimum Wage to ensure compliance with the National Minimum Wage legislation. The income and earnings are subject to Income Tax and National Insurance contributions.
- The employer separately and distinctly pays or reimburses an additional amount in respect of certain travelling expenses.
- If those additional payments in respect of travelling expenses are paid under the terms of a valid dispensation, they may be paid without any additional liability to tax.
- The additional payments in respect of expenses would be disregarded for National Insurance purposes.

Separate and distinct expense payments/reimbursements made by ER but not covered by dispensation

- The employer pays an amount at least equal to or greater than the National Minimum Wage to ensure compliance with the National Minimum Wage legislation. The income and earnings are subject to Income Tax and National Insurance contributions.
- The employer separately and distinctly pays or reimburses an additional amount in respect of certain travelling expenses.
- If those additional payments in respect of expenses are not paid under the terms of a valid dispensation, those additional payments would count as general earnings but the employee can claim a tax deduction from earnings from HMRC at the end of the tax year in respect of expenditure which is eligible for a deduction through Self Assessment.
- The additional payments in respect of expenses would be disregarded for National Insurance purposes.

Expenses paid by employee out of total income received

- The employer pays an amount at least equal to or greater than the National Minimum Wage to ensure compliance with the National Minimum Wage legislation. The income and earnings are subject to Income Tax and National Insurance contributions but there is no separate and distinct payment in respect of expenses. The employee pays for his travelling expenses from his total income.
- The employee can claim a tax deduction from HMRC at the end of the year in respect of expenditure which is eligible for a deduction through Self-Assessment.
- No National Insurance contributions disregard is available in such circumstances.

What you should do

THOSE OPERATING PAY-DAY BY PAY-DAY RELIEF MODELS

Consider whether your business model is compliant with tax and National Insurance legislation. If you are in any doubt, you are recommended to seek advice from a professional adviser or HMRC. HMRC is seeking to identify those businesses currently operating pay-day by pay-day relief models.

WORKERS/BUSINESSES CONCERNED ABOUT SUCH MODELS

You can provide HMRC with details, in confidence, about businesses operating such pay-day by pay-day relief models by email. See www.hmrc.gov.uk/NEWS/relief-models.htm.

Employee's expenses-travel for necessary attendance see *Simon's Taxes* **E4.780**

HMRC Notice 11 July 2011

Mistake in PAYE coding

The taxpayer appealed against surcharges for late payment of his income tax for the tax years 2006/07, 2007/08 and 2008/09, and against interest on the late-paid tax and the surcharges.

It was discovered in January 2010 that for the past three tax years a mistake had been made with the taxpayer's PAYE coding notice, and that his employer had only deducted basic rate tax from his earnings, although he was earning more than £100,000 per annum.

The taxpayer was unaware of this error until January 2010, when he told the Revenue, which issued a new code and sent him tax returns for each of the three years.

The department subsequently issued assessments for each year, showing tax due of £11,473, £13,502 and £15,322 respectively.

Given the size of the amounts, the taxpayer could not immediately pay the total in one instalment, but he managed to settle the bill in September. Meanwhile, HMRC had issued late payment surcharges.

The taxpayer appealed.

Before the First-tier Tribunal, he explained he paid the tax 'as quickly as he reasonably could', but the payment dates for the tax were never made clear to him. He was under the impression that he and an HMRC agent had arrived upon an agreement as to the timescale in which he would pay the taxes.

The Revenue maintained the taxpayer should have been aware that his tax was under-deducted, and that 'ignorance of the law is not a reasonable excuse for late payment of tax liability'.

The tribunal judge, Anne Redston, said the taxpayer was not ignorant of the law; he was merely ignorant of the fact that an incorrect coding notice was being used. He relied on his employer and HMRC to ensure the right amount was being deducted. The judge considered that this was a reasonable belief, and true of most taxpayers.

She allowed the appeal on the basis the taxpayer genuinely believed that he had negotiated a delayed timescale for paying the tax, and that, upon discovering the underpayment, he acted in the manner of someone who seriously intended to honour his tax liabilities.

The taxpayer's appeal was allowed.

John Brady (TC1268)

Remittance Basis Rule Changes (Lecture P669 – 14.21 minutes)

On 17 June the Consultation Document (ConDoc) was released relating to the proposed amendments to the taxation of Remittance Basis Users (RBU's). If enacted, the amendments will be effective from 6 April 2012. The proposals are in three specific areas.

- Increasing the Remittance Basis Charge to £50,000 for some RBUs
- Simplifying some of the existing rules relating to remittances
- Introducing an exemption for using overseas funds to invest in UK businesses

Remittance Basis Charge

The increase of the Remittance basis charge will apply to any RBU who has been resident in the UK for at least 12 out of the last 14 tax years prior to the year of claim. All other aspects of the charge remain in place.

Simplifying the Rules

The simplification proposals are a mixed bag. These include the following:-

1. The first £10 of nominated income can now be remitted tax free.
2. All Foreign Currency Bank Accounts are now exempt t from CGT.
3. Statement of Practice SP 1/09 is to be given a statutory base.
4. Assets brought to the UK solely for sale will not be a remittance if the funds are "exported" within two weeks and purchaser retains the asset in the UK.

Investing in the UK

Finally the investment relief is to be introduced. This will apply to any remittance that is made for the sole purpose of investing into a company which is conducting a qualifying business in the UK. There is no limit to the amount that can be invested nor is there any restriction in the form of investment, which can be equity, loan or combination of the two. Further the investment can be made direct by the RBU or through their offshore company or trust structure.

A qualifying business is any trading activity including the normally unacceptable activities. Also developing and letting of commercial properties. These activities can be carried on directly or the company can invest into companies carrying qualifying activities. There are some excluded activities which relates to residential property and activities which may allow the investor to fund his life style.

There are anti-avoidance provisions including the taxing of all UK sourced income and gains deriving from the investment and the requirement that on realisation of the investment the funds must either be re-invested into another qualifying investment or exported from then UK within two weeks.

Conclusion

The new investment is a really exciting proposal and could prove useful for clients. However, the other amendments are minor with the exception of the RBC increase.

Contributed by Paul Bramall

Capital Taxes

Earn-out deals for genuine business sales (Lecture B667 – 15.23 minutes)

Earn-out deals typically involve additional deferred consideration which is calculated by reference to the actual two to three years post-acquisition profits of the Target Company or business.

Unless stated otherwise, all statutory references are to TCGA 1992.

Spectre of *Marren v Ingles*

Since earn-out consideration is unascertainable at the date of the contract, the basis for taxing it largely follows the principles laid down in the landmark tax case of *Marren v Ingles* [1980] STC 500.

The seller's CGT consideration comprises the 'up-front' sale proceeds and the market value of the right to receive the additional earn-out consideration, which would normally be heavily discounted for its contingent and risky nature as well as the time value of money.

The earn-out right represents incorporeal property and is therefore an asset for CGT purposes (s 21(1)(a)). Thus, when the actual earn-out payments are received by the seller, they trigger subsequent CGT disposals since they represent capital sums derived from the right under s 22(1).

Marren v Ingles also established that the right is acquired at its market value when the original sale contract is executed. As there will often be several earn-out payments, each receipt (before the final one) will represent a part disposal of the right. Thus, the capital gain on each earn-out payment will be calculated after deducting the part-disposal value of the right (based on the rules in s 42).

Business asset taper days

Sellers often sought to side-step the initial tax charge on the value of the right by using loan notes to defer the gain. The earn-out right was deemed to be a non-qualifying corporate bond, enabling the normal 'paper for paper' rules to apply.

Under the old business taper relief regime, it was normally possible to arrange for the seller to benefit from the effective 10% tapered CGT rate on the entire earn-out consideration.

Introduction of entrepreneurs' relief

On the introduction of entrepreneurs' relief, it was generally no longer possible to obtain the benefit of the effective 10% entrepreneurs' relief-relieved CGT rate on the earn-out loan notes.

Even where the seller had sufficient allowance, it was never usually possible to ensure the acquiring company was their 'personal company' for entrepreneurs' relief purposes. This meant that the earn-out gains were taxed at 18%, i.e. the pre-23 June 2010 CGT rate.

Current strategy

With an entrepreneurs' relief limit of £10 million, there is far more headroom on the amount of the earn-out right attracting entrepreneurs' relief 10% rate as part of the share sale consideration.

There is an 18% differential between the 10% entrepreneurs' relief rate on the initial value of the earn-out right (taxed as part of the share sale consideration) and the 28% CGT rate that applies to gains on the final earn-out.

Provided it can be substantiated, the higher the value of the earn-out right that can be agreed with HMRC, the greater the amount of tax that can be saved at 28%.

This will often mean avoiding the automatic CGT deferral rules by either:

1. arrange with the purchaser for the earn-out to be paid in cash; or
2. ensuring an election is made under s 138A(2A) to opt out of the deferral treatment.

This will lead to a higher up-front CGT charge. However, given the prevailing level of interest rates, the 18% tax saving should significantly outweigh the interest cost of accelerating part of the tax charge.

Disappointing earn-out proceeds

If earn-out proceeds fall well below expectation, it is possible that a capital loss will arise, typically, on the final earn-out disposal. The seller can make a claim to carry-back the loss under s 279A against the original gain on the share sale.

Using a profit warranty

In some cases, it might be possible to maximise the value of the earn-out consideration taxed at the entrepreneurs' relief rate of 10% by structuring the share sale for the maximum possible deferred consideration value.

In such transactions, the deferred consideration should be ascertainable, and should not therefore be subject to the *Marren v Ingles* computation basis. Instead the full deal value will be taxable under the fixed deferred consideration rule in s 48.

