Contents

PERSONAL TAXES 3
Gaines-Cooper – What does it mean to you? **(Lecture P686 – 8.20 minutes) .. 3**
Family investment companies and 50% tax **(Lecture P687 – 12.28 minutes). 5**
Taxation of Directors fees **(Lecture P688 – 9.43 minutes) ... 6**
Compensation or share of profits 7
Relief for losses on shares in trading companies 8

CAPITAL TAXES 10
What does residence mean for PPR? **(Lecture P689 – 10.02 minutes) 10**
Evidence of PPR intention? 11
Rent-a-room relief - Whether house used as principal private residence 11
CGT: whether shares of negligible value 12
IHT Agricultural Property Relief 13

ADMINSTRATION..14
Disputed beneficial ownership of asset 14
First-tier Tribunal awarding costs to appellant 14
Penalties for failure to comply with notices 15
Wrong year 15
Too many errors 16
Submission of P35: whether a reasonable excuse 16
Discussion document re PAYE Pooling 17
Penalties for inaccuracies on returns **(Lecture P690 – 14.25 minutes) .. 18**

BUSINESS TAXES 26
Planning for the reduction in AIA **(Lecture B686 – 20.43 minutes) .. 26**
Overseas partnerships **(Lecture B687 – 9.36 minutes)..... 30**
Warehouse owned by distribution company: whether goods subjected to any process 31
Discrimination or not? 32
Sale and leaseback of films: whether trading 32
Taxability of refundable deposits 33
Employment v Self-employment 34
Sole trader: costs of defending manslaughter charge 34
Close company - assessments on undeclared profits 36
Concession on a concession – ESC C16 continues **(Lecture B688 – 8.27 minutes)..... 36**
Allowable interest? 38
Universal credit and the self-employed 39
Independent study on General Anti-Avoidance Rule (GAAR) published 41
Avoiding pitfalls on issuing shares to employees **(Lecture B689 – 14.43 minutes) .. 41**

VAT 44
Removal of LVCR from all goods imported in to the UK from the Channel Islands 44
Toolkits to help minimise common errors - update 44
Membership fees 44
Businesses are separate 45
Proportionate penalty unfortunately 45
Financial services retail distribution review **(Lecture B690 – 16.12 minutes) ... 46**

© Reed Elsevier (UK) Limited

Disclaimer

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

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

PERSONAL TAXES

Gaines-Cooper – What does it mean to you? (Lecture P686 – 8.20 minutes)

The Supreme Court has dismissed the appeal by Robert Gaines-Cooper in the final round of his landmark battle to be classed as not resident and not ordinarily resident in the UK. But what does the outcome mean to those individuals watching the case with a vested interest, and how does this change the landscape for the future?

This case centred around Mr Gaines-Cooper's strict compliance with the respective guidance published at the time by HM Revenue & Customs (HMRC), the booklet IR20, with regards to determining an individual's residence. Briefly, Mr Gaines-Cooper had contended that, based on HMRC's guidance, he was not domiciled, resident or ordinarily resident in the UK for a number of years ending with the 2003/04 tax year. Instead, he argued that his chief residence was in the Seychelles, where he had resided since 1976 and where he wished to remain. He therefore contended he had made a domicile of choice and become resident for tax purposes in the Seychelles.

The booklet IR20 (now replaced by HMRC6) stipulated a set of rules regarding 'days of presence' in the UK, as a determining factor when considering an individual's residence for tax purposes. Mr Gaines-Cooper based his calculation of days present in the UK on the guidance, and accordingly, argued that he could not be considered a UK resident, as he did not spend the required number of days in the UK.

The Supreme Court agreed with the conclusions reached by the previous courts, that Mr Gaines-Cooper could not be determined as not resident in the UK. Considering the guidance document in full, the judges concluded that any claim for non-residency would require 'multifactorial consideration' of an individual's circumstances. On the balance of the evidence, therefore, Mr Gaines-Cooper had simply not taken enough steps to be considered non-UK resident in the first place.

The main point of the case instead revolved around elements not contained in the guidance but were considered by HMRC to be implied, namely the requirement to break UK residence status in the first place. The Courts have agreed that IR20 did not apply until the UK residence status has been lost. Many taxpayers who equally followed the guidance in IR20 may now find that they too never lost their UK residence for tax purposes.

What does this mean?

This final decision reached by the Supreme Court now gives us some certainty as to how HMRC will apply its published guidance in cases where individuals leave the UK and claim to be not resident and not ordinarily resident.

Where an individual leaves the UK to undertake full-time employment for a complete tax year they will normally be classed as being not resident and not ordinarily resident in the UK. This has always been the case and has now been reinforced by the judgment. This is, of course, subject to the individual not breaking the '90 day test' in respect of visits to the UK during that period. However, individuals who claim to have left the UK permanently or indefinitely that does not involve undertaking full time employment for a full tax year will now need to show that they did in fact leave the UK, including breaking their ties here.

Those who have already left the UK and who relied on the rules, as they previously understood them in IR20, may now be at risk of challenge from HMRC. Similarly, those relying on the updated guidance published in HMRC6, will also now need to consider their position.

Only when it has been accepted that an individual has left the UK permanently will the well-known '90 day test' apply. In other words, the guidance will only apply to those who have actually lost their UK residence for tax purposes. HMRC maintains that this has always been the case, even if that was not always understood to be so.

Indeed the booklet HMRC6 which replaced the IR20 makes it clear that HMRC sees the '90 day' test as one which will bring someone within the UK tax net rather than one which helps someone shed their UK residence status.

So how do you lose your UK residence status?

For those who plan to claim they have left the UK permanently or indefinitely, the advice must now be to adopt a belt and braces approach. It appears that in order to have some certainty that HMRC will accept that non UK residence has been established, the individual will need to cut all ties with the UK, including:

- selling any UK residences (including rental properties)
- staying outside the UK for a complete tax year following departure
- ceasing employment in the UK
- selling business interests in the UK
- resigning from UK directorships
- taking their spouse and minor children with them.

Furthermore, HMRC is likely to expect the individual to have established a clear country of residence overseas. Tax inspectors now expect to see a footprint of your activities overseas, such as the filing of tax returns, membership of clubs and to see you on a list of a local doctor.

Breaking all ties with the UK may seem drastic but, if there is significant income or gains involved, it will make sense to play safe. It should be noted that, with a system of self-assessment, the onus is on the taxpayer to prove that they have ceased UK residence, not for HMRC to prove that they have not.

Most importantly, it seems, those wishing to change their residence status will need to consider all the relevant factors to their specific circumstances, an approach adopted at the Supreme Court when considering the Gaines-Cooper case. Looking forward, the proposed new statutory residence test (SRT) will take this method a step further.

The future certainty of a statutory test

The introduction of these rules, it is hoped, will clear away much of the uncertainty in this area in the future. The intended new rules are a mix of objective tests (day-counting) and more subjective rules looking at a sliding scale of how closely a taxpayer is linked to the UK and considers a number of qualifying factors before considering the number of days a person spends in the UK.

The test is likely to clarify how to lose your UK residence status for tax purposes building on HMRC's contentions that residence for tax purposes should be 'adhesive' in nature. The flip side to this is that individuals coming to the UK who have not been UK resident in the previous three tax years will keep their original residence status for longer and it will be easier to avoid becoming UK resident for tax purposes.

The government has stated its desire to introduce the SRT as a priority and is intended to be applied from April 2012. More information on the SRT is expected to be announced in the forthcoming weeks, to coincide with the Autumn Statement on 29 November and subsequent release of the 2012 Finance Bill on 6 December.

Contributed by Francesca Lagerberg, Grant Thornton UK LLP

Family investment companies and 50% tax (Lecture P687 – 12.28 minutes)

Moving investments from an individual's personal name into a corporate structure is clearly one way of reducing the impact of the 50% income tax charge. If required, different classes of shares can be created – this will give rise to an estate planning structure similar to a trust (but without the individual making an immediately chargeable transfer).

The main fiscal advantage of these arrangements is the reduction in the investment income tax rate from 50% to corporation tax of just 26%, but there are several other benefits which should not be overlooked:

(i) Dividends paid to shareholders from such a company benefit from the 10% tax credit. Dividends may therefore be paid gradually over a number of years and there will be no further income tax liability if the recipient happens to be a basic rate taxpayer.

(ii) Dividends received by a company are generally exempt from corporation tax under Part 9A CTA 2009, whereas, had the dividends been received directly, they would have been subject to rates of up to 36.11%. This exemption applies to both UK and foreign dividends received.

(iii) Indexation remains available for corporate capital gains.

The disadvantages of using a company in these circumstances remain and are generally well known, the main one being the so-called double tax charge. It is also not usually sensible for investments which would have qualified for helpful IHT reliefs such as business property relief to be dealt with in this way, given that they will lose their favoured status. Transferring assets to a company may also trigger latent capital gains, although it will sometimes be possible to argue that the individual has previously carried on an investment business so that relief under S162 TCGA 1992 will be available. In this case, the base cost of the underlying investments would also be uprated.

One of the biggest (and often unremarked) advantages of a family investment company is the ability to use it for leveraged investment. The theory here is that a reasonably modest investment (of, say, £3,000,000) may only generate a comparatively unexciting return (say, 4.5%), whereas a more substantial investment (of, say, £10,000,000) might produce a much higher rate of return (say, 8%). In some cases, the economies of scale may be sufficiently large so that they outweigh the cost of borrowing to make up the difference.

In an individual's hands, the cost of servicing the interest on the borrowing will typically have to be met out of post-tax income. This will often make the taking of the loan uneconomic. However, by using a corporate structure, the loan relationship rules ensure that interest on the money borrowed is offset *before* the tax charge is imposed. Using the figures above and assuming a borrowing rate for the additional £7,000,000 of 5%, this gives:

	Individual	**Corporate**
	£	£
Return	800,000	800,000
Income tax	(400,000)	
Loan interest paid	(350,000)	(350,000)
	50,000	450,000
Corporation tax		(117,000)
	£50,000	£333,000
Yield	1.67%	11.1%

Contributed by Robert Jamieson

Taxation of Directors fees (Lecture P688 – 9.43 minutes)

With HM Revenue & Customs (HMRC) targeting the employment status of directors, the position of those receiving fees gross of tax should be reviewed to ensure it is sustainable.

The PAYE/National Insurance contribution (NIC) regulations apply to office holders' as they do to employees. Directors (executive or non-executive) are office holders in a company and are therefore prima-facie caught by them. Indeed, anyone acting as a director, even if not formally appointed, will be treated as an office holder and is therefore within the scope of the regulations.

Arguments based solely on directors having multiple appointments, being non-UK resident, operating through their own company etc are not in themselves reasons to not apply PAYE/NIC.

Of course it is worth remembering that:

- many people hold simultaneous part time employments taxed under PAYE and there is no reason in principle to differentiate multiple office holders
- non-UK resident directors receiving fees for carrying out duties here are subject to PAYE in full. There is no de minimis in terms of the number of days physically present in the UK
- whilst full exemption is available where all duties are performed outside the UK, where only some of them are, HMRC's agreement to any apportionment of remuneration will need to be obtained.

IR35 impact?

The 'IR35' legislation and accompanying NIC regulations were introduced with effect from 6 April 2000 to prevent the avoidance of PAYE and Class 1 NIC through workers using intermediaries such as personal service companies.

It applies where, had that intermediary not existed, the relationship between the worker and client would have been one of employer and employee. In such cases, it is the intermediary that is responsible for operating PAYE and paying Class 1 NIC on all earnings from the engagement after deducting a limited allowance for

- expenses and capital allowances
- pension contributions
- secondary Class 1 NIC

.

In general, IR35 is not going to apply to director's fees as a director's appointment is personal in nature and, therefore, the personal service company cannot contract with the client company instead of the director personally.

In practice, it is not unusual to see a contract between a personal service company and the client company for the director's appointment. However, HMRC has successfully challenged the legitimacy of such contracts in the past arguing that the real contract is between the director and the client company with any PAYE and NIC liability therefore resting with the client company.

This is a complicated area not least due to the fact that should HMRC successfully challenge an arrangement there is a possibility for double taxation. In normal circumstances, there is legislation which allows an offset of any tax paid by an individual paid gross against a company's PAYE liability if it is upheld than the individual is in fact an employee. This legislation does not extend to offset any corporation tax paid by a personal service company if it is found that the client company has a PAYE liability in respect of the fees paid to the personal service company.

It is also worth noting that the PAYE and NIC legislation are incongruent which can result in different treatment for PAYE and NIC purposes.

Finally, on the subject of IR35 and PAYE, you should be aware that just because it does not apply in respect of directors' fees, it would be in point in so far as the director also provides separate consultancy services through a personal service company at the same time (see below).

When might PAYE not apply?

Essentially where:

a) The director genuinely undertakes some duties separate from those of acting as a director and does so on a basis consistent with being self-employed (the usual factors based on case law needing to be considered). Here, a separate fee set at a level commensurate with the consultancy role might be treated as derived from a self-employment. We would recommend separate contracts and invoicing for the purpose.

b) Extra Statutory Concession A37 applies. This might be considered (broadly) where;

  i. The fees are being paid direct to a professional partnership of which the director is a member (additional conditions apply).
  ii. A company has the right to appoint a director to the board of another and having done so, arranges for any directors fees to be handed over to it by the director and is charged to tax on them accordingly as part of its profits. Private equity investors present a typical scenario.
  iii As in ii above, a company receives fees even where no formal right of appointment to the board of another exists but only provided the director does not 'control' that first company, which is often a stumbling block for directors using their own personal service company.

What is the exposure for an employer?

There may be scope to mitigate this if the director has accounted for tax on their earnings under self-assessment but this is likely to be difficult for the most recent year unless the self-assessment filing date has already passed. Any resulting offset is also unlikely to meet all of the liability. Failing this, the company will often have to pay the PAYE in full, relying on being able to claw it back from the director personally: not, unfortunately, always guaranteed to work.

Contributed by Francesca Lagerberg, Grant Thornton UK LLP

Compensation or share of profits

An accountant became a partner in a large firm of accountants. Following a period of ill-health, she retired from the partnership in November 2007. She received a payment of £191,532. She accepted that £63,333 of this was taxable, but considered that the balance of £128,199 represented non-taxable compensation. In July 2008 she became a partner in a smaller firm. However, her relations with a senior partner were unsatisfactory, and in February 2009 she was asked to leave. She subsequently received payment of £205,250. She accepted that £102,500 of this was taxable, but considered that the balance of £102,750 represented non-taxable compensation. HMRC issued amendments to her returns, charging tax on the payments of £128,199 and £102,750 which she had treated as non-taxable. The accountant appealed, contending that she had been discriminated against on the basis of her gender, and the payments were compensation for this.

Decision:

The First-tier Tribunal reviewed the evidence in detail and allowed her appeal in part. Judge Bishopp held that the payment which the accountant had received in 2007 represented her share of profits, and was taxable accordingly. However, on the evidence, there was 'no real doubt' that she had been treated badly by the firm which she joined in 2008, and it appeared that the partners in that firm recognised she 'had been treated unfairly, and that compensation had to be paid'. Accordingly the tribunal dismissed her appeal with the payment with regard to the £128,199 which she had received from the first firm, but allowed her appeal with regard to the £102,750 which she had received from the second firm.

Comments - This case deals with a fundamental issue in terms of the taxability of the payment received. As might be expected the case has been fully anonymised as there were significant issues involving gender discrimination. Although the tribunal found Self v HMRC and Morgan v HMRC of little help "… in deciding whether payments made by a partnership to an individual partner are profits of the firm, …, it is necessary to decide whether the payments were received by the individual partner in his capacity as a partner in the firm and whether that was 'the very justification for the receipt'.

TC01527: AB

Relief for losses on shares in trading companies

The appellants were two directors of a close company which was incorporated in the UK. At a meeting on 1 May 2004, with their consultant, the appellants agreed, in the absence of the third director, to pay £50,000 to the company for the acquisition of shares. Although it was accepted that they had paid £50,000 each, there was no contemporaneous notes of the meeting—the only evidence was a letter written by the consultant three years later—and neither of them were able to produce share certificates for those shares or the Companies' House register of members, and there was no record of shares at Companies' House. The company ceased to trade on 31 October 2004 and the company was dissolved on 3 July 2007. In their tax returns for the year ending 5 April 2005 the appellants claimed an allowable loss under TA 1988 s 574. HMRC disallowed the claims on the grounds that there was no evidence that they had subscribed for shares as required by TA 1988 s 574. The appellants appealed.

The issue arose as to whether the appellants had purchased shares in the company, and whether they were entitled to claim loss relief under TA 1988 s 574. The appellants argued that they did subscribe for shares because the company, which as it was small operated with a degree of informality, had an obligation to issue them. The references to an issue of shares in s 574(3)(a)—which provides that "an individual subscribes for shares if they are issued to him by the company in consideration of money or money's worth"—did not impose a further requirement that the shares should be "issued". In any event the shares were issued when title to them was complete and whilst that was normally when shares were registered in the membership register, it was not limited to that situation; the consultant's letter referred to the company's obligation was sufficient to support a conclusion that the shares were both subscribed for and issued for the purposes of s 574.

Decision:

For the purposes of TA 1988 s 574 shares would only be subscribed for if the company had an obligation to issue them as a result of receiving the payments. On the facts, the letter by the consultant recorded only what happened at the meeting, and at most it was evidence of what two of the directors intended at that time and not that they had also reached a clear understanding with the company. Further matters remained to be resolved including the position of the third director. In addition there had been no prior course of dealing, or evidence that the taxpayers understood the importance that the payment should be made for shares as a result of advice they had received. It followed that the appeals would be dismissed.

Appeals dismissed.

Comments - ITA 2007 s 131 provides relief for losses on shares in trading companies, subject to certain conditions. Anyone who wishes to claim relief under this provision will need to provide evidence that he or she has actually subscribed for the shares in question, normally by producing a share certificate. The appellants here failed to produce such evidence, and the First-tier Tribunal therefore dismissed their appeals.

J Halnan v HMRC (and related appeal) TC01423

CAPITAL TAXES

What does residence mean for PPR? **(Lecture P689 – 10.02 minutes)**

Provided that a taxpayer has resided in their property for some time, principal private residence relief should be available when they sell their property for the periods that they resided in that property plus the last three years of ownership irrespective of their actual occupation during that final period.

This article considers four Tribunal cases that were heard in 2010 where HMRC questioned the availability of PPR, questioning whether residence was intended with any degree of permanence.

Mr Paul Favell (PF)

PF bought a property in March 1999 and transferred it to his son in June 2003; the property was let for most of the period.

PF claimed PPR relief for the last three years on the basis that he lived there for 11 months in 2001 when he separated from his partner.

The Tribunal said that, in the complete absence of any objective documentary evidence, PF was not entitled to PPR.

Jason Moore (JM)

JM bought a property to reside in with his partner but she refused to move into the property so he renovated the property and let it out.

On sale, he claimed that he had lived in the property for a short while when his relationship broke down but provided no documentary evidence to support this.

The Tribunal concluded that the main purpose of the renovation was to be able to sell the property and that even if he did reside in the property for a short period, there was not any degree of permanence.

Anthony Metcalfe (AM)

Like JM, AM bought a property with his partner; both moved out after short periods. The electricity bill during that period totalled £39 and there was no evidence to support his permanent occupation.

The Tribunal concluded that he may have taken up temporary residence but that was insufficient.

Malcolm Springthorpe (MS)

MS bought the property and renovated it; during this period it was exempt from Council Tax. Once renovated it was let to students. There was no real evidence of occupation.

Once again, the Tribunal were not convinced that there was any permanent intent to reside in the property and so PPR was refused.

Advising clients

The burden of proof is on the taxpayer to provide evidence that there was some degree of permanence to their occupation.

It is important to advise clients to:

- Change addresses on correspondence that they receive including bank statements
- Ensure Council Tax records support family occupation
- Watch out for low level of utility bills
- Be very careful when they are in the building trade

They should not claim PPR if they have lived in a ‘buy to let’ in just the few months leading up to sale.

© Reed Elsevier (UK) Limited

Evidence of PPR intention?

A married couple had lived together, with their two daughters, on a farm. The wife began an affair, and in July 2002 the husband (C) purchased a nearby house, and moved into it with his elder daughter. He obtained planning permission to build a second house on part of the land. In March 2003 he sold the house for financial reasons, but retained the land for which he had obtained planning permission, and built a new house on the site. He moved into the new house in July 2003 (having stayed at his mother's house for the intervening four months).

In July 2005 he moved back to the farm with his wife, and in October 2005 he sold the house which he had built in 2003. C and his wife subsequently divorced, and he moved into another house with his daughters. In 2009 HMRC issued assessments charging capital gains tax on the disposals of the houses which C had sold in March 2003 and October 2005. C appealed, contending that he was entitled to principal private residence relief for both houses.

Decision:

The First-tier Tribunal accepted his evidence and allowed his appeal, finding that at the time C moved into the houses, 'he intended to live there permanently'.