This has the benefit of bringing in the full deferred amount without any discount for risk and contingency, which often substantially reduces the value of the earn-out right under the Marren v Ingles rules.

Under the ascertainable deferred consideration route, effect is given to the earn-out arrangement by providing that any under-performance against the maximum profit/earnings etc. is clawed back by a series of profit warranties.

Since such deals are typically based on a multiple of earnings, it should be possible to define the warranty damages in terms of an appropriate multiple of the profit shortfall. Careful drafting of the profit warranty clauses is required to ensure that this route is effective.

The subsequent warranty payments would therefore reduce the original maximum deferred consideration under s 49(2).

In this way, the seller should pay the 10% entrepreneurs' relief rate on the entire deal value (up to the available limit).

Summarised from an article by Peter Rayney, Taxation 20 July 2011

Capital losses claimed against interest

In June 2005, HMRC enquired into the taxpayer's 2003/04 return, prompted by information they had received from his bank, which showed the interest paid to him was greater than the amount shown on the return.

The enquiry led to further examination of his returns for the preceding three years. It transpired the taxpayer had been deducting capital losses on his investments from the interest paid to him by his bank.

He said he did this in light of informal advice from an accountant. He subsequently accepted the advice was incorrect.

HMRC issued discovery assessments under TMA 1970, s 29 in respect of the three earlier years and amended his 2003/04 return.

The taxpayer appealed to the First-tier Tribunal, which found he had been negligent and dismissed his appeal.

On appeal to the Upper Tribunal (Tax and Chancery Chamber), the taxpayer argued he had exercised considerable care in following what he believed to be correct advice and providing HMRC with an accurate statement.

He denied that his error could be described as negligent. He had provided all the information that was needed with his return, even if he had put the wrong amounts in the boxes.

The Upper Tribunal judge said the First-tier Tribunal had concluded that the taxpayer had a duty of care to enter the correct details in the boxes of the return. He had not done this, and thus the tribunal had found his conduct to be negligent. The judge said this was a reasonable conclusion.

He noted, however, that the tribunal had dismissed the appeal against the amendment to the 2003/04 assessment without further comment. With regard to this, HMRC had no need to use their power under s 29 power, as it was the case that the self-assessed tax was insufficient.

The taxpayer's appeal was dismissed, and the judge directed that the taxpayer pay HMRC's costs.

Colin Moore v CRC, Upper Tribunal (Tax and Chancery Chamber)

Grant of future underlease

In 1996 the landlord (P) granted the deceased (K) a 100 year lease to a property (the headlease). P consented by licence to underlet to K granting an underlease to a nominee company (O) (the underlease). K then granted the underlease to O for 86.5 years, to commence in 2007, and it was granted without rent or premium being payable. The date of the disposition of the future underlease was the date of the grant and not the date the underlease actually commenced. At the same time, K created a settlement. The trust property was the underlease and N was the bare nominee for the trustee. The terms of the licence to underlet included covenants by K and O. K covenanted with P to enforce the covenants given by the undertenant in the underlease and O covenanted with P to observe K's covenants in the headlease. Although the underlease did not require O to pay rent, O did covenant to pay K an amount equal to the amount of service charge, approximately £9,000 pa, that she had to pay under the headlease to P. The trustee was obliged to pay K the service charge and advance service charge, to keep the property in repair and obey various other covenants. K died on 2 May 2008. The headlease with vacant possession would have been worth £2.1 million but because of the underlease, the headlease (in reversion) was worth £50,000. HMRC issued a notice of determination that the creation of the sublease was, under FA 1986 s 102, a disposal by way of gift by K of property subject to a reservation of benefit which fell to be treated as property to which she was beneficially entitled immediately before her death. The trustee and life tenants were said to be liable for the resulting inheritance tax. The executor of B's estate, the trustee and K's sons, who were the beneficiaries of the trust, appealed. The issue arose as to whether the property gifted by K to the trust was, as per FA 1986 s 102(1)(b), at any time in the relevant period "not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise". The appellants argued (i) the underlease including the covenants was a single property and that was what K transferred: the covenants were not reserved, they were part of the leasehold estate; (ii) even if not, the nature of the covenants in reflecting those of the headlease meant K was entirely excluded from enjoyment of the property; and (iii) if not, the benefit was of such a nominal nature that K was "virtually" entirely excluded.

The underlease was granted at a very substantial undervalue and it was a gift. However, it was qualified by covenants. The covenants were a condition of the underlease and were not independent property interests even capable of being granted separately to the lease. The reservation of the service charge by K was a reservation of a benefit: it was difficult to see how that, and the covenants for the repair of the property, could be otherwise than a benefit to K. Although the covenants in the underlease were identical to those on the headlease, K was not excluded from benefit of the property. K held the property under the headlease subject to the many covenants in that grant. It was clearly of benefit to her that after the grant of the underlease, the trustee now owed her the same covenants. Whilst vis-à-vis P the trustee and K now had joint and several liability on the covenants, the former under the licence to underlet and the latter under the headlease, nevertheless K could, under the terms of the underlease, pass her liability on to the trustee. That had to be of benefit to her. The reservation of service charge and the other covenants meant that the trust as tenant and donee could not enjoy the lease to the entire exclusion of the donor: far from it, the service charge had to be paid to K and the covenants obeyed or the property could be forfeited. Nor was K "virtually" excluded from benefit. To be virtually excluded was to be as good as excluded; to be excluded for all practical purposes. An exceedingly remote chance of benefit or where the benefit was real but very slight

might mean a settlor was "virtually" excluded but not otherwise. Section 102 was concerned with the possibility of benefit and not whether K actually did benefit. The moment the underlease fell into possession, the trustee was obliged to pay an amount equal to the service charge charged under the headlease to K, as well as obey various other covenants. Whether K died before any payments were made was not relevant: it was the potential for benefit that mattered. The service charge was, in absolute terms, substantial, some £9,000 pa. The other covenants also had a real potential to involve the trustee in expenditure of significant sums of money, expenditure which K would have had to incur except that the terms of the grant of the underlease made the trustee liable to do it. Even if "virtually" should be measured by comparison to the size of the gift, the appellants had failed to show that the service charge and other covenants were practically insignificant. It would be a real burden to anyone, who had given away the right to occupy the property, to carry on paying a service charge of very much more than a nominal amount and £9,000 per annum was far from a nominal amount. It followed that the appeal would be dismissed; *Ingram v IRC* [1999] STC 37 and *Munro v Comr of Stamp Duties of New South Wales* [1934] AC 61 distinguished; *Oakes v Comr of Stamp Duties of New South Wales* [1953] 2 All ER 1563 considered.

Appeal dismissed.

Buzzoni (executor of the estate of Kamhi, deceased) and ors v R&C Comrs TC1129

Administration

HMRC Litigation and Settlements Strategy Relaunched

HMRC has relaunched this strategy which sets out the principles within which HMRC handles all disputes about taxes, duties or credits, where those disputes are subject to civil law procedures and whether they are resolved by agreement with the customer or through litigation.

The Litigation and Settlements Strategy (LSS) sets out the principles within which HM Revenue & Customs (HMRC) handles all disputes about any of our taxes, duties or credits, where those disputes are subject to civil law procedures, and whether disputes are resolved by agreement with the customer or through litigation. This includes most of HMRC's compliance activity.

The two key elements of HMRC's approach to tax disputes are—

- supporting customers to get their tax right first time, so preventing a dispute arising in the first place
- resolving those disputes which do arise in a way which establishes the right tax due at the least cost to HMRC and to its customers, which in most cases will involve working collaboratively.

The LSS encourages HMRC staff to—

- minimise the scope for disputes and seek non-confrontational solutions
- base case selection and handling on what best closes the tax gap
- resolve tax disputes consistently with HMRC's considered view of the law
- subject to that, handle and resolve disputes cost effectively - based on the wider impact or value of cases across the tax system and across HMRC's customer base
- ensure that the revenue flows potentially involved make any dispute worthwhile
- (in strong cases) settle for the full amount HMRC believes the Tribunal or Courts would determine, or otherwise litigate
- (in "all or nothing" cases) not split the difference
- (in weak or non-worthwhile cases) concede rather than pursue

The LSS was introduced in 2007 and was refreshed in July 2011.

HMRC's new single compliance process (Lecture P670 – 9.39 minutes)

Introduction

As yet another attempt to change the enquiry regime in terms of working an enquiry, HMRC has announced trials of a single compliance process for enquiries across a range of different taxes.

By simplifying and standardising the process for compliance checks HMRC will they claim, improve customer experience and reduce costs as the check will only take as long as the risks and behaviours encountered dictate. Whilst essentially good news all round, this initiative is clearly resource driven and there are a number of important points to appreciate when acting for a client.

The trials of the new process will run to the end of November in 10 different locations across the UK: Reading/Slough, Newcastle, Warrington, York, Exeter, London Euston and Southampton in England; Cardiff in Wales; Belfast and Edinburgh/Dundee.

The new process will be rolled out nationally from January 2012, subject to the results of the trials.

The approach

The SCP will focus solely on the risks and behaviours identified in cases and throughout the life of the compliance check, irrespective of the head of duty (VAT, Income Tax, Corporation Tax and PAYE) involved. The process will be capable of addressing lower risk cases at an appropriate level, but HMRC rather spoil the message by adding that the process will also increase in intensity should the approach be warranted. Further information is available from a briefing paper for tax agents, from which we can determine the best way to deal with all enquiries under this process.