Comments - There have been several recent cases where an appellant has contended that a property became his principal private residence during a period of temporary separation from his wife, and the Tribunal has found that there was insufficient evidence to support such a claim. These cases have demonstrated that the taxpayers in question often do not consider the importance of the property in question being a residence not a property.

In this case, however, the Tribunal accepted the appellant's contention that two different properties had been his principal private residence during a period of separation. It was probably significant that, although he subsequently resumed living with his wife, the reconciliation was not permanent and the couple subsequently divorced. In cases of this nature, it is essential to submit adequate evidence in support of the claim. The more evidence accumlated the better the chance of success in keeping the valuable relief.

A J Clarke TC1461

Rent-a-room relief - Whether house used as principal private residence

The Appellant, Mrs Michelina Woods, appealed against assessments to income tax issued on 12 February 2010 for the three tax years ended 5 April 2007 under section 28A (1) and (2) TMA and against discovery assessments for the four tax years ended 5 April 2004 under s 29 TMA. Penalties were issued on 17th March 2010 for incorrect returns for the seven tax years ended 5 April 2007 under section 95 TMA.

The assessments and penalties followed an enquiry into Mrs Woods tax returns which had been opened because of disallowable expenditure being claimed for a Mercedes vehicle, and a claim within the rent a room scheme for rental income received. HMRC contended that the Appellant fraudulently or negligently submitted incorrect returns for the seven years ended 5 April 2007. The Appellant disputed this.

The background facts were not in dispute. Mrs Woods is a self employed mortgage adviser. She has been married since September 1996. She has two children, the younger born in 2004. Mrs Woods confirmed that she had owned four properties during the relevant period covered by the enquiry. The relevant properties were 13 Willington Street, Nuneaton of which she was the sole owner, which had been purchased in January 1986. Secondly, 21 Manor Court Road, Nuneaton of which she was the sole owner, purchased in 1991. Thirdly, 345 Queen Elizabeth Road, Nuneaton, owned from 2003 to 2009. Fourthly, 27 Fife Street,

Nuneaton purchased jointly with her husband in June 2005. Mrs Woods received rental income from 13 Willington Street. She contended that income received was covered by rent-a-room relief as this property was her main residence

There were three principal issues for the Tribunal to determine. First, whether the specified property let by the Appellant was her main residence during the relevant tax years and thus whether rental income falls within the Rent a Room scheme. Secondly, whether certain business expenses were allowable as deductions. Thirdly, the amount (if any) of penalties to be imposed.

Decision:

The Tribunal came to the conclusion and found as a fact that Mrs Woods' main residence was 21 Manor Court Road for a number of reasons. First, the proposition that a two bed-roomed terraced house occupied by tenants was a main residence rather than a semi detached family home where her husband and children lived is inherently unlikely. Secondly, there is considerable documentary evidence of the use in various respects of 21 Manor Court Road by Mrs Woods. Thirdly, the evidence of Mrs Woods residing at 13 Willington Street is limited. Fourth, the particular circumstances of the two bed-roomed terraced house at 13 Willington Street make it even more unlikely that Mrs Woods would choose to use it as her main residence. These included her pregnancy and giving birth in 2004; a frightening Rottweiler guard dog at the property, the state of disrepair of the property, the fact that the tenants were in the course of damaging the property and the requirement to sleep on a put up bed downstairs.

The appeal will be dismissed. The claim for rent-a-room relief fails. The business expenses and general administration expenses are determined in the amount set out by HMRC. The penalties are confirmed at 30%. The Appellant has failed to establish that the assessments for 2005 – 2007 should be amended. HMRC have satisfied the conditions for discovery for the years ending April 2001-2004.

Comments – The wealth of evidence other than the initial impression militates against the taxpayer. It is crucial that when claiming a relief the facts actually support the case. The Tribunal cannot make a statement that the taxpayer is not telling the truth but of course refers to the bounds of credibility being stretched as was the decision in this case.

Michelina Woods TC1505

CGT: whether shares of negligible value

Three individuals acquired shares in a company (D) in December 2000, at a total cost of £3,333,333 to each of the three. D subsequently made significant losses, and entered a creditors' voluntary agreement in March 2002. The shareholders subsequently claimed relief under TCGA 1992 s 24(2) on the basis that the shares had become of negligible value by 5 April 2001. HMRC rejected the claims, considering that the shares still had some value at that date, and the shareholders appealed.

Decision:

The First-tier Tribunal reviewed the evidence in detail and allowed the appeals, finding that D had made substantial losses during the first three months of 2001, and concluding that 'each of the appellants' shareholdings would in all probability have been unsaleable at 5 April 2001 in the open market in a sale by private treaty at arm's length'. Accordingly they were of negligible value at that date.

Comments – TCGA 1992 s 24 provides that the owner of an asset may claim that it has become 'of negligible value', and may crystallise a loss on the basis that there is a deemed disposal and reacquisition of the asset. HMRC were reluctant to accept that shares which had cost each of the appellants more than

© Reed Elsevier (UK) Limited

£3,000,000 should have become of negligible value within four months of their acquisition. However the Tribunal reviewed the evidence in considerable detail and accepted the appellants' claims.

S Barker v HMRC (and related appeals) TC01487

IHT Agricultural Property Relief

A farmer (W) had purchased some farmland in 1957. Initially he farmed it himself, but in 1980 he let it to a family farming partnership of which he was a member. W lived in a bungalow on the farm from 1966 until 2002, when he became ill. After leaving hospital he moved to a care home where he died in 2006. His bungalow remained unoccupied during his illness, although he occasionally visited it. His executors claimed that the bungalow qualified for agricultural property relief. HMRC rejected the claim on the basis that the bungalow had not been occupied for the purposes of agriculture throughout the seven years ending with W's death. The executors appealed. The First-tier Tribunal allowed their appeal

Decision:

The Upper Tribunal reversed this decision and upheld HMRC's ruling. On the evidence, the partnership had 'ceased to occupy the bungalow for the purposes of agriculture when (W) moved to the care home with no reasonable prospect of ever returning home'.

Comments - The Upper Tribunal reversed the First-tier decision, and held that the only reasonable conclusion was that the bungalow had ceased to qualify for agricultural property relief when the farmer ceased to live in it. There have been a number of cases where there has been diminished use by the relevant taxpayer and the decision by the Upper Tribunal demonstrates logic although it may not be to the advantage of the taxpayer.

HMRC v Atkinson & Smith (WM Atkinson's Executors) Upper Tribunal

ADMINSTRATION

Disputed beneficial ownership of asset

HMRC discovered that a trader (S) had failed to declare a capital gain on the disposal of four properties. He acknowledged that a capital gain had been made and that he had submitted an incorrect tax return for 2005/06 by not declaring a chargeable capital gain made on the sale of the properties. However the issue was whether the properties had been bought and sold for himself beneficially or on trust for himself and his brothers, so that the capital gain was shared between them.

Decision:

The First-tier Tribunal reviewed the evidence in detail and allowed the appeal in part, finding that one of S's brothers had a beneficial interest in the properties but that the other brother did not, so that S was only taxable on 50% of the gain. The Tribunal also found that S had underdeclared his business takings, and dismissed an appeal against an amendment to his declared profits.

Comments - When HMRC discovers that the owner of a property has failed to declare the capital gain on its disposal, it will normally issue an assessment charging tax. The First-tier Tribunal here accepted the appellant's claim that, although he was the legal owner of the properties in question, he was not the sole beneficial owner, as one of his brothers also held a beneficial interest in the property in question.

Mr Tarlochan Singh TC 01487

First-tier Tribunal awarding costs to appellant

In this case where the facts are not fully set out in the decision, HMRC sought to collect tax from an employee rather than the employer, but the First-tier Tribunal allowed the employee's appeal. The employee subsequently applied for costs.

Decision:

The Tribunal granted the application, holding that HMRC had acted unreasonably and directing that HMRC should pay 50% of the employee's costs.

Comments – The Tribunal report is very brief and it is unfortunate that the Tribunal Centre has not yet released the initial decision in this case, where the facts are presumably set out in more detail. However, the case is still worth noting as one of the relatively rare cases where the First-tier Tribunal has ordered HMRC to pay the appellant's costs (although the order here was for HMRC to pay 50% rather than 100% of such costs).

N Deluca v HMRC TC01422

Penalties for failure to comply with notices

Mr Parker is an accountant and partner in Parkers Accountancy and Taxation. In January 2009 HMRC opened an enquiry into the partnership tax return for 2006/07. In July 2009 HMRC issued an information notice under FA 2008, Sch 36 para 1, requiring production of material set out in that notice.

In November 2009 the tribunal directed Parker to comply with the information notice and dismissed his application for closure of the tax enquiry into the partnership. Parker failed to comply with the information notice, and in January 2010 an initial penalty of £300 was charged. In May 2010 HMRC imposed penalties totaling £1020 (102 days at £10 per day), and Parker appealed

Decision:

The First-tier Tribunal upheld the penalties and dismissed P's appeal.

Comments - FA 2008 Sch 36 para 40 provides for the imposition of penalties of up to £60 per day where a person persistently fails to comply with a notice under Sch 36 para 1. In this case, the Tribunal imposed penalties at one-sixth of the possible maximum.

D Parker v HMRC TC01424

Wrong year

The taxpayer operated a newsagent, tobacconist and confectioners shop with a subpostoffice attached. In November 2008, the Post Office decided to close the sub-post office and made the taxpayer a compensation payment of £75,589. She included this payment, less the first £30,000, in the profit and loss account of the business for the year to 8 August 2009 and in her tax return for the year 2009/10.

In August 2010, HMRC opened an enquiry into the taxpayer's 2008/09 return on the basis that the compensation payment should have been taxed in that year. They decided that it was compensation for loss of office and should not have been included with the income of her trade.

The Post Office had sent details of all compensation payments made to sub postmasters and sub postmistresses to HMRC to ensure that they were taxed correctly. In light of that, HMRC had sent a statement of advice to the sub postmasters and sub postmistresses. However, the taxpayer argued that she had not received this statement and had therefore treated the payment as income, including it in her trading income as she had been doing since the business was acquired.

Decision:

The First-tier Tribunal ruled that the payment had been correctly assessed under ITEPA 2003, s 401. It sympathised with the taxpayer who had not received the notice from HMRC, but suggested that this was a matter for the HMRC complaints department or the Adjudicator.

The taxpayer's appeal was dismissed.

Comments – There have been a number of cases where the recipient has received payment for the termination of the office of sub postmaster such as Uppal v HMRC. Accordingly there is established history for the determination that the sum flows from the office of the sub postmaster.