Driving the enquiry (with HMRC behind the wheel)

The claim is that the SCP will allow for the enquiry to be driven by the risks or behaviours identified and that, according to HMRC, includes:

- Building on the principles of the openness and early dialogue by informing the taxpayer and agent at the first opportunity of the particular risks to be addressed to give time savings and clarity for both parties about the risks being addressed.
- Developing a relationship with the agent/business for mutual understanding of the benefits of particular approaches and how these maintain the pace or speed up the process at every stage in the enquiry.
- Collaboration between HMRC and agent/business at every stage in the enquiry and communicating any findings directly so that there should be "no surprises".
- Swifter record reviews carried out "on site".
- Only seeking the facts and evidence to address the particular risks identified and not using the enquiry to undertake a general "fishing expedition", meaning that discussions are more focussed.
- Sample record reviews as opposed to a full review when appropriate.
- Working to Litigation and Settlement Strategy principles, importantly that HMRC will not generally enter into a dispute unless the revenue flows potentially involved justify doing so.

The 4 levels of enquiry under SCP

LEVEL 1

This is where there is no need for a face to face meeting. Maximum time estimated to work the enquiry is 1.5 days.

LEVEL 2

A simplified and faster route for those cases where a lower intensity face to face intervention is required. 2 days estimated.

LEVEL 3

Cases requiring a greater amount of time because the depth and breadth of the enquiry is more involved. 4 days estimated.

LEVEL 4

The most demanding cases such as those indicating tax evasion characteristics or those highly complex in nature. 8 days estimated.

Your role to ensure all is fair for your client

Clearly this is a resource driven initiative, being sold to us on the basis that it will reduce the time, costs and hassle experienced by agents and clients. You must ensure that in adopting the SCP approach none of the following happens:

1. HMRC unfairly seeks to obtain agreement to additional taxable profits arising, by encouraging your client to settle if he wants them to make a speedy exit. Do not allow HMRC to rush things along if you consider that will be detrimental to the client.
2. HMRC use SCP but wrongly identify what they consider to be risk areas – perhaps as a result of only a superficial consideration of what they regard as facts but which in reality are nothing of the sort. That may well be derived from a check-list review which you feel shows a basic lack of understanding of how the business operates. If so, you need to be ready to make the point firmly and at an early stage of the enquiry.
3. HMRC attempts to apply a higher level to the enquiry than you consider justified.
4. HMRC use the new 4 levels approach to insist on a meeting with the client when you consider that all can be settled without that.
5. A tax enquiry becomes drawn-out and HMRC seemingly refuses to apply this initiative when it is adopted nationwide (planned to be from January 2012). Even at this stage you could refer to the SCP procedures to try and get the enquiry settled.

Contributed by Gerry Hart

Revised legislation for handling misconduct

Fresh proposals to clamp down on dishonest tax agents have been published by HMRC in light of responses to *Working with Tax Agents: The Next Stage*, the consulation issued in December 2009, which led to draft legislation, published in February 2010, that was strongly criticised by tax professionals.

The latest discussion paper, ***Working with Tax Agents: Dishonest Conduct***, sets out the Revenue's revised proposals and draft rules.

Key points include:

- Issuing of 'dishonest conduct' notices, with a right of appeal, where there is evidence a tax agent has dishonestly advised or assisted clients.
- Access to the working papers of dishonest tax agents, subject to approval by the First-tier Tribunal once conduct has been determined.
- Where working papers are no longer in the power or possession of the tax agent, HMRC will be able to request them from a third party.
- A civil penalty on the dishonest tax agent, and power allowing the Revenue to publish details on its website when an agent does not make a full disclosure.

The new document also notes that only illegitimate tax loss will be caught, after concerns were expressed that legitimate tax planning, such as advising a client to invest in an ISA, could be caught within the remit to stamp out dishonest advisers.

The consultation period will end on 16 September 2011.

Tax fraudsters offered disclosure facility

The Revenue is proposing to tighten the undertaking of its civil investigations of fraud by offering suspected tax cheats the opportunity to enter into a contract to divulge the details of wrongdoing.

Under the **contractual disclosure facility** (CDF) covered in a discussion document published on 20 July 2011, individuals believed to have committed serious tax fraud would be invited to come forward within 60 days in exchange for an agreement by HMRC not to undertake a criminal investigation, removing the risk of prosecution by the taxman.

An inquiry would then be carried out using only civil powers, with a view to a settlement for tax, interest and a financial penalty. Anyone who signed the contract, but did not go on to admit fraud would face the possibility of a criminal investigation.

The CDF is intended to better focus the paths of civil investigations and their criminal equivalent, activity in which the Revenue is currently increasing with the reinvestment received following the government's spending review of last October – but the department operates civil procedures to address cases in which criminal scrutiny is not considered the most cost-effective approach, or for situations in which a prosecution is unlikely to be in the public interest.

The Exchequer secretary to the Treasury, David Gauke, said the latest proposal in the fight to retrieve unpaid taxes 'will help HMRC to ensure that the [civil investigations of fraud] procedure is used in cases where taxpayers genuinely want to come clean.'

Disclosure facility criticized by legal experts

The Revenue's latest stratagem in its increasingly dogged fight against tax dodging has been criticised by legal experts for threatening to create uncertainty.

A discussion document published on Wednesday (20 July) proposes the **introduction of a contractual disclosure facility** (CDF), which would allow taxpayers suspected of defrauding HMRC to come forward with details of their offence without fear of criminal prosecution. They would face only civil procedings.

Those who are invited by the taxman to enter into such an agreement would 60 days in which to do so. But law firm McGrigors, which specialises in tax investigations, says the timeframe isn't long enough and could lead to 'unattractive' legal risks for the taxpayers who submit to the CDF

Director Phil Berwick said that, for the scheme to work properly and draw in the maximum tax revenue, the disclosure facility has to be appealing to the tax evader by offering legal certainty.

He remarked, 'Sixty days is too short a timeframe in which to ask somebody to make such an important disclosure, even in outline form. They have to be given time to get the disclosure right because they face criminal prosecution and possible jail if they get it wrong.

'If taxpayers are going to use this scheme, they need to seek professional advice. Advisers are going to want to do proper due diligence. Setting such a stringent deadline is a recipe for mistakes.'

The CDF was better received by accountancy group PKF, whose tax investigations partner John Cassidy said it was wholly reasonable that HMRC should seek to broaden the remit of their civil investigation of fraud (CIF) procedures, also known as COP9, which are currently undertaken only when a suspected fraudster owes more than £75,000 in back taxes.

'This is only fair and may encourage more petty tax fraudsters to come clean. It also opens the way for HMRC to use the CIF route to follow up on individuals who do not take up the **current VAT registration amnesty**,' he said, going on to point out that the mooted upgrade of the COP9 regime seeks to ensuring that taxpayers who do not cooperate can be prosecuted. The *Gill and Gill* case of 2003 set a legal precedent that the Revenue cannot switch from an active civil prosecution to the criminal equivalent for the same offences.

Mr Cassidy said, '*Gill and Gill* really undermined the effectiveness of civil investigations for HMRC. Currently, once a CIF letter is issued, there is no legal threat hanging over the individual.

'There is no doubt that the threat of going to jail does encourage people to cooperate. Without that leverage on the taxpayer, HMRC seem to have been reluctant to start enquiries in recent years and are missing out on a lot of unpaid tax as a result.'

Corporation tax online—reasonable excuse claims guidance

HMRC has published revised guidance and a new form on reasonable excuse claims for online company tax returns submitted late after 1 April 2011.

What counts as a reasonable excuse for filing an online return late?

This guide provides an overview of what HM Revenue & Customs (HMRC) may generally consider to be a reasonable excuse and what you should do if you want to appeal against a late filing penalty. It also contains specific guidance for Self-Assessment, VAT and Corporation Tax, with links to forms you can use to make your reasonable excuse claim.

Reasonable excuse—examples of what HMRC might consider

Generally, a "reasonable excuse" is when some unforeseeable and exceptional event beyond your control has prevented you from filing your return on time. For example—

- a failure in HMRC's own computer system
- your computer breaks down just before/ during the preparation of your online return
- a serious illness has made you incapable of filing your tax return

HMRC will not accept an excuse where you haven't made a reasonable effort to meet the deadline. For example, you—

- found the online system too complicated to follow
- left everything to your accountant to do and they let you down
- forgot about the deadline
- did not try to re-submit return on time once problem with the system was put right

HMRC system failure—what to do if you can't file online

1. *Check you have completed everything correctly*

2 *Check for system errors* - If HMRC's system still won't accept your return:

- print or make a note of any error message details
- check the service issues and availability page on the HMRC website to find out if the online service is temporarily unavailable or if there are any known problems and what you should do
- contact HMRC's Online Services Helpdesk for further advice

3 *Problems with your own equipment or software* – you must:

- check with your software provider as part of your normal support arrangements
- save, print or make a note of the error message details - this will allow your provider to help you but will also be needed if you need to make a reasonable excuse claim

Remember, if you can't submit your return online by the deadline, and you decide to submit a paper return, HMRC may reject the return. If the return is then resubmitted after the filing deadline HMRC may charge a penalty. You may still be able to make a reasonable excuse claim.

Making a claim for reasonable excuse

If you think you have a reasonable excuse for filing late - or for Corporation Tax in the wrong format - then you should contact HMRC immediately.

You will need to provide your name, your authorised agent name, address and contact details, your reference number, full details of why you either filed your online return late or had to send in a late paper return and the date you tried to file your return online with details of the IT system error message.

You must make your reasonable excuse claim in writing and send it to your HMRC Office. HMRC provides forms to help you make a Self-Assessment, VAT or Corporation Tax reasonable excuse claim. Using these forms correctly will allow HMRC to consider your claim more easily.

iXBRL filing

From 1 April 2011 all Company Tax Returns for accounting periods ending after 31 March 2010 must be submitted online and all Corporation Tax and related payments made electronically. In addition, all computations must be submitted in Inline eXtensible Business Reporting Language (iXBRL) format. Generally, you must send the accounts forming part of your Company Tax Return in iXBRL format, although there are exceptions where PDFs will be acceptable.

If the delivery date of a particular iXBRL-enabled software product prevents filing a Company Tax Return on time, HMRC will consider the circumstances sympathetically.

Companies House postpones mandatory online filing

An aim of Companies House is to become a fully digital registry as soon as possible and last November they announced their intention to mandate electronic delivery of most of their filing services by March 2013.

However, given their success in driving the take-up of our electronic services since November and the government's absolute determination not to add new regulations that affect small business, they have now decided that they will not proceed with legislation to mandate electronic services by March 2013. Instead of focussing in the short term on the process to mandate, they will devote their resources to improving digital services for customers, including assisted digital services for businesses who need help using digital services, and make them the service of choice.

The biggest challenge is to drive the take-up for the electronic filing of company accounts. They are committed to using the iXBRL format for collecting accounts data, which is the same approach adopted by HMRC. They will work with the software industry to build on the work already done to meet the requirements of HMRC for submitting accounts electronically and in doing so make any change as simple as possible for companies and their agents. This will build on the success of the joint accounts filing service launched last year.

They remain focused on their goal of being a fully electronic registry. Mandating electronic services is an issue which they will reconsider once the moratorium on new regulation for small businesses has ended in 2014.

Business records checks by HMRC—consultation response and brief

Business Record Checks (BRCs) are designed to enable HMRC to inspect the adequacy of a business' records keeping by means of a quick **pre-return** check, in order to reduce the burdens on business that would be associated with a subsequent in-depth enquiry post return.

The check will consist of an examination of the business records, related to the size and nature of a business to check whether or not records comply with the requirements of Section 12B (3). The check will focus on the record keeping as such, rather than on tax liability issues, which may not crystallise until the return is made to HMRC.

HMRC plan to charge a statutory penalty where their checks discover serious record keeping failures. Charging a penalty is intended to change the behaviour of those who, despite all of the support available, have kept records which fall short of what the law requires.

Consultation

A consultation document was issued in December 2010.

The scope of the consultation was concerned chiefly with the issue of how best HMRC might implement a programme of Business Records Checks with penalties for significant record keeping failures. In particular—

- What more might be needed to ensure a clear understanding of the statutory record keeping obligations.
- What level of penalties (within the existing statutory maxima) would be appropriate to bring about behavioural change by those whose record keeping falls significantly short of the statutory requirements?
- Whether a period of time (and if so the length of that period) should be allowed for businesses to bring their record keeping up to scratch before Business Records Checks with penalties are introduced.

Business Records Checks will review both the adequacy and accuracy of business record keeping within the Small and Medium Enterprise (SME) Sector. No new legislation is proposed, the programme will use existing law in relation to record keeping requirements and penalties for failure to comply with those requirements. Penalties will only be imposed for significant record keeping failures

Main areas of concern

HMRC has now published its response to the consultation document where there were two main areas of concern:

1. What would constitute a "significant" record keeping failure?
2. The readiness of HMRC staff to undertake a new programme of Business Records Checks. (Although this was not within the scope of the questions asked in the Consultation Document it is an important point and HMRC will monitor this closely during the test-and- learn period.)

Test and learn basis

A key feature of how HMRC now intend to proceed is to carry out Business Records Checks on a test-and-learn basis. During this period they are not seeking to apply the record keeping penalty provision. As the legislation exists, HMRC cannot give an undertaking that it will never be applied but circumstances would need to be highly exceptional. There will be no authority to apply the penalty at local team level in the test-and-learn.

The test-and-learn will give HMRC a period in which to consider issues on this subject through practical experience. They will continue to consult on the extent of record keeping failure that would lead to a penalty.

A series of "Test and Learn" Business Record Checks commenced on 4th April. The intention is to test that the process works as anticipated in a small sample, and to learn lessons which can be implemented quickly to improve the approach.

The end of the test-and-learn period and the commencement of Business Records Check proper will be clearly announced so that there should be no confusion at that point.

Applying penalties

There was some recognition that for the system to operate properly there would be a need for penalties. If penalties are applied up to the maximum it was felt that these should be scaled in some way so that they would take into account the size of the business and the severity of the failure. There were also some suggestions that a scale should be applied to the number of failures, e.g. £500 for a first offence, then a greater sum for subsequent failures.

HMRC's experience indicates that whilst the majority of customers will respond to the advice and support provided by HMRC a minority will not. It is their view that a penalty is needed to influence the change required and negate any benefit of non-compliance.

There were concerns that penalties were inappropriate, that the approach was flawed and that HMRC should apply penalties only where there had been a loss to the exchequer and that such losses are addressed through existing compliance checks, rather than Business Record Checks.

Business Record Checks will directly target a key problem found frequently in small and medium businesses in the existing compliance checks which by their nature can be costly and

necessarily intrusive. Checking business records earlier in the process, before a return is made will give HMRC greater assurance that legal obligations with regard to records are met in a cost effective way.

Suspension of penalty

There is no statutory power for HMRC to suspend collection of a penalty for a record keeping failure.

Some respondents suggested that HMRC could achieve similar effect to suspension by not imposing a record keeping penalty for a "first offence", but, instead, issuing a "warning" and imposing a penalty only where a follow-up Business Records Check shows that, despite the warning, there are continuing and significant record keeping failures.

HMRC's view is that this would undermine a key objective of Business Records Check which is to achieve an improvement in record keeping across the population of businesses whose records currently fall below standard, and not just those businesses who have been subject to a Business Records Check. The intention is that the prospect of penalties for significant record keeping failures should deter those who might otherwise be inclined not to bring their record keeping up to scratch. A policy of not charging a penalty for an initial finding of significant record keeping failure would risk creating the perception that there is no need to change behaviour in relation to poor record keeping unless and until one has been caught out at least once.

Penalties for record keeping v inaccurate returns

Some respondents expressed that the two scenarios of record keeping and inaccurate returns should be viewed independently and penalties applied separately by HMRC for varying reasons, but there is probably an equal level of opinion for looking at these items together.

HMRC believes that there is an important distinction between penalties applied for a loss to the exchequer once a return is submitted and for inadequate records. Business Records Checks will occur in real time when a return has not yet been made and those whose business records fall significantly short of adequate will be penalised. The aim is to achieve increased accuracy through an improved standard of records.

Time to adjust—what will constitute a reasonable period?

Opinions ranged from about 3 to 18 months. The majority of opinion rests with a period of about a year to enable businesses to make the necessary improvements to their record keeping. This is seen as giving sufficient opportunity for continuing promotion of the HMRC support systems and seeking and acting on professional advice. A raised awareness level would then be present before penalties are first charged.

COP9 (2011) Civil Investigation of Fraud

The updated Code of Practice 9 explains the practice of HMRC in cases of suspected serious tax fraud and applies to investigations started after 1 August 2011.

HMRC will investigate any situation where they suspect serious tax fraud. The investigation will be undertaken with or without the taxpayer's voluntary co-operation. In theory, if the taxpayer does co-operate, the investigation will proceed more quickly, efficiently and advantageously for both parties than if they refuse to co-operate.

The Code of Practice is designed to help taxpayer's make an informed decision on co-operation by explaining how HMRC carry out such investigations and how, through full co-operation and disclosure of irregularities, the taxpayer may achieve a significant reduction in any penalty found to be due and avoid other unwelcome consequences, for example insolvency and the publication of your name.

The Code of Practice covers all taxes and duties administered by HMRC.

HMRC will keep an open mind to the possibility that there may be an innocent explanation for the suspected irregularities and they undertake to treat you fairly and courteously and in accordance with the law.

Civil investigation of fraud statement

The Commissioners reserve complete discretion to pursue a criminal investigation with a view to prosecution where they consider it necessary and appropriate.

Where a criminal investigation is not considered necessary or appropriate, the Commissioners may decide to investigate using the Civil Investigation of Fraud procedure.

Where materially false statements are made or materially false documents are provided with intent to deceive in the course of a civil investigation, the Commissioners may conduct a criminal investigation with a view to a prosecution of that conduct.

The procedure

If the Commissioners decide to investigate using the Civil Investigation of Fraud procedure the taxpayer will be given a copy of this statement by an authorised officer.

The statement provides the taxpayer with details of how the investigation will proceed.

The aim of the investigation is to uncover the full facts, determine the tax liabilities arising and collect these together with interest and, where appropriate, civil penalties for fraudulent conduct.

HMRC will invite the taxpayer to make a full disclosure of all tax irregularities. This will be their only opportunity to secure the maximum benefit from making a full and complete disclosure of all irregularities in your tax affairs. HMRC may request that they attend a meeting with them to discuss and agree the format of their disclosure and to obtain information about the nature of the irregularities.

It is a matter for taxpayer to decide whether or not to attend and respond.

Generally HMRC also ask the taxpayer to prepare a report detailing the nature, extent and reason for those tax irregularities, together with supporting evidence. They will agree a timetable for submission of the report at the meeting.

When the taxpayer submits their report HMRC test that disclosure, before seeking an agreement with them as to the amount of additional tax, interest and penalties and make arrangements with them for payment. The taxpayer will be expected to make payments on account during the investigation.

If the taxpayer chooses not to attend or respond, HMRC will conduct a thorough investigation of their tax affairs and will take into account their conduct during the course of the investigation in determining the level of any penalties due. Where they have a tax debt but refuse to make a payment, HMRC may commence immediate preventive action to protect its position. Actions include insolvency and bankruptcy petitions, applications for court freezing injunctions over bank accounts and assets, and the imposition of Securities in appropriate cases.