R Orme TC1460

Too many errors

The taxpayer's tax returns for the years 2001/02, 2003/04 and 2004/05 contained discrepancies arising mainly from a wrongly made claim for gift aid and then a late claim to carry back gift aid relief. These gave rise to penalties which the taxpayer claimed were excessive. Initially the inspector had imposed a 45% penalty, but this was later reduced to 30% following a statutory review. The taxpayer appealed, claiming that the penalty was excessive.

Decision:

The First-tier Tribunal noted that the taxpayer was elderly, but that he had entrusted the completion of his returns to an agent who had acted for him for many years. The judge was sympathetic about the original error in making a late gift aid claim, but said this had been exacerbated by other mistakes in the later returns.

Interest income had been omitted from the 2004/05 return, and there was nothing to show that this would have been disclosed had details not been reported to HMRC from the relevant institution. The penalties in the circumstances seemed reasonable to the tribunal.

The taxpayer's appeal was dismissed.

Comments – The tribunal might well have taken a different line particularly as the taxpayer was 85 but the combination of errors in more than one year and the late claims meant the penalties remained and they even considered increasing them. This demonstrates the need to take care

V Karnani TC1469

Submission of P35: whether a reasonable excuse

An accountancy firm failed to submit its 2007/08 P35 by the due date, and HMRC imposed a penalty of £1200. The firm appealed, contending that its senior partner had attempted to file the return online in April 2008, and had assumed that HMRC had received it.

Decision:

The First-tier Tribunal dismissed the appeal, finding on the balance of probabilities that the return had not been filed online, and holding that the circumstances did not constitute a reasonable excuse.

Comments - In cases of this kind, the submission of evidence is crucial. The First-tier Tribunal found that the accountancy firm had failed to submit satisfactory evidence in support of its claim that it had submitted its P35 online, and also held that the firm had not demonstrated a reasonable excuse.

DJ Windsor & Co v HMRC TC01403

Discussion document re PAYE Pooling

At the 2009 Pre Budget Report, the previous Government announced that HMRC would consult on legislation to reduce administrative burdens on businesses by enabling connected employers to pool their PAYE references, returns and payment obligations.

Since then, the current Government announced its intention to improve the operation of PAYE for employers, individual customers and HMRC with the introduction of Real Time Information (RTI). This will require employers to submit information about the tax and other deductions they make at the time payment is made to employees. As this is a significant development in the operation of PAYE, work on PAYE Pooling was put on hold while HMRC developed the framework for RTI.

If, as a result of this discussion, the decision is to take PAYE Pooling forward it will be developed to fit with the RTI framework. Many of the in year and end of year processes discussed in this document will need to be amended in line with RTI. Under RTI, employers will no longer submit in-year movements forms P45 and P46 or the End of Year forms P35 and P14. P11Ds will still be required once RTI has been brought in.

Many organisations, such as corporate groups of companies, professional partnerships, charities and public bodies, are made up of a number of separate entities. All entities within the organisation that are employers will have their own PAYE reference and are required to make payments and returns to HMRC to meet their PAYE obligations.

HMRC recognises that the operation and maintenance of a number of PAYE references within an organisation can be an unwelcome administrative burden. An administrative easement could be achieved by allowing employers that are connected in this way to be treated as a single entity for PAYE purposes. This has been termed as PAYE Pooling and the following example illustrates what we mean:

ABC Ltd, ABC (Leeds) Ltd and ABC (Manchester) Ltd are three separate companies within the ABC Group. Each company employs a number of staff and, as separate employers, they each make payments and returns to HMRC under their respective PAYE references.

With PAYE Pooling, a single PAYE reference could be set up for the ABC Group allowing the three employers to make combined payments and joint returns to HMRC.

As suggested in this example, PAYE Pooling has the potential to reduce the administrative burden on connected employers by allowing them to submit combined returns and payments to HMRC under a single PAYE reference. Some of the areas where HMRC thinks a pool of employers may achieve an administrative easement are set out below (this list is not exhaustive).

Payments - Employers calculate the Income Tax and NICs due from the payments they make to their employees and pay this to HMRC. Rather than each employer making separate payments to HMRC, a PAYE pool will be able to make one combined payment monthly, quarterly or annually depending upon the amount and nature of the payments.

Forms P45 and P46 - When someone changes jobs, their old employer should give them a form P45. This shows the leaver's total pay and tax to the date they left (unless the employee was on a week 1/month 1 tax code in which case this box will be left blank). When they start a new employment, the new employer must complete Part 3 of the P45 and send this to HMRC. If the employee doesn’t have a P45, both the employer and employee must complete a P46 and return this to HMRC instead.

As a pool will be treated as a single entity for PAYE purposes, if an employee moves from one employer to another within the pool, we will treat this as the same employment and these forms will not be required. Similarly, under RTI starter and leaver information would not need to be included in the RTI submissions for that employee.

© Reed Elsevier (UK) Limited

Expenses and benefits - By 6th July following the end of the tax year, employers must submit a form P11D for each employee for whom they have provided any benefits in kind or expenses (unless these are statutorily subject to PAYE). The P11D shows the cost of the benefits in kind and expenses to the employer and any amount made good by the employee.

A separate return, form P11D(b), showing the employer's total Class 1A NICs liability arising from the benefits in kind provided should be completed and returned by 6th July. The payment of Class 1A NICs should be received by HMRC by the 19th July, if paying by cheque or 22nd July if paying electronically.

Although P11Ds will be required for each employee as they are now, the pool will achieve some administrative easement by only needing to submit one P11D(b) and one payment of Class 1A NICs.

Some employers may have agreed a dispensation or PAYE Settlement Agreement (PSA) with HMRC to reduce the paperwork associated with expenses and benefits. A dispensation is a notice from HMRC that removes the requirement to report expenses and benefits at the end of the year. A PSA is a flexible scheme employers can use to settle any PAYE tax and NICs due to HMRC on three types of expense and benefit: minor items, irregular items, and items it's impractical to operate PAYE on for P11D purposes.

Penalties for inaccuracies on returns (Lecture P690 – 14.25 minutes)

Section 97 and Schedule 20 to Finance Act 2007 set out the new penalty regime for errors on returns which has now commenced. The regime was further amended by FA 2008. Details of the commencement arrangements are given below – these remain relevant in relation to a compliance issue which may run over a period of years. A brief review of the legislation follows as a recap.

Penalty triggers - inaccuracies

A penalty will apply when a person gives a specified document to HMRC, and the document contains an inaccuracy which is careless or deliberate and which amounts to or leads to any of the following :

- An understatement of his liability to tax;
- A false or inflated statement of a loss he has incurred, or
- A false or inflated claim to repayment of tax.

Where the error in the document is attributable to the deliberate supply of false information by a person (T), or the deliberate withholding of information by T, with the intent of the document containing an inaccuracy, there is a penalty payable by T, in the amount of 100% of the potential lost revenue. (FA 2008 modifications)

Penalty trigger – assessments

When an assessment is issued by HMRC to a person which understates his liability to tax and he has failed to take reasonable steps to notify HMRC within 30 days after that it is an under assessment, he is liable to a penalty. In determining what steps were reasonable to have taken, HMRC must consider whether the person knew or should have known about the under assessment, and what steps would have been reasonable to take to notify HMRC.

Penalty rates

The degrees of culpability which determine the rate of penalty are:

- Careless – if the inaccuracy is due to failure by the person to take adequate care, or if an inaccuracy which was not careless or deliberate is discovered and the person did not take reasonable steps to notify HMRC.
- Deliberate but not concealed – if the inaccuracy is deliberate, but the person does not make arrangements to conceal it, and
- Deliberate and concealed – if the inaccuracy is deliberate, and the person makes arrangements to conceal it, for example by submitting false evidence in support of an inaccurate figure.

Amounts of penalty

The penalty rates rise according to the degree of culpability by the person. The rates of penalty, which are applied to the potential lost revenue (as defined) are as follows:

Culpability	**Penalty rate**		
	Category 1	**Category 2**	**Category 3**
Careless	30%	45%	60%
Deliberate but not concealed	70%	105%	140%
Deliberate and concealed	100%	150%	200%

The penalty rate for a penalty in respect of an under assessment not notified is 30%, and the rate applied to T is 100%.

Categories

The category 1, 2, 3 ranking was introduced in Finance Act 2010 Sch 35. This comes into force from 6 April 2011, before which only Category 1 penalties applied to all types of inaccuracy.

An inaccuracy is in category 1 if:

- It involves a domestic matter, or
- It involves an offshore matter, and
    - The territory in question is a category 1 territory, or
    - The tax at stake is a tax other than income tax or capital gains tax

An inaccuracy is category 2 if:

- It involves an offshore matter
- The territory concerned is a category 2 territory, and
- The tax at stake is income tax or capital gains tax

An inaccuracy is category 3 if:

- It involves an offshore matter
- The territory concerned is a category 3 territory, and
- The tax at stake is income tax or capital gains tax.

An inaccuracy involves an offshore matter if it results in a potential loss of revenue that is charged on or by:

- Income arising from a source in a territory outside the UK
- Assets situated or held in a territory outside the UK
- Activities carried on wholly or mainly outside the UK
- Anything having effect as if it were income, assets or activities of a kind described above.

As far as defining territories is concerned, these are designated by Treasury Order, (Penalties, Offshore income etc (Designation of Territories) Order 2011 SI No 976) the enabling power and guidance for this being in FA 2007 Sch 24 para 21A. Category 2 territories are not defined, but fall to be determined by exception.

Category 1 territories

Anguilla	Aruba	Australia
Belgium	Bulgaria	Canada
Cayman Islands	Cyprus	Czech Republic
Denmark (Note 1)	Estonia	Finland
France	Germany	Greece
Guernsey	Hungary	Ireland
Isle of Man	Italy	Japan
Korea (South)	Latvia	Lithuania
Malta	Montserrat	Netherlands (note 2)
New Zealand (note 3)	Norway	Poland
Portugal	Romania	Slovakia
Slovenia	Spain	Sweden
United States of America (note 4)		

Notes

1. Not including Faroe Islands and Greenland
2. Not including Bonaire, Sint Eustatius and Saba
3. Not including Tokelau
4. Not including overseas territories or possessions

Category 3 territories

Albania	Algeria	Andorra
Antigua and Barbuda	Armenia	Bahrain
Barbados	Belize	Bonaire, St Eustatius & Saba
Brazil	Cameroon	Cape Verde
Colombia	Congo, Republic of	Cook Islands
Costa Rica	Curaco	Cuba
Republic of Korea	Dominica	Dominican Republic
Ecuador	El Salvador	Gabon
Grenada	Guatemala	Honduras
Iran	Iraq	Jamaica
Kyrgyzstan	Lebanon	Macau
Marshall Islands	Mauritius	Micronesia
Monaco	Nauru	Nicaragua
Niue	Palau	Panama
Paraguay	Peru	Saint Kitts and Nevis
Saint Lucia	San Marino	St Vincent & the Grenadines
Seychelles	Sint Maarten	Suriname
Syria	Tokelau	Tonga
Trinidad & Tobago	United Arab Emirates	Uruguay

Potential lost revenue

The potential lost revenue is defined by the legislation, and would normally be the tax at stake. However, the potential lost revenue where the tax has been delayed as a result of the inaccuracy is 5% of the tax for each year, for each year of delay, with a pro rata adjustment for part years of delay.

Disclosure

Taxpayers can to reduce the gross penalty by disclosure, for which a range of reductions have been specified. The disclosure of an inaccuracy is defined as:

- Telling HMRC about the inaccuracy,
- Giving HMRC reasonable help in qualifying the inaccuracy or under assessment, and
- Allowing HMRC access to records for the purpose of ensuring that the inaccuracy or the under assessment is fully corrected.

It further goes on to list two types of disclosure and to refer to the "quality" of the disclosure. Disclosure is unprompted if made at a time when the person has no reason to believe that HMRC has discovered or are about to discover the inaccuracy or under assessment, and otherwise is "prompted". The quality of a disclosure is determined by the timing, nature and extent of the disclosure. The following rates of penalty will apply:

Culpability	**Maximum penalty (no discount)**	**Unprompted minimum penalty**	**Prompted minimum penalty**
Careless	30%	0%	15%
	45%	0%	22.5%
	60%	0%	30%
Deliberate	70%	20%	35%
	105%	30%	52.5%
	140%	40%	70%
Deliberate & concealed	100%	30%	50%
	150%	45%	75%
	200%	60%	100%

Suspended penalties

HMRC may notify a taxpayer that his penalty for a careless, but not deliberate inaccuracy (all or part of it) has been suspended for a period of up to two years, and will set conditions of the suspension. However, the power to suspend a penalty will only be available if compliance with a condition of the suspension would help the taxpayer to avoid becoming liable for further penalties for careless inaccuracies.

At the end of the period of suspension, if HMRC are satisfied that the conditions of the suspension have been complied with then the suspended penalty will be cancelled; if the conditions have not been complied with, the suspended penalty will become payable. If during the period of suspension a further penalty becomes payable under para 1 (for an inaccuracy in a return) then the suspended penalty will also become immediately payable.

Inaccuracies when an agent is acting

The law states that a taxpayer is not liable to a penalty in relation to anything done or omitted by his agent if HMRC is satisfied that the taxpayer took reasonable care to avoid an inaccuracy. This would mean that the taxpayer would need some evidence that he took reasonable care over his tax affairs.

© Reed Elsevier (UK) Limited

Guidance on the meaning of reasonable care

All of the penalty reform depends upon the definition of reasonable care adopted by HMRC. Guidance on this aspect is in the Compliance Handbook Manual, which includes significant guidance on "reasonable care".

Reasonable care will vary depending on the capabilities and circumstances of the individual acting, and in particular on the type of business or transaction he is dealing with. Thus:

- An unrepresented taxpayer will have a lower expectation of his capabilities than a represented taxpayer
- Where a complex or unusual transaction is to be undertaken, the taxpayer is expected to take extra care
- Reasonable care extends to the records that a taxpayer keeps to enable him to report his income and gains correctly
- Reasonable care can also extend to the systems in place to ensure that tax is dealt with properly in relation to business transactions.

Uncertainty and reasonable care

There is particular guidance for those undertaking a transaction about which the tax outcome is uncertain:

"In HMRC's view it is reasonable to expect a person who encounters a transaction or other event with which they are not familiar to take care to find out about the correct tax treatment or to seek appropriate advice.

If after that the person is still unsure they should draw attention to the entry and the uncertainty when they send the return or document to us. In these circumstances the person will have taken reasonable care to draw our attention to the point and if they are wrong they will not have been carelessly so."

Thus, disclosure, which is normally considered in the context of the issue of discovery, now will extend to the issue of penalties where it is found that a transaction or event has been incorrectly reported or taxed. The proper disclosure of the transaction and the uncertainty relating to it will achieve the "reasonable care" required in order for the taxpayer to avoid a penalty should the treatment prove incorrect.

The guidance then provides some examples of when reasonable care has been applied and no penalty is due:

"Examples of when a penalty would not be due include

- a reasonably arguable view of situations that is subsequently not upheld
- an arithmetical or transposition inaccuracy that is not so large either in absolute terms or relative to overall liability, as to produce an obviously odd result or be picked up by a quality check
- following advice from HMRC that later proves to be wrong provided that all the details and circumstances were given when the advice was sought
- acting on advice from a competent adviser which proves to be wrong despite the fact that the adviser was given a full set of accurate facts.

Reasonable care – agent acting

When an agent is acting on behalf of a client, the taxpayer must still exercise reasonable care, and must be able to evidence this to the officer concerned. This might involve providing access to correspondence between the agent and his client. The guidance states that reasonable care when an agent is acting includes :

- Appointing an agent competent to deal with his affairs,
- Giving the agent all of the relevant information, and
- Checking the return, as far as possible, before it is submitted.

© Reed Elsevier (UK) Limited

Agents will; want to review their process and procedures to establish how these aspects can be evidence and to provide clients with the support that they might need.

Appeal cases

The Athenaeum Club TC0833

As its name suggests, the taxpayer is a members' club. The club is VAT-registered.

In July 2009, the club received a bill from a VAT-registered company in respect of its water supplies. The bill was for £216,871 with no separate itemisation for VAT. As a result, the club's general manager contacted the local VAT office to ascertain how to deal with it. The VAT officer was unsure, stating it was a "grey area", and offered to investigate the point. In the meantime, the club was required to prepare a tax return and make a decision concerning the VAT reclaimable in respect of the water charges.

In an earlier year, the club had been told by HMRC told that VAT-registered businesses were generally required to charge VAT on their supplies; furthermore, another water company had told the club that standard rate VAT was chargeable on the supply of water to business customers. There was also a water services bill from a third water company in respect of water supplies to a company related to the club on which standard rate VAT had been charged.

Consequently, the club's general manager took the view that the £216,000-odd bill included VAT and she reclaimed 3/23 (that being when the standard rate of VAT was 15%) of the billed amount.

Subsequently, the HMRC officer responded to the club, advising it that the VAT reclaim had been excessive as the supply was in fact zero-rated. A month later, the officer notified the club that its error had been classed as "careless", thereby rendering the club liable to a penalty of between 15% and 30% of the £28,287 that it had overclaimed. In the event, the penalty was determined at 15%. That decision and the decision not to suspend the penalty were upheld on an internal review and, therefore, the club notified its appeal to the Tribunal.

The Tribunal allowed the appeal. Although it noted that the club could have made different enquiries (for example, calling the water supplier itself or the HMRC National Advice Service), the Tribunal concluded that it was not unreasonable for the club to telephone its own local VAT officer. Furthermore, the officer's own inability to advise straight off showed that the matter was not straightforward. In the circumstances, particularly in view of the other advice that the club had received, the Tribunal concluded that reasonable care had been taken and, therefore, the error had not been caused by carelessness. Consequently, the appeal was allowed.

Express Food Supplies TC00728

- p/e 4/09 – repayment return for £21,660.82 – totally out of trend with normal returns of business
- HMRC wrote asking if return was correct and asking for purchase invoices to support input tax claim
- Return had been completed by a temporary bookkeeper who had posted zero-rated purchase invoices in VAT column – correct repayment was £1,082.23 – taxpayer's accountant notified HMRC of correct figure
- HMRC assessed careless error penalty of 15% of potential lost revenue (i.e. £21661 - £1082 x 15%)
- 15% penalty is minimum penalty for a 'prompted disclosure' when an error(s) is careless – could be as high as 30%
- Client admitted he had been careless – repayment was five times more than his biggest ever VAT repayment so he should have been aware of potential for error, even though bookkeeper completed accounts and return

This is the first appeal based on a 'careless error' penalty as far as VAT is concerned since the regulations took effect on 1 April 2009. This was a pretty clearcut case – even though an independent third party completed the records for the period in question, the taxpayer should have known that the end result of her work was a totally inaccurate return. He should have asked more questions to establish why the return showed such a big repayment. As the old saying goes, if something appears too good to be true, it probably is!

GD & Mrs D Lewis T/A Russell Francis Interiors TC00983

The appellants were in the furniture business, but also held a small property portfolio. On 29 May 2009 they exchanged contracts on the purchase of a commercial property in respect of which they had opted to tax. The deposit of £25,000 plus VAT of £3,750 was paid on that date. The balance of the purchase price was £225,000 plus VAT of £33,750 which was paid on completion on 14 July 2009.

The appellants mistakenly believed that the effective date for the transaction was the date of exchange of contracts and therefore claimed the whole of the VAT back on the return for the period to 30 June 2009. On 7 August 2009, HMRC notified them that this return was subject to verification, and on 11 August 2009 the input tax reclaim was partially denied (in the amount of £33,750). On 18 December 2009 HMRC imposed a penalty for the inaccuracy of £5,062, being 15% of £33,750, which was subject to the maximum discount for prompted disclosure.

The appellants sought a review of this decision which was upheld on 29 March 2010.

This appeal sought additional material from both sides as it was an early appeal under the legislation, but the grounds of appeal were that HMRC should apply special circumstances to reduce the penalty, which resulted from a simple misunderstanding of the taxpoint rules and would have resulted in no loss of tax to HMRC. They accepted that they were careless, but considered that the penalty was excessive and should be reduced. HMRC challenged that there was no loss of tax (stating that the VAT may have been claimed again on the next return).

The Tribunal accepted that special circumstances should apply to reduce the penalty, and thus reduced it to £2,531, being 7.5% of the potential lost revenue.

However, it is clear that the Tribunal misdirected themselves, as the definition of potential lost revenue in FA 2007 Sch 24 para 8 states the following:

Potential lost revenue: delayed tax

8 (1) Where an inaccuracy resulted in an amount of tax being declared later than it should have been ("the delayed tax"), the potential lost revenue is:

(a) 5% of the delayed tax for each year of the delay, or
(b) A percentage of the delayed tax for each separate period of delay of less than a year, equating to 5% a year.

So in this case, the potential lost revenue to which the penalty of 15% should have been applied was:

£33,750 x 5% x ¼ = £421.88, bringing the penalty to £63.28

Revenue & Customs Brief 15/11 - 6 April 2011

HMRC issued R & C Brief 15/11 on 6 April 2011 to announce a change in the interpretation of the way self-correcting errors are interpreted for penalty purposes.