Penalties for inaccuracies

The new rules apply in the same way as to all taxes and duties affected by them. The size of the penalty will depend on whether the error was deliberate, concealed and what disclosure is made.

Publishing the names of deliberate tax defaulters

HMRC may publish the name, address and other information about those who deliberately evade their tax obligations. This will not happen if the taxpayer immediately tells HMRC everything about what they did to deliberately evade tax and then co-operate fully.

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The Agent View (Lecture B666 – 10.09 minutes)

The third strand of the HMRC Agent strategy proposals is the Agent view. This is potentially the most controversial aspect of the consultation. It sits alongside the Enrolment and self serve as part of the overall strategy, and is the area that most tax agents are unhappy with.

What is it for?

HMRC is being very open with us. The tax authority will in future monitor the total engagement of each agent to understand how they perform in comparison with the wider professional community, and they have stated this in the consultation document. This will enable HMRC to take the following action if that engagement falls outside expected norms (more on this below):

- Initially to contact the agent firm to indicate the engagement which has been highlighted. HMRC has said (and in particular in the agent meeting I attended) that one of the reasons for a contact may be that a particular agent acts, for example, only for clients who are already in trouble with HMRC, taking on the more difficult enquiry cases as a specialist. In this case, certain factors may show up on this agent's record which show that many of his clients have been in default – far more than for a "normal firm". Having made contact and established the reasons why this practice is different, HMRC said that this would then be reflected on the agent's record and no further issues of this nature would be raised. So I see that particular type of contact as refining the understanding that HMRC has about an agent.

- The contact might also be made where a particular pattern of errors – say in capital allowances – has been built up over time. Not just the odd error but a consistent picture. In this case, the agent might be offered additional support – the use of toolkits (if appropriate) might be suggested, or some additional technical support. This helps the agent overcome the problem, and is in HMRC's interests as they would like to be able to rely on everything that comes from agents. Dealing with minor problems of this nature enables the tax authority to have more confidence in the agent base, and to start to identify the really poor agents.

- Where serious problems have arisen, and these cannot be resolved by the type of contact outlined above, the agent might be reported to their professional body. In the case of agent firms, I suggest that this means the body which regulates the agent firm. The bodies will then take whatever action they consider appropriate.

- Finally, and in the most serious cases, HMRC might consider "disengaging" with an agent, either by restricting access to self serve facilities or ultimately considering that the risk to HMRC and the customer is so great that HMRC can no longer work recognise the agent. This would be a rare step (and here we are not referring to agents who are dishonest as that comes under a separate arrangement yet to be outlined). It is this area which will provoke the most concern, and the worry that agents will not be able to properly represent their clients' interests if the threat of "dis-enrolment" hangs over them.

What does the agent view look like?

HMRC has asked for comments and suggestions about the agent view, but the consultation outlines the following the purpose and content of the agent view as follows:

> "The strategy proposes that HMRC will create an 'agent view' for each enrolled agent that will bring together details of them and their client portfolio into a consistent and coherent picture to support communication and engagement. As part of developing that 'agent view' HMRC proposes to include the compliance performance of an agent's clients. This would provide the foundation for HMRC to target technical updates, support services and compliance campaigns to those agents with the most relevant client portfolios."
>
> "The vast majority of agents are well qualified, technically able and competent in the role they undertake for their clients. However, the minority of agents may knowingly or unknowingly fall below the high professional standards expected by the tax agent community. The 'agent view' will support HMRC in identifying those agents whose total

> engagement is significantly outside of the average performance for agents with a similar client portfolio."
>
> "The information used to create the 'agent view' could include filing and payment profiles of client portfolios, as well as the level and type of cases selected by HMRC through its risk assessment processes. While this might be the trigger for an appropriate discussion, HMRC does not want to create a situation where the compliance of clients is the determining factor in the 'agent view' as that may result in less compliant clients being refused access to agent services and their compliance falling further.
>
> "In the longer term, HMRC envisage that the information could be collated in 'real time' to add to the data collected from returns and claims and assist in identifying patterns outside of sector trends and norms."
>
> "The overall effectiveness of the agent view could be assessed by monitoring like for like compliance performance of represented taxpayers."

So HMRC is not wedded to any particular type of information which forms part of the agent view – and although the suggestion is that client compliance data will affect the agent view, it is clear that HMRC recognises the risks associated with such a step, and will not make this the determining factor.

So I'll finish this section on what the agent view comprises with HMRC's questions on the subject :

- What client and agent performance indicators would you suggest are used to inform HMRC's 'agent view' and what should an acceptable level of performance be in each case?
- What would be appropriate safeguards, and how should an agent be able to challenge HMRC's views?

Page 28 of the consultation document indicates that HMRC might share "sector norm" data with agents before the agent view is active, so that agents can assess their own clients against "expected behaviour".

Where are the key issues?

While one can understand the need for the agent view, and indeed appreciate that it is a necessary part of HMRC's job in scrutinising agents' work, many agents are very wary about the disengagement aspect.

Taking the use of the agent view data one step at a time:

Having a record of good and bad agents

In years gone by, the DI was alleged to have a little black book. It's not clear whether this was an actual written record, or whether like a good police sergeant he had a clear understanding of who was up to what "on his patch". It is possible that his view could be coloured by having crossed swords with an agent vigorously and successfully defending his client. So the past is not so rosy and perfect after all and we could probably recall different standards being used in different local office areas– the "old way" could allow prejudice and worse to colour the name of an agent firm. The "new way" might be viewed as an evidence based national "little black book" – with data collected by a computer and not an officer who has just been bested in an argument.

All of the criteria used to judge an agent's performance will be set out and available to all agent firms and agents are to be judged against a nationally consistent view. If you accept the little black book, this has to be an improvement on it. Agents may (an probably do) feel that uncomfortable with the idea of HMRC judging their performance, but we might agree that in doing their job, if HMRC are going to rely on our work more then they **must** have some checks in place. And we have constantly called for HMRC to identify those who have poor standards and do something about them!

How this will be done

The consultation document clearly envisages this being a transparent process, with agents able to see what is on record about them and able to challenge it, as illustrated in the following quote:

> "HMRC will need to apply significant care to ensure that relevant and up to date information is collated and is keen to hear views on the safeguards needed, for example, for agents to challenge the correctness of the information gathered, the validity of the conclusions drawn and the resolution proposed."

The non-affiliated agent issue

The second level of concern about an agent's performance might lead to reporting the agent to their supervising body (if they have one). Here, of course, HMRC has a problem with non affiliated agents, as there is nobody to make a report to. Obviously it is then up to the professional bodies to take appropriate action about such reports, but these reports have been possible for years. Here are some issues to consider. Do we need some criteria which would trigger a report – should the professional bodies put forward criteria? And equally, what should be the role of the bodies in notifying HMRC of poor work by an agent which is determined by the relevant standards committees.

The ultimate sanction – refusing to deal with an agent

Finally, "disenrollment" as I have called it. This would be where HMRC refuses to deal with an agent – writing to all of their clients and notifying them. This is potentially the end of the agent's business, so I would expect this to be very carefully handled. Many tax agents consider that there should be an independent body instituted to deal with such cases. The body should be able to hear the case put by both sides and decide what is appropriate. It might also have the power to suggest an alternative course of action – maybe putting an agent into "special measures", to rectify a particular issue.

For reasons of efficiency, it is likely that the Tribunal is not the place for this as any hearing would need to be held very swiftly, and I understand that there are very serious delays in getting cases before even the first tier Tribunal.

You can make your response to the consultation either directly to HMRC, or through the professional bodies. Most of the bodies involved prior to the release of the consultation document are holding special events to gather the views of members.

Contributed by Rebecca Benneyworth

Business Taxes

Completeness of income

The taxpayer appealed against assessments to income tax and National Insurance for the years 1989/90 to 2003/04, with the exception of 1992/93, when he was abroad.

He appealed also against penalty determinations for the years, during which had been involved in house and garage music, performing as a rapping MC. His income was inconsistent and variable.

In April 2005, HMRC requested that he complete self-assessment returns for the six years to April 2001.

The taxpayer replied he could not submit accurate returns because 'the distinction between tax years [had] become blurred' in his attempts to find a suitable accountant, but he could provide an 'overview' of his finances.

After the returns were submitted, the Revenue opened an enquiry and requested the taxpayer's books and records.

He was unable to provide records; they had been stolen. The department accepted he had provided what he could, but it was concerned about the lack of proper business records.

After two years of negotiations, a settlement could not be reached, so HMRC issued a closure notice and issued assessments for the years in question. The taxman also imposed penalties equal to 45% of the tax charged.

The First-tier Tribunal decided to allow the appeals relating to the years 1989/90 to 1991/92 and 1993/94 to 1995/96, on the basis the taxpayer had shown that the work during those periods was lower than assessed.

However, with regard to the years from 1997, HMRC argued it was clear the taxpayer's income had been understated in his returns and he had not provided enough evidence to show the amounts declared were correct.

The tribunal agreed with the department.

Turning to the penalties issue, the tribunal said a reasonable taxpayer would have paid more attention to his tax affairs and kept better records. His conduct was negligent, even though he had not wilfully attempted to mislead or deceive the Revenue. The tribunal decided the penalty was appropriate.

The taxpayer's appeals for the years 1989/90 to 1995/96 were allowed; those for the years 1996/97 to 2003/04 were dismissed.

Christopher Reid (TC1134)

Resurfacing partnership farm drive – capital or revenue?