Under the 2007 Finance Act, new penalties were introduced for inaccuracies on returns or other documents. Under these penalties, if a return contains an inaccuracy that relates to a timing error which is automatically reversed in a subsequent tax period, the penalty is not calculated on the full amount of tax underpaid in the first period, but on a reduced amount to take account of the timing error.

For example, if someone reclaims £100,000 VAT on a purchase in period 1 when it should have been reclaimed in period 2, they claim £100,000 too much in the first period but £100,000 too little in the second. Any penalty for the overclaim in period 1 is not calculated on the £100,000 but on a reduced amount to take account of the automatic reversal of the inaccuracy in period 2.

HMRC's Current position

HMRC's approach to date has been that in order for the penalty to be calculated in this way, the customer had to have submitted both the return containing the initial inaccuracy, and the one containing the automatic reversal of the inaccuracy in a later period. This means that in some cases HMRC has charged a penalty on the full amount because they acted to correct the inaccuracy on the first return before the second return could be submitted, thereby preventing the inaccuracy from being reversed.

Revised position

HMRC is changing its approach for cases where HMRC intervened to correct the inaccuracy before the second return was received, preventing the inaccuracy from being reversed. When HMRC are satisfied that, but for their intervention, the inaccuracy would have been automatically corrected in a subsequent return, customers will receive the reduced penalty based on the rules for delayed tax. HMRC will shortly update our guidance to reflect this.

What you should do

If you have been charged a penalty for an inaccuracy on a return and you believe that, had HMRC not intervened before a subsequent return could be submitted, the inaccuracy would have been automatically reversed in a subsequent period, you should contact HMRC to request that the penalty is reviewed, mentioning the Brief in your request.

This only applies to timing inaccuracies, those that are automatically reversed in a subsequent period after they are made without you having to do anything more. It does not apply to the VAT Error Correction procedure nor to compensating but unrelated inaccuracies.

Contributed by Rebecca Benneyworth

BUSINESS TAXES

Planning for the reduction in AIA (Lecture B686 – 20.43 minutes)

From April 2012, the Annual Investment Allowance (AIA), which gives 100% relief upfront for qualifying plant and machinery, reduces from £100,000 to £25,000 p.a.

This article looks at the timing issues associated with maximising claims for the AIA over this transitional period. All references are to the Capital Allowances Act 2001 unless otherwise stated and, in the numerical examples, all amounts are VAT-exclusive.

Reduction in AIA

For companies, the old limit of £100,000 applies for expenditure up until 31 March 2012. For unincorporated businesses and LLPs, it applies up until 5 April 2012. The way in which the limit operates for accounting periods straddling these dates is demonstrated by Adkins Ltd.

Adkins Ltd has an April year-end. For y/e 30 April 2012 the maximum AIA that can be claimed is:

	£
1 May 2011 – 31 March 2012	
(336 days/366) x £100,000	91,803
1 April 2012 – 30 April 2012	
(30 days/366) x £25,000	2,049
	£93,852

This is all very logical. However, FA 2011 s 11(7) limits the amount of allowance for the period after the change of rate to the amount calculated for that part of the accounting period. For Adkins Ltd, it means that if it were to spend, for example, £92,000 on plant in the accounting period and all the expenditure took place in, say, February, it would all be relieved at 100% (as it would be within the £93,852 limit for the accounting period). However, if all the expenditure took place in April 2012, only £2,049 of it would qualify for AIA, the balance going into the general or special rate pool, as appropriate.

Businesses will often tend to buy plant and machinery shortly before the end of an accounting period, to make sure that allowances can first be claimed in that period rather than the next. As Adkins Ltd shows, it may be appropriate in many cases to advance expenditure to an earlier date than normal over the coming months.

Delaying expenditure

Depending on circumstances, delaying expenditure may also be beneficial. This is demonstrated by Adam Lambert.

Adam Lambert is a self-employed builder with a June year-end. His taxable profits (before capital allowances) are typically £70,000 p.a. On the advice of his accountant, he normally buys any plant and machinery he needs in May or June each year. In 2012, he will buy a van for £20,000 and some items of machinery for a total of £5,500. He had no expenditure on plant in 2011 and does not expect to have any in 2013.

Adam may be expecting to get his normal 100% allowance on the plant and van if he buys them in, say, May 2012, but he will of course be disappointed! His maximum AIA for the y/e June 2012 will be £82,377, calculated as follows:

1 July 2011 – 5 April 2012	
(280 days/366) x £100,000	76,503
6 April 2012 – 30 June 2012	
(86 days/366) x £25,000	5,874
	82,377

However, his available allowance for expenditure post 5 April 2012 is only £5,874. Thus the total capital allowances he will receive on his expenditure of £25,500 in May 2012 will be:

y/e 30.6.12
(100% of £5,874) + (19.53%* of 19,626) = £9,707, giving a tax and Class 4 NI saving @ 42% of **£4,077**

* This is the hybrid rate of WDA that will apply for this accounting period, as the annual WDA on the general pool reduces from 20% to 18% in April 2012.

y/e 30.6.13
WDA @ 18% on (19,626 – 3,833) = £2,843, giving a saving of **£1,194.**

The total tax and Class 4 NI saving over the two tax years (2012/13 and 2013/14) is therefore **£5,271**.

If Adam has either missed the 5 April 2012 cut-off, or cannot fund his expenditure until after that date, the above tax position can be significantly improved by his buying the plant in, say, May, but delaying the purchase of the van until July, when he will be in a new accounting period with a full AIA of £25,000 available. His total expenditure will therefore be eligible for AIA, £5,500 of it in y/e 30.6.12 and £20,000 in y/e 20.6.13. The tax and Class 4NI savings @ 42% in the respective tax years will therefore be **£2,310** and £**8,400**, i.e. £**10,710** in total.

Although he will be paying an extra £1,767 of tax and NI for 2012/13, the fact that his tax and NI is likely to be much lower the next year could lead to a reduction in payments on account for 2013/14.

Advancing' expenditure

As Adkins Ltd showed, many businesses will want to incur capital expenditure on plant at an earlier date than normal. In current economic conditions, with many smaller businesses already struggling to manage their cash flow, what can a business do to get relief early without having to stump up lots of cash early? To plan properly, we need to know what the legislation says about the date on which expenditure takes place for capital allowance purposes.

s 5 covers the general rule, namely that expenditure is incurred on the date on which the obligation to pay becomes unconditional. A business buying goods is legally required to pay for them on delivery, unless there are special payment terms in the contract. Thus if the buyer is legally required to pay on delivery, the obligation to pay becomes unconditional when the goods are delivered. This will therefore be the date on which capital allowances can be claimed in most cases.

Note that the date on which the obligation to pay for an asset becomes unconditional and the date on which the purchaser is legally required to pay for that asset are not necessarily the same. For example, the sales agreement may require payment to be made within two weeks of delivery. If so the obligation to pay becomes unconditional on delivery, but the purchaser is not legally required to pay until two weeks after delivery.

Deferred payment

Some clients may consider arranging terms with a friendly supplier, whereby they have plant delivered in, say, March 2012, but pay for it much later. This will not necessarily work in terms of advancing the

expenditure for AIA purposes, as there is an exception to the general rule in s.5. If there is a gap of more than four months between the dates on which the obligation to pay becomes unconditional and the date on which payment is required to be made, the expenditure is not incurred until the date on which payment is required to be made (s 5(5)).

Therefore if a company with a year-end 31 March 2012 has plant delivered on, say, 20 March 2012, paying a deposit of £15,000 two weeks earlier and the balance of £50,000 on 15 September 2012, only the initial payment of £15,000 in March would be eligible for AIA in y/e 31 March 2012. However, if the balance was instead paid before 20 July 2012, all the expenditure would qualify in y/e 31 March 2012.

Hire purchase contracts

These are covered by separate rules. Under s 67, expenditure still to be incurred under a hire purchase contract at <u>the time the asset is brought into use</u> is treated as incurred on the date on which the asset is brought into use. This means that such a contract may be the easiest way of bringing forward the date on which qualifying expenditure is incurred. This is demonstrated in Cork Ltd**.**

Cork Ltd has a July year-end. It purchases plant under a hire purchase agreement, as follows:

- 1 March Deposit paid £5,000
- 12 March Delivery of plant
- 19 March Plant brought into use
- 31 March First of 24 monthly payments of £600

The total capital payments under the contract are £17,480, with interest to be charged of £1,920.

The 24 monthly capital payments are deemed to have been incurred when the plant is brought into use (19 March), so the total of £17,480 falls in the period before 1 April 2012.

Cork Ltd's maximum AIA for the accounting period is ((244 days/366) x £100,000) + ((122 days/366) x £25,000). = £75,000, but only £8,333 would be available for the period April to July. By buying under a hire purchase contract, the full capital cost will qualify for AIA in y/e 31 July 2012, even though most of the capital cost is not actually paid until after this period.

What exactly is a hire purchase contract?

This can be quite a difficult thing to ascertain in practice, as different suppliers may use virtually identical terminology to describe different types of contract. Under hire purchase agreements, the purchaser is not legally the owner of the property until the final payment has been paid, but assuming this is done, he will become the owner. Another name for such a contract is a **lease purchase** contract. In contrast, an ordinary leasing arrangement will not effect a transfer of legal ownership at any stage.

Two characteristics that help to distinguish hire purchase contracts from other leasing arrangements are:

- The payments should be referred to as 'instalments' rather than rentals; and
- The payments should exclude VAT, whereas rentals under a lease have VAT added to them.

Treatment of 'fixtures'

The special capital allowances treatment of hire purchase contracts does not apply for 'fixtures' (s 69). Instead, they are governed by the general rule, whereby payments due more than 4 months after the obligation to pay becomes unconditional are treated as incurred when paid.

As explained in HMRC's *Capital Allowances Manual* at CA26025, a chattel, such as a radiator, may become a fixture once it is fixed to a building or land. In determining whether an asset is a fixture or a chattel, one must consider both:

- the method and degree of annexation; and
- the object and purpose of annexation.

If the asset cannot be removed without serious damage to the building or land, that is strong evidence that it is a fixture, but the second test is usually given greater significance by the courts. Where the asset is intended to be permanent and produce a lasting improvement to the property, it is a fixture. If the attachment is temporary and is no more than is necessary for the asset to be used and enjoyed, the asset remains a chattel.