The appellant, a farm partnership, appealed against an amendment to the partnership tax return made by HMRC in May 2010 under TMA 1970, s 28B.

The amendment increased the partnership profit on the basis that it related to expenditure, which was capital in nature and therefore not allowable as a deduction in the accounts.

The cause of the dispute was the re-surfacing of the farm drive at a cost of £23,300.

HMRC submitted that the drive should have been regarded as an 'entirety' in its own right, and concreting it was to provide an entirely new and better surface than before; it should therefore be considered a renewal.

The appellant argued that the new surface of the drive had been laid over the old tarmac surface, filling potholes and creating a hard-core base over the original stone. It maintained nothing new had been added to the drive.

The First-tier Tribunal agreed with the appellant that the work on the farm drive consisted of a concrete surface being placed over the existing one and, as such was a repair to an existing asset.

The taxpayer's appeal was allowed.

G Pratt and Sons (TC1269)

Construction subcontractor – recognising income

The taxpayer traded as a sole trader, carrying on a business as a construction subcontractor, until 2002, when he transferred his business to a limited company. His accounting period was the same as the tax year. The contracts were generally fixed price contracts for carrying out works over a period of between a month and a year, typically for two to three months. At the end of the contract, or sometimes at intervals during the contract, the taxpayer would make an application for payment to the main contractor. The contractor would issue a valuation certificate based on an assessment of the quality of the work. Payment would follow some 30 days after the application for payment, and 14 days after the issue of the valuation certificate. No debt was due and owing to the taxpayer until the valuation certificate had been issued. However, the tribunal later found that the sums requested in applications for payment were generally paid in full or in amounts which varied by only a few% from the amounts claimed. From 1997 onwards, the taxpayer employed accountants to prepare his annual accounts and tax returns. The accountants took the view that income could not be recognised when the application for payment was made, but only when the valuation certificate was issued. The Revenue opened an enquiry into the taxpayer's tax returns. The Revenue concluded that the accounts did not properly state the profits for the relevant year, and amended the returns for the relevant years. The taxpayer appealed. Until 2000, the common law principle had been that the profits and losses of a business for tax purposes were those determined by applying the correct principles of the prevailing system of commercial accountancy. After that date, s 42(1) of the Finance Act 1998 provided that the profits were to be computed on an accounting basis which gave a true and fair view subject to any adjustment required or authorised by law in computing profits for those purposes. At the material time, there had been no statutory definition of "a true and fair view". The First-tier Tribunal (the tribunal), both members of which were chartered accountants, concluded that the accounts had been prepared through the negligent conduct of the accountants, and did not comply with generally accepted accounting practice. In doing so, the tribunal made reference to various standards of income recognition which came into force after the relevant accounting periods (FRS 5 AN G and UITF 40). The taxpayer appealed.

The taxpayer submitted that: (i) no reasonable tribunal could have concluded from the evidence that the only correct point at which to recognise income was when the application for payment was made rather than when the valuation certificate was issued, rather than concluding that both methods were acceptable methods of commercial accounting; (ii) the tribunal had exceeded its jurisdiction in making a finding of professional negligence on the part of the accountants; and (iii) that the tribunal had erred in finding that the Revenue had "discovered" a tax loss in relation to the relevant years, since it had made no finding of fact which could support that conclusion.

(1) The tribunal was a specialised tribunal not merely by virtue of its function, but also by virtue of the expertise of its members. It followed that particular deference was to be given to its decision, which had been given after a four day hearing.

Edwards (Inspector of Taxes) v Bairstow [1955] 3 All ER 48 applied; *Georgiou (t/a Marios Chippery) v Customs and Excise Comrs* [1996] STC 463 applied; *Procter & Gamble UK v Revenue and Customs Comrs* [2009] All ER (D) 177 (May) applied; *MA (Somalia) v Secretary of State for the Home Department* [2010] All ER (D) 258 (Nov) applied.

(2) In the circumstances, based on expert evidence, the tribunal had been entitled to conclude that the method of accounting used by the taxpayer was not a reasonable one. The reference to the accounting standards could be justified as they had been referred to by the taxpayer's legal team, and the tribunal had not erred in judging the accounts in question by reference to contemporary standards.

(3) The tribunal had not, in fact, found the accountants guilty of professional negligence, but of "negligent conduct", applying the standard of professional negligence to determine whether there had been a breach of duty. It did not follow necessarily that a court would uphold a claim for professional negligence by the taxpayer against them. Accordingly, the tribunal had not exceeded its jurisdiction.

(4) In the circumstances, the tribunal had not itself made the discoveries, but rather relied upon evidence adduced by the Revenue.

Decision of charles hellier and john cherry [2010] UKFTT 92 (TC) affirmed.

Smith v Revenue and Customs Comrs [2011] All ER (D) 118 (Jul)

Taking on a corporate partner? (Lecture B669 – 17.32 minutes)

With decreasing corporation tax rates and increasing personal tax and National Insurance rates rising, there are potentially significant tax savings to be made from incorporation.

Goodwill

Where goodwill exists, the company could 'buy' goodwill at deemed market value which hopefully should be covered by entrepreneurs' relief.

The price paid could be left on the directors' loan account being drawn down over the years from the company's future profit share, reducing the amount taken out as dividends.

But does this always work?

- Is there any valuable goodwill in the business and even if it does exist, is it 'personal' goodwill?
- If goodwill does exist, will entrepreneurs' relief be available where only one partner incorporates?

Even if it does work, do you really want the goodwill in the company where a potential double charge might arise on the gain when the partnership is subsequently sold and money extracted from the company?

And what if the individual wants his money sooner or they want to transfer their share in the corporate partner to someone else?

If goodwill is transferred, ensure that you have a serious commercial rationale for the new partner beyond the tax savings and so ensure that ITA 2007,s773 does not apply and treat the transaction as income rather than capital proceeds.

Employment-related securities

The partner will be a director of the company which becomes a corporate partner, and so he will be deemed to have acquired the shares by reason of his employment.

If he paid a nominal amount for the shares, knowing that the company will shortly sign up to the partnership deed and take a profit share and the company does not acquire the goodwill, is it right to say that the value of the shares is negligible? If not, then income tax will be payable on any element of underpayment.

If the profit share going into the company is a regular amount or percentage, it may be difficult to defend an argument from HMRC that the shares in the corporate member are valuable. It would be better for the company to receive irregular or unpredictable amounts so making it difficult to attribute a high value on incorporation.

Other considerations

1. If the partnership is structured as an LLP, HMRC will invariably treat all partners (even those on a fixed share) as self-employed.
2. The new company should be treated as a trading company for capital gains tax and business property relief purposes.

3. If a number of corporate partners are brought into a partnership, they are counted as associated companies for small company rate purposes.
4. If the individual stands down as a partner at the same time as the corporate partner is brought in, he will crystallise tax on a cessation basis. If he maintains his partnership and has the flexibility to share profits with the corporate partner as he wants, there may be scope to exploit when tax is paid in terms of individual versus corporate payment dates and calculations of income tax payments on account.
5. If the partner is in the happy position of earning more than he spends, an additional benefit of having a corporate partner is the ability to pay corporation tax on profit share now, and pay income tax on drawings potentially at lower rates in later years by managing dividend flows or liquidating the company and claiming entrepreneurs' relief.

Summarised from an article by Jan Ellis, Taxation 27 July 2011

Close company loan written offs (Lecture B668 – 12.02 minutes)

It is well known that, where a shareholder director of a family business has had a loan from his company which is subsequently written off, a tax charge arises under S416 ITTOIA 2005 on the amount released, grossed up at the dividend ordinary rate of 10%. If relevant, further tax is due from the individual at the difference between 32.5% (or 42.5%) and 10%. In other words, the loan waiver is treated in much the same way as dividend income.

It should be emphasised that the charge under S416 ITTOIA 2005 takes precedence over the benefit in kind rules for a loan waiver in S188 ITEPA 2003 (S189 ITEPA 2003). This means that the maximum effective rate of income tax is 36.11%.

However, the problem with these arrangements is often NICs. HMRC take the view that writing off the loan is the equivalent of paying 'earnings' to the director concerned. There are arguments against this point of view, but HMRC appear to be adamant that it applies and so, if this contention is to be resisted, a long and costly battle is likely to ensue.

A recent decision by the First-Tier Tribunal may go some way to assisting taxpayers in this regard. In *Stewart Fraser Ltd v HMRC (2011)*, the taxpayer (F) was the controlling shareholder and a director of a close company. Following the waiver of loans by the company to him, F had paid income tax under S416 ITTOIA 2005. HMRC argued that Class 1 NICs were also in point, given that the waivers constituted earnings in respect of F's employment as a director. The taxpayer, however, declared that the waivers had been granted to him as a shareholder in order to compensate him for the lack of dividends (which was due to an ongoing dispute with a minority shareholder).

HMRC gave particular weight to the fact that shareholder meetings had been silent on the matter of the waivers, which had in fact been decided at an ordinary directors' board meeting. The Tribunal noted that F had not produced any evidence to support his contention that the waivers had been made as a payment to him qua shareholder. Thus their conclusion was that the waivers must be an emolument of his employment.

Although the company lost the case, the decision is helpful to taxpayers such as F since it points to an argument against the imposition of an NIC charge. When presenting their case, HMRC's view was summarised by the Tribunal as follows:

> 'Had (the loans) been waived for him in his capacity as a shareholder, then HMRC would have expected to see this discussed and approved at a shareholders' meeting involving all the shareholders.'

What this indicates is that, if a company wants to avoid an NIC charge on loans written off, it is essential to approve the write-off at a general meeting of the shareholders (or, alternatively, to pass a written resolution circulated by the shareholders – not the directors – under Ss292 and 293 Companies Act 2006).

Contributed By Robert Jamieson

Companies acquiring businesses carried on prior to 1 April 2002 by a related party

This brief affirms, following the Upper Tribunal's decison in Greenbank Holidays Ltd, HMRC's view that no relief is due in circumstances where it is claimed that goodwill is created out of synergies realised as a consequence of the acquisition.

This Brief affirms HM Revenue & Customs (HMRC) view that no corporation tax relief is due in circumstances where it is claimed that goodwill is created out of synergies realised as a consequence of the acquisition.

Background

HMRC has previously stated that they would challenge past claims with a view to litigation where there are arrangements to claim Corporation Tax relief for goodwill under the corporate intangible fixed asset regime where a company has acquired a business that was carried on by a related party before commencement of the regime (1 April 2002).

A case on goodwill, *Greenbank Holidays ltd v Revenue and Customs Comrs* [2011] UKUT 155 (TCC), [2011] All ER (D) 245 (Apr), was recently heard by the Upper Tribunal (UT) and was found in favour of HMRC.

HMRC's position

Comments at paragraphs 24 to 28 of the UT judgement indicate the approach that a Tribunal may take in relation to goodwill arguments where synergy benefits might arise from the acquisition or merger.

Both the First-Tier and Upper Tribunals confirmed—

- “goodwill” includes internally-generated goodwill
- “goodwill” is neither created by the purchaser on acquisition nor created when recognised in the purchasers accounts
- the goodwill recognised by the purchaser is the same asset as that disposed by the vendor
- paragraph 121 Schedule 29 FA02 (now Section 884 CTA 2009) determines the time of creation in relation to the commencement of Sch 29/Part 8
- the Section 70 FA09 amendment is a confirmatory amendment

The rules of the regime exclude goodwill in these circumstances, so no relief is available.

HMRC are aware of arrangements where customers are continuing to claim relief in circumstances similar to those in Greenbank, notwithstanding the decision in that case. An argument is advanced that the goodwill is created through “synergies” achieved on merging the business acquired with the existing business. HMRC believe the Greenbank decision applies in all cases, including those in which a synergy claim is made, and will continue to challenge past or future claims with a view to litigation.

HMRC Brief 25/2011 8 July 2011

Value Added Tax

HMRC Position following the Tribunal Decision in Paymex Ltd

This brief explains the HM Revenue & Customs (HMRC) position following the First Tier Tribunal decision in Paymex Ltd ([2011] UKFTT 350).

The Tribunal found against HMRC and upheld the appeal of Paymex Ltd that the liability of the services of Insolvency Practitioners when conducting and supervising consumer Individual Voluntary Arrangements are exempt from VAT. HMRC are not appealing this decision.

Background

Paymex Ltd is the representative member of a VAT group which includes Blair Endersby. Blair Endersby provides Insolvency Practitioners (IPs) to run and maintain Individual Voluntary Arrangements (IVAs). An IVA is made and conducted in the context of a statutory framework and can only be conducted by a licensed IP. It enables an insolvent individual to make a proposal for an IVA with their creditors. The IP carries out two services; nominee services which involve the preparation of the proposal to be agreed between the debtor and their creditors, and supervisory services involving the supervision and monitoring of the agreement, including taking regular payments from the debtor and paying the creditors in accordance with the agreement.

Tribunal decision

The Tribunal decided that the services of an IP, including both the nominee and supervisory stages, constitute a single exempt supply for VAT purposes. The Tribunal went on to decide that the two core elements were negotiation of debts and transactions concerning payments. Since it had found both core elements to be exempt, it was not necessary for the Tribunal to determine which of the supplies were dominant. However it stated that if it had been necessary for it to do so it would have found negotiation to be the 'core' supply.

HMRC position

HMRC will not be appealing this decision and subject to the normal rules on input tax adjustment, capping and unjust enrichment, HMRC will pay claims for overpaid tax charged on the services of Insolvency Practitioners that fall within the findings of this Tribunal decision.

R&C Brief 27/2011

VAT and sporting services (Lecture B670 – 12.59 minutes)

This article explains the recent First Tier Tribunal decision which suggests that many sports clubs can treat more of their income as VAT exempt. It goes through the background to the sporting services exemption, then examines some recent developments including the FTT's decision in The Bridport and West Dorset Golf Club Ltd. The notes below also describe two other recent cases on the subject of the exemption, The British Association for Shooting and Conservation Ltd and Mrs Phillida Barnett and Mrs Lara Read t/a Burghill Valley Golf Club, and also the HMRC statement on the consequences of the ECJ decision in Canterbury Hockey Club and Canterbury Ladies' Hockey Club.

Major golf win

The UK law restricts the sporting exemption to services supplied by not-for-profit organisations to their members, if they operate a membership scheme. Accordingly, daily green fees charged by a golf club to visitors have been regarded as taxable. In 2009 a club submitted a "Fleming claim" for £140,000, arguing that this provision (or its interpretation by HMRC) was contrary to the exemption in art.132(1)(m) VAT Directive, and the restriction was not permitted within art.133(b) or 134(b).

There were also subsidiary issues concerning the application of the cap and compound interest, but the Tribunal agreed with the parties to leave these until the outcome of other litigation clarified the principles.

Art.132(1)(m) exempts "the supply of certain services closely linked to sport or physical education by non-profit-making organisations to persons taking part in sport or physical education".

Art.133 permits member states to restrict a number of exemptions, including this one, by setting conditions including "(c) those bodies must charge prices which are approved by the public authorities or which do not exceed such approved prices or, in respect of those services not subject to approval, prices lower than those charged for similar services by commercial enterprises subject to VAT; (d) the exemptions must not be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT."

Art.134(b) provides that exemption shall be lost "where the basic purpose of the supply is to obtain additional income for the body in question through transactions which are in direct competition with those of commercial enterprises subject to VAT." Art.134 is mandatory, whereas art.133 gives member states scope to choose.

The provisions are transposed in Group 10 Sch.9 VATA 1994. The relevant provision is item 3: "The supply by an eligible body to an individual, except, where the body operates a membership scheme, an individual who is not a member, of services closely linked with and essential to sport or physical education in which the individual is taking part."

The chairman decided that the exemption had to be interpreted purposively, and that the restrictions on exemption were exhaustive – that is, a member state could not restrict the exemption in circumstances not envisaged by arts.133 and 134. The membership scheme restriction should not be applied to the normal activities of the club (i.e. supplying the right to play golf) because that was not "additional income".

Art.133(c) and (d) are not obviously transposed into the UK law. HMRC argued that the membership scheme rules are there to achieve the same objective – avoiding distortion of competition – but the chairman did not agree that this was an effective alternative. In doing so, he acknowledged that he was departing from his own earlier decision in Keswick Golf Club (VTD 15,493). He suggested that the parties should apply for the hearing to be continued (i.e. adjourned until a different day, but not treated as a separate case) to consider to the capping and interest issues.

First Tier Tribunal (TC01214): The Bridport and West Dorset Golf Club Ltd

Shooters win

The British Association for Shooting and Conservation (BASC) has grown out of the merger of a number of different associations, the oldest dating from 1908. It was incorporated under the Industrial and Provident Societies Act in 1997. It has a number of aims relating to the sport of shooting, including representing the interests of its members in promoting the right to hunt.

HMRC accepted that some of its subscription income is zero-rated as relating to the issue of a magazine, and some is exempt as relating to insurance. HMRC had ruled in 1994 that the balance was exempt, but in 1996 they issued a new decision that it should be taxable at the standard rate. BASC disagreed and continued to treat the income as exempt, and appealed against the resulting assessment of £397,551 for the year 2006.

In 2008, the Tribunal (VTD 20,739) had to consider whether the income could be exempt within:

Group 9 item 1(e) as income of a body which has objects which are in the public domain and are of a political, religious, patriotic, philosophical, philanthropic or civic nature; or

Group 10 item 3 as consideration for the supply by an eligible body to an individual, except, where the body operates a membership scheme, an individual who is not a member, of services closely linked with and essential to sport or physical education in which the individual is taking part.

The chairman decided that the political exemption could not apply, and the services of the association were not sufficiently closely related to sport to enjoy that relief. On appeal to the High Court, the judge observed that the subsequent decision of the ECJ in Canterbury Hockey

Club (Case C-253/07) suggested that a wider interpretation of the sporting exemption was appropriate, and remitted the case to the Tribunal to reconsider the facts in the light of this judgment.

On rehearing, the chairman set out the tests of exemption as follows:

"...the supply must be made by a non-profit-making organisation; the organisation must make a supply of services; those services must be supplied to persons taking part in sport; the services must be closely linked to sport; and the supply must be essential to the transactions exempted. There was never any dispute that the first two of those conditions are satisfied, nor has it ever been in dispute that the shooting of game is a sport. It is now agreed, following the judgment in Canterbury Hockey Club, that the third is met. The parties disagree about the closeness of the link between the supplies and the sport to which they relate, and whether, assuming a sufficiently close link, the supplies are essential."

The chairman considered further evidence and concluded that, without the Association's campaigning activities, sporting shooting would no longer exist in a recognisable form in the UK. The supplies were therefore "essential to the sport" and met the conditions for exemption. The appeal was allowed.

First Tier Tribunal (TC00562): The British Association for Shooting and Conservation Ltd

Jolly hockey

HMRC announced a change to the treatment of affiliation fees collected by national sports bodies in line with the ECJ judgment in Canterbury Hockey Club and Canterbury Ladies' Hockey Club (C-253/07). From 1 September 2010, it will be compulsory for bodies which meet the eligible body conditions in Notice 701/45 Sport to exempt fees where the true beneficiaries are persons taking part in sport, even if they have previously been treated as standard rated because of the way in which the fee was calculated. HMRC previously regarded fees which were calculated according to the size of the club, or the number of teams fielded, as "not charged to individuals" and therefore incapable of falling within the exemption.