Plant and machinery that is a 'fixture' in a building, such as a water heating system or a lift, comes within the definition of 'features integral to a building' for capital allowance purposes. This category, introduced during the reform of capital allowances in FA 2008, places the asset in the special rate pool, where the WDAs are reducing in April 2012 from 10% to 8% p.a. Where possible, it is particularly advantageous if such expenditure can be allocated against the AIA and a 100% write-off in the year of acquisition obtained.

Thus, in *Cork Ltd,* if the asset being purchased were in fact a lift, all the capital expenditure would not be recognised as incurred before 1 April 2012 and the AIA claim for y/e 31 July 2012 would be much smaller.

Leasing assets

A further way of improving the tax position on plant and machinery may be to lease the asset rather than to buy it (either outright or on hire purchase). For finance leases, relief is given for depreciation and interest costs. Depreciation is usually on a straight line basis and will outstrip the new rate of WDA in most cases as a result. Relief for operating leases will be given for the amount charged in the profit and loss account, which is often equal to the rentals paid in the period.

Short-life asset elections

Despite the opportunities I have outlined above for maximising AIA on forthcoming expenditure, clearly many businesses are going to find themselves with up to £75,000 p.a. of plant expenditure that, going forward, will not qualify for 100% allowance in the year it is incurred (as it would have done previously). An important change in FA 2011 s 12 will provide some comfort for such businesses, as the life of a short-life asset has been extended to 8 years from the end of the chargeable accounting period of acquisition, rather than the 4 years that have been in the legislation since it was first introduced in FA 1988. This applies for expenditure from April 2012 and means that the vast majority of expenditure that would normally go in the general pool will therefore qualify for the election. (Note that, unlike the AIA, the election does not apply to special rate pool expenditure, but like the AIA, most cars are excluded from qualifying for de-pooling.)

If an election is made to de-pool such an asset, it is put in its own 'individual pool' rather than the general pool. Assuming that the sale proceeds are less than its tax written down value (TWDV), this will trigger a balancing allowance in the year of sale, rather than the remainder of the TWDV being written off slowly over time.

© Reed Elsevier (UK) Limited

The election has to be made within 2 years of the end of the corporation tax period of acquisition or, for unincorporated businesses and LLPs, by the anniversary of the final filing date for self-assessment. If it is justifiable, plant for which one would wish to make the election should be depreciated over a period of no more than 8 years in the accounts.

Conclusion

As has been shown, the next few months will give great opportunities for capital allowances planning for any small or medium-sized business. Where the accounting period straddles the date of change, this will be the case even if the expenditure on plant and machinery is less than the new £25,000 annual limit for the AIA.

If the finance costs are reasonable, greater use of hire purchase contracts may prove useful, except for expenditure on fixtures. Other forms of deferred payment running beyond four months after the date the asset is brought into use will not prove effective. Leasing assets rather than purchasing them is another strategy that may improve the tax position in many circumstances.

Finally, where AIA is not available, the wider availability of short-life asset elections will, for most general pool expenditure, at least mean than full tax relief for the economic cost of the asset will be received over the period of ownership.

From an article by Kevin Read, writing in Taxation magazine.

Overseas partnerships **(Lecture B687 – 9.36 minutes)**

The residence of a partnership is not generally an issue for tax purposes. UK partnerships are not themselves liable to tax – the liability to tax is that of the partners and it is the residence of the partners which is the important factor. It was for this reason that, in 2006, HMRC discontinued their practice of issuing certificates of residence for partnerships.

What can be critical for UK tax purposes is where the business of the partnership is carried on. By virtue of S857 ITTOIA 2005, where a partnership carries on a trade wholly or partly outside the UK and the control and management of the trade is abroad, any non-UK income of the firm may be taxed on the remittance basis in respect of the share of any partner who is not domiciled in the UK.

The recent case of *Mark Higgins Rallying v HMRC (2011)* analysed the requirements for this test. The facts were as follows. Mr Dixon and Mr Higgins were partners in a motor rallying partnership. Mr Dixon, who had been a successful rally driver in his youth, was Mr Higgins' mentor. Mr Dixon was also a solicitor – he therefore provided guidance on contractual and legal matters affecting the partnership as well as introducing connections in the rally world for the purpose of obtaining contracts. Mr Dixon was both resident and domiciled in the Isle of Man, whereas Mr Higgins, although also domiciled in the Isle of Man, was resident in the UK. If, as the partners claimed, the partnership was controlled from abroad, any non-UK income of the partnership was taxable on the remittance basis. HMRC disagreed with this contention.

The conclusion of the First-Tier Tribunal was that the appropriate tests for the location of control and management of a partnership should be the same as those which apply to companies. This means that all the issues examined in the cases of:

(i) *Untelrab Ltd v McGregor (1996)*;

(ii) *Wood v Holden (2006)*; and

(iii) *Laerstate BV v HMRC (2009)*

are relevant here. The place where the partners meet or sign documents is important (but not conclusive). It is where the real management at the highest level takes place which is the key determinant.

The First-Tier Tribunal concluded that the high-level decisions of the partnership were made outside the UK, because 'those were determined by the views of Mr Dixon as the commercial brains of the partnership'. Mr Dixon was making these decisions in the Isle of Man where he was based. The control and management of the partnership was therefore situated outside the UK and so the partners' appeal was allowed.

Contributed by Robert Jamieson

Warehouse owned by distribution company: whether goods subjected to any process

A company (F) purchased large quantities of electronic components, which it sold to customers in smaller quantities. It claimed industrial buildings allowances on the warehouse where the components were kept.

In the relevant period the Appellant was one of the largest and most profitable of the companies in the Premier Farnell group. It purchased products, mainly electronic components, in large quantities and dealt with them, in the Building, in a sophisticated way, designed to enable the Appellant to sell products in small quantities to its customers and to fill orders from customers within a very short turnaround period (usually delivery was the next day after the order was received). The operation at the Building was able to, and did, service very high volumes of sales to UK and European external customers, and also other group companies located around the world. The sales to other group companies were generally, if not always, made to enable those companies to meet orders placed with them by their customers, rather than to build up their stock.

HMRC rejected the claim on the basis that F was carrying on a trade of distribution so that the warehouse failed to qualify for allowances. F appealed, contending that it was subjecting the goods to a process.

Decision:

The First-tier Tribunal rejected this contention and dismissed the appeal. Judge Walters observed " the trade necessarily includes other important activities, among them the activities of deciding which and what quantities of products to stock, reviewing the lines of products stocked, deciding on selling prices, organising the important IT system, determining selling prices, and running the call centre to deal with customers' queries. All of these operations and activities are encompassed in 'purchase and sale of goods by distribution', which is a convenient description of what the Appellant's trade consists in. However what is determinative of this appeal is our decision that the Appellant's trade does not consist in the subjection of goods to a process, even on the assumption that such is an apt description of the operations undertaken in the Building"

Comments - CAA 2001 s 274 provided that 'a trade consisting of storing goods or materials … which are to be subjected, in the course of a trade, to a process' was a qualifying trade for the purposes of industrial buildings allowances. The First-tier Tribunal upheld HMRC's view that the company was not subjecting the goods in question to a process, so that its warehouse failed to qualify for such allowances.

Farnell Electronic Components Ltd v HMRC TC01440

Discrimination or not?

FCE Bank and Ford Motor Company Ltd (FMCL) were UK-resident companies owned by the US-resident company, Ford Motor Company (FMC).

FCE claimed loss relief in respect of trading losses made by FMCL. HMRC refused the claim on the ground that the owner of both busineses was US resident; FCE and FMCL otherwise satisfied the requirements for group relief.

FCE's appeal was allowed by the First-tier Tribunal; HMRC appealed.

FCE and FMCL’s argument centred on the point that group relief would have been allowed had FMC been UK resident.

They believed the effect of the non-discrimination article in the 1975 UK/US double taxation agreement was that group relief was available between two UK-resident, directly-held 75% subsidiaries of a US parent company in circumstances in which it would be available if the parent company was UK resident.

Otherwise, the legislation was discriminatory because it was only the foreign control element that caused the companies' claim to fail.

Decision:

HMRC relied on the decision in *Boake Allen Ltd v CRC* [2007] STC 1265, but Mr Justice Henderson said the case had no relevance to the FCE appeal because the group relief claim affected only the UK subsidiaries and had no impact on the American parent.

The judge felt the Revenue's single argument for refusing relief was the parent company's residence in the US.

The department could produce no ‘positive case to explain why… group relief was confined to UK-parented groups’.

HMRC’s appeal was dismissed.

Comments - A UK resident company was entitled to claim group relief in respect of losses incurred by a sister UK resident company, despite the fact that both companies were owned by a common US parent. This case demonstrates some of the crucial issues when examining whether losses can be claimed under group relief where the relationship is other than UK company to UK company connected by third UK company

CRC v FCE Bank plc, Upper Tribunal (Tax and Chancery Chamber)

Sale and leaseback of films: whether trading

The partners in two partnerships, Samarkand and Proteus, claimed the benefit of loss relief in respect of tax losses they say arose from (1) expenditure on the acquisition of films, and (2) certain other costs, incurred by their respective partnerships.

Samarkand acquired interests in the films The Queen and Irina Palm in 2006/7 and Proteus acquired an interest in Oliver Twist in 2005/6. In each case the films were acquired as part of a single transaction which encompassed their acquisition and their associated lease back in return for fixed, increasing, secured and guaranteed rental payments for a 15 year period.

The availability of relief for the losses of a partnership, and the allowability of deductions in computing partnership income for expenditure on films are dependent upon the satisfaction of a number of statutory conditions. HMRC say that many of those conditions were not satisfied and that consequently the partners were not entitled to the benefit of loss relief or that it should be limited.

Decision:

The First-tier Tribunal reviewed the evidence in detail and dismissed the appeals, declining to follow the CA decision in Micro Fusion 2004-1 Llp v HMRC on the grounds that the legislation at issue in that case had specifically referred to a 'trade or business', rather than simply to a trade. Judge Hellier held that the partnerships were not trading, and that 'the partners were not entitled to sideways loss relief because the businesses of the partnerships were not carried on on a commercial basis with a view of profit'.

Comments - The First-tier Tribunal specifically declined to follow the CA decision in Micro Fusion 2004-1 Llp, since that case related to earlier legislation which referred to a 'trade or business', which is a wider concept than a 'trade'. The tribunal upheld HMRC's view that the partnerships were not trading and the partners were not entitled to sideways loss relief.

Samarkand Film Partnership No 3 v HMRC (and related appeals) TC 01453

Taxability of refundable deposits

The appellant company (Total) were suppliers of liquefied petroleum gas to customers in Mauritius. All customers were required to pay to Total deposits in respect of the bottles or containers in which their gas was stored. An issue arose as to the impact that the receipt of those deposits had on Total's liability to pay value added tax (VAT) and income tax. Total contended that they gave rise to no liability at all. The respondent (the Revenue) contended that they gave rise to a liability to both types of tax.