HMRC will not require retrospective application of the exemption before that date. However, any body which wishes to claim the exemption at an earlier date can do so, subject to the rules on unjust enrichment and the cap (which, from 1 April 2010, stands at four years for the first time).

R&C Brief 15/2010

Who makes the supply?

A woman ran a proprietary golf club which had originally been set up by her late husband. In 2001 she and her daughter, now principals in the business, followed the advice of a VAT consultant and set up two not-for-profit companies to supply exempt sporting services – one to members of the golf club and one to visitors.

HMRC investigated and concluded that the arrangements did not work. They were intended to circumvent the rules on "commercial influence", even though the mother and daughter still extracted money from the two companies in the form of rent and management charges; the directors of the not-for-profit companies were supposed to be independent of the owners. The officer investigating issued alternative decisions: his preferred view was that the golfing supplies continued to be made by the partners throughout, and as an alternative he regarded the establishment of the structure as an abuse of rights.

The Tribunal considered the facts and also the recent case of The Atrium Club, which had certain overall features in common. The chairman concluded that the facts were very different. Here, the supplies continued to be made by the partners and not by the separate companies. There was no question of abuse of rights, because the scheme did not confer any rights.

It was significant that in Atrium Club, the sporting supplies had been made by one non-profit subsidiary in the 1990s, then another in the early 2000s, then a third from 2005 onwards. The argument was about whether the holding company or the middle company had made supplies. It strengthened the holding company's case that the business had been transferred to the middle company and from the middle company by other companies – it had not been carried on by the holding company either before or after. In the present case, the business was "transferred" from

the partnership to the two new companies in 2001: it was easier for HMRC to argue successfully that the partnership continued to carry the business on and the "transfer" was not real.

The decision is interesting for a detailed examination of the question "who makes the supply?" and how that question should be answered. It is considered under the following headings:

- Who is the person assumed to be making the supply from the viewpoint of the customer?
- Who is the Person who sets the price (or is entitled to set the price) for the supply?
- Whose assets are used to make the supply?
- Is the scale of the Operation such that it is unlikely to be operated in the Manner contended?
- To whom are payments made?
- Who would the customer claim against in the event of a default?
- How is the arrangement regarded for direct tax purposes?
- What degree of control does one party hold over another?
- Who has authority to make changes to the terms of a contract?

Although some of these questions could be answered in a way that suggested that the companies made the supplies, the overall evidence was very strongly in favour of the partners continuing to do so.

FTT (TC0087): Mrs Phillida Barnett and Mrs Lara Read t/a Burghill Valley Golf Club

Contributed by Mike Thexton

DIY housebuilder—was building a dwelling? Appeal dismissed

Mr and Mrs Sherratt built a farmhouse on their farm, subject to the conditions that:

"The occupation of the dwelling shall be limited to a person solely or mainly employed, or last employed, in the locality in agriculture …

"The proposed development shall always remain ancillary to the existing agricultural use of the site and shall not be sold, leased nor otherwise disposed of separately from, the remainder of the premises."

The only other buildings on the 100+-acre site were—

- two open-sided steel sheds
- three steel containers
- a building housing a generator and
- a mobile home.

HMRC denied the Sherratts DIY housebuilder's relief, on the ground that:

"the separate use, or disposal of the [new farmhouse was] prohibited by the term of any covenant, statutory planning consent or similar provision" (see VAT Act 1994, Sch 8, Group 5, Note 2(c)).

Much of the argument in this appeal centred on whether the conditions in Note 2(c) refer to 'use separate from another building. As may be recalled from the above summary on case TC1227, the Tribunal in Wendels was of the view that the restriction in Note 2(c) is concerned with use in conjunction with another dwelling or disposal separate from another dwelling.

There was no other dwelling on the Sherratts's farm (the mobile home was removed when the house was completed) and none of the other structures constituted a building as far as they were concerned. HMRC's guidance appears to indicate that the conditions relate to other buildings but, as is clear from HMRC's arguments in TC1227, Wendels and this case, HMRC will argue before the Tribunal that the conditions are not buildings-related.

The issue whether the separate use condition has to relate to another building was not decided by the Tribunal. It held that the planning condition in this case prevented disposal of the farmhouse separately from the rest of the farm and that was enough for the farmhouse to fail the Note 2(c) test. It may therefore be concluded from this case only that the separate disposal condition may attach to surrounding land, as opposed to any specific building.

The appeal was dismissed.

David Sherratt and Elizabeth Sherratt TC1236

DIY housebuilder—was building a dwelling? Appeal allowed

Mr Phillips's father and mother owned land in Scotland, part of which was used for a holiday business. Mr Phillips was given part of that land on which to build the house which was the subject of this appeal. HMRC denied Mr Phillips DIY housebuilder's relief, on the ground that:

"the separate use, or disposal of the dwelling [was] prohibited by the term of any covenant, statutory planning consent or similar provision" (see VAT Act 1994, Sch 8, Group 5, Note 2(c)).

The holiday business consisted of the short-term letting of chalets. Mr Phillips's mother and father lived by the chalets and managed the business but said they needed help. Mr Phillips's wife started to take bookings for the business when she moved into the new house. This accorded with the planning condition in question, which required:

"that the house … shall be occupied only by persons engaged in the management or operation of the business trading as Wester Brae Highland Lodges, together with family members".

HMRC took the view that this condition prohibited "separate use" of the house, since the house could not be used separately from the business. A similar argument had failed in Margaret Elizabeth Wendels TC737 but HMRC considered that case to have been wrongly decided and since it was not binding, being merely a First-tier Tribunal decision, HMRC did not need to appeal successfully against it in order to ignore it.

In Wendels the appellant was permitted to build a house, provided that occupation of the house was limited to a person solely or mainly employed in a family cattery business. The Tribunal noted that the planning condition restricted occupancy of the house. However, in its view the restriction in Note 2(c) was concerned with use or disposal, not occupancy; indeed, use in conjunction with another dwelling or disposal separate from another dwelling. A restriction on occupancy was relevant to neither of those, so the appeal was allowed.

The Tribunal did not disagree with Wendels. In Mr Phillips' case it held that the restriction relating to his new house "was an occupational restriction which did not affect the use of the property".

The appeal was therefore allowed.

Ian Phillips TC1227

Default surcharge when one day late

The taxpayer, a luxury hotel, appealed against a VAT default surcharge of £18,453.66 for the quarter ended 30 September 2010. The company had made the payment one day late; it arrived on Monday 8 November, instead of Friday 5 November.

The company was aware the money had to be in HMRC's bank account by 5 November and that it would not reach the bank account until the 8th.

The appellant accepted the payment was not made in a timely manner, but argued that the surcharge at 15% was disproportionate.

The First-tier Tribunal judge found the taxpayer had a persistent history of submitting late payments, and this was not an isolated case. The company could have taken the appropriate steps to ensure the payment was received in time but had failed to do so.

The appeal was dismissed, and the surcharge confirmed.

If a business cannot pay its VAT on time, it can apply for a time-to-pay deal with HMRC's Business Payment Support Service. If one is agreed before the VAT is legally due for payment, the company will avoid a surcharge.

Furthermore, a part-payment made on time will not be subject to a default surcharge as this is calculated on the unpaid balance. If the part-payment means the default surcharge on the remaining balance is less than £400 (for a period when either a 2% or 5% penalty applies), then it will be waived as de minimis.

Neil Warren, independent VAT consultant, suggested that reliance on the principle of proportionality on the basis that the surcharge is excessive is unlikely to receive sympathy from a tribunal.

He said, 'The best way to appeal a surcharge is to claim reasonable excuse for the lateness (which did not apply in this case) rather than rely on the excessive amount of the surcharge based on proportionality.'

Eastwell Manor (TC1155)

HMRC targets London's fast food outlets

HMRC NAT 61/11: HMRC tackles London's fast food VAT dodgers

A new taskforce to tackle VAT abuse in London's fast food outlets was announced today by HM Revenue & Customs (HMRC).

HMRC has identified that there is a problem with some fast food outlets deliberately falsifying their records and mis-declaring their true sales levels in order to avoid paying the correct taxes.

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

> "This taskforce will come down hard on fast food outlets that have chosen to break the rules and evade the taxes they should be paying. Honest businesses have absolutely nothing to worry about.
>
> "This taskforce comes hard on the heels of one launched last month targeting the restaurant sector in London. If you deliberately seek to evade tax HMRC can and will track you down, and you'll face not only a heavy fine, but possibly a criminal prosecution as well."

This is the 4th taskforce launched by HMRC since May 2011. HMRC is planning a further nine taskforces in 2011/12, with more to follow in 2012/13. The taskforces come as a result of the Government's £900m spending review investment to tackle tax evasion, avoidance and fraud from 2011/12, which aims to raise an additional £7bn each year by 2014/15.

Notes for editors

Taskforces bring together various HMRC compliance and enforcement teams for intensive bursts of activity targeted at specific sectors and locations where there is evidence of high risk of tax evasion. The first taskforces were launched targeted the restaurant trade on 12 May 2011.

The taskforces are part of the department's broader work to tackle evasion and avoidance, including Managing Deliberate Defaulters and offshore penalties.

Compliance activity through taskforces is 1:1 and targets the highest-risk cases in that sector and location, typically focusing on groups of up to around 600 customers in specific locations.

HMRC press release 13 July 2011