The relevant law is:

> Section 10(2) of the Income Tax Act 1995, so far as material, provides: 'any sum or benefit, in money or money's worth, derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit…'
>
> Section 4(1) of the Income Tax Act 1995 required tax to be paid on income derived during the relevant year. Section 10(2) (a) of the Act defined gross income as being: 'any sum or benefit, in money or money's worth, derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit…'.

The Assessment Review Committee (ARC) found that the provision of cylinders did not constitute a supply of services and that the deposits paid in relation the cylinders were not charges for their supply, therefore no VAT was payable. The ARC further found that the deposits were not trading receipts and that they were not liable to pay income tax. The Supreme Court allowed the Revenue's appeal, holding that the deposits had been mixed with Total's other funds and used as working capital and thus were chargeable for VAT and constituted trading receipts on which income tax fell to be paid. Total appealed to the Privy Council.

The issue for consideration was whether Total was liable to pay VAT and income tax on the deposits in respect of the bottles or containers in which their gas was stored.

Decision:

It was settled law that sums received from, or for the benefit of, a customer that were to be held and ultimately paid to the customer without reduction fell to be treated as if they belonged to the customer and were not trading receipts.

In this case, the Supreme Court had erred in holding that the deposits were subject to income tax as trading receipts and in holding that they were chargeable to VAT. The deposits held by Total properly constituted

security deposits. They were not consideration for the supply of goods or of services and were not chargeable for VAT. Every new deposit had been received from the outset on the basis that it was refundable, as and when the customer returned, and did not replace, the bottles or containers used to hold gas. There was no identifiable point at which the legal nature of any particular receipt might be said to have changed to convert it into a trading profit. The Revenue had failed to show that the principles of commercial accounting that had been adopted in Total's annual audited accounts did not correspond with the International Accounting Standards.

The appeal would be allowed.

Comments - In the 1962 case of Elson v Prices Tailors Ltd, it was held that unclaimed deposits paid for goods which had never been collected, were trading receipts. However, the facts were somewhat different: in the present case the evidence suggested that the deposits would ultimately be returned to the customer (if and when the customer ceased to require the use of the metal bottle to which the deposit related). Therefore the Privy Council held that the deposits remained the property of the customers, and were not trading receipts of the company. It is worth comparing the decision in Gower Chemicals Ltd v HMRC. In that case Gower had included deposits in its profit and loss account and then made an 'error or mistake' claim to reverse the treatment. The Special Commissioners decided that the deposits should be treated as 100% trading income with a provision.

Total Mauritius Ltd v Mauritius Revenue Authority [2011] UKPC 40

Employment v Self-employment

The company (W) marketed a 'weight loss' programme. Customers were asked to attend weekly meetings, where they were weighed. W paid women to lead these meetings but failed to account for PAYE or NIC on the amounts it paid to the women to do so. HMRC issued determinations under Income Tax (PAYE) Regulations 2003, SI 2003/2682, reg 80 for 2001/02 to 2006/07 inclusive. W appealed, contending that the women should be treated as self-employed (and that two of the determinations were invalid). The First-tier Tribunal reviewed the evidence in detail, rejected these contentions and dismissed the appeal, holding that the determinations were valid and that the women were employees of W.

Decision:

The Upper Tribunal upheld this decision.

Comments - The Upper Tribunal upheld HMRC's view that the women who worked for the company were employees. This decision was expected as it is in line with the FTT decision and one of the important cases in the Privy Council dealing with employment v self employment – Narich Property Ltd - which examined the Australian branch of Weight Watchers.

Weight Watchers (UK) Ltd v HMRC (and related appeals) (Upper Tribunal)

Sole trader: costs of defending manslaughter charge

Mr Duckmanton is the owner of a business known as "Car Trans". His self-assessment tax returns describe the business as being "car transporter, maintenance and haulage" or "car transportation". Mr Duckmanton held a standard international operators licence and one aspect of the business was transporting vehicles from Solihull to the docks at Southampton. For regulatory purposes Mr Duckmanton was the nominated transport manager as well as being a mechanic in his own maintenance workshop along with the foreman Mr Gleadall.

On 17 September 2002 there was a minor accident in Southampton when a vehicle operated by Mr Duckmanton's driver, Mr Roberts, struck the back of a car at a traffic- light controlled pedestrian crossing, causing damage to the value of £1,000. Two days later on 19 September 2002 in exactly the same location the same driver, Mr Roberts, was involved in another accident, unfortunately this time causing the death of a pedestrian. Mr Roberts blamed the accident on the vehicle saying it had 'faulty brakes'. He said that his vehicle 'would not stop' and, in attempting to avoid a collision with vehicles, mounted the kerb, hitting the pedestrian. Mr Roberts subsequently retracted this statement and admitted to driver error. Subsequent brake tests for the Police accident report however showed that the vehicle's brakes were out of adjustment.

Mr Duckmanton and Mr Gleadall admitted that a number of vehicle maintenance records had been falsified to cover up the workshop's increasing difficulty in keeping up with the mandatory scheduled preventative maintenance programme for the business' vehicles. In particular, records relating to two inspections scheduled for August 2002 had been subsequently falsified to hide the fact that the accident vehicle had missed its scheduled mandatory inspection.

He was subsequently convicted of attempting to pervert the course of justice, but was acquitted of manslaughter. Self-assessment tax returns were submitted on behalf of Mr Duckmanton for the year 2003-04 which included a claim for legal expenses incurred by him in defending the charge of Gross Negligence Manslaughter and pleading guilty to the two charges of Attempting to Pervert the Course of Justice. HMRC opened an aspect enquiry into the returns in particular for the purpose of examining the legal fees claimed which amounted to £74,919 (subsequently reduced by agreement to £48,752). HMRC then extended their enquiry to Mr Duckmanton's 2005 and 2006 returns, again with particular regard to legal fees claimed amounting respectively (again subsequently reduced by agreement) to £55,929 and £163,991. Following an extensive exchange of correspondence between HMRC and Mr Duckmanton's tax advisers, closure notices were issued on 20 August 2009 for each of the years 2003-04 to 2005-06 inclusive stating that the legal expenses claimed were not allowable. The closure notices were appealed on 31 October 2009.

Mr Duckmanton's contentions are that his sole purpose in defending the charge of Gross Negligence Manslaughter was to enable him to retain his "operators licence". Without this licence he says that he would have been unable to trade as a car transporter operator and would thus have had to cease trading. HMRC contend that the legal fees were incurred in defending criminal charges and that accordingly they cannot be said to have been incurred during the pursuit of a trade.

Decision:

The First-tier Tribunal dismissed his appeal, holding that the expenses were not wholly and exclusively incurred for the purposes of D's trade. Judge Connell held that 'if the sole purpose of the taxpayer in incurring expenditure is business preservation, the expenditure should not be disallowed simply because the purpose of the expenditure necessarily involved some other result. If however, as in this case, legal fees are incurred with the object of firstly defending criminal charges, secondly preserving a business reputation and thirdly avoiding the possibility of a substantial damages claim, then the requirements of the legislation are clearly not satisfied.' On the evidence, D's 'main purpose in incurring significant expenditure on legal and other professional fees was to defend the manslaughter charge for the purpose of protecting his liberty and personal reputation'.

Comments - The Tribunal upheld HMRC's view that the costs of defending a manslaughter charge were not wholly and exclusively for the purpose of the accused person's business.

P Duckmanton v HMRC TC01506

Close company - assessments on undeclared profits

HMRC formed the opinion that a close company (P) had underdeclared its profits. They issued discovery assessments, and also issued assessments under what is now CTA 2010 s 455 (previously s.419 TA 1988), on the basis that the underdeclared takings had been loaned or advanced to P's controlling director.

Decision:

The First-tier Tribunal reviewed the evidence in detail and upheld the assessments in principle, while reducing the amounts. Judge Barton found that the director's evidence was 'less than credible'.

Comments - CTA 2010 s 455 provides for a charge to tax 'if a close company makes a loan or advances money to a relevant person who is a participator in the company or an associate of such a participator'. This provision is not restricted to cases where the loan or advance is recorded in the company accounts: it can also apply where there have been underdeclarations of takings which have not been retained in the company but have found their way into the pocket of a director or other participator. The First-tier Tribunal upheld assessments which HMRC had issued on the basis that this had happened here.

Powerlaunch Ltd v HMRC TC01426

Concession on a concession – ESC C16 continues **(Lecture B688 – 8.27 minutes)**

The rules around Extra Statutory Concession (ESC) C16 have changed. Previously, if a company was struck off under ESC C16, company law prevented the distribution of undistributable reserves in the course of a winding up unless the company was being formally liquidated. Therefore the Treasury Solicitor could have claimed any distribution of the share capital account and share premium account as unlawfully distributed and made a claim for *bona vacantia* (basically leading to the assets passing to the Crown). By concession, the Treasury Solicitor had stated that it would not make such a claim where the assets distributed were not more than £4,000. At the time this caused somewhat of a stir.

However, with effect from 1 October 2008, an alternative to using the striking off procedure was introduced in the form of s641(1)(a), Companies Act (CA) 2006. This requires a special resolution to be passed and a solvency declaration to be made by the directors prior to a reduction in share capital. This will automatically be treated as a capital distribution under s122, Taxation of Chargeable Gains Act (TCGA) 1992 without falling into the trap (however unwittingly) of illegally distributing undistributable reserves under ESC C16.

The Treasury Solicitor has now made the decision to remove its ESC C16 de minimis concession on the basis that the changes in CA 2006 make it easier to reduce a company's share capital. Consequently, the Treasury Solicitor's concession is now considered to be less relevant. The full links to this change on the Treasury Solicitor's website at http://www.tsol.gov.uk.

Of course while this may have changed, HMRC's ESC C16 is completely separate and assurances will still need to be given to HMRC, as detailed in ESC C16, in order for distributions to be treated as capital. In brief these assurances are:

- that the company has ceased trading
- that the company will collect its debts, pay off its creditors and distribute its remaining assets to its shareholders
- that it will thereafter seek striking off and dissolution
- that the shareholders agree to pay any tax liabilities arising on the concessionary basis.

Also on-going is HMRC's consultation as to whether ESC C16 should be removed and replaced with a statutory provision. This is part of the on-going process to review all concessions and either turn them into

legislation or remove them entirely. This was as a result of a case called *Wilkinson* which HMRC believe has made it impossible for it to use the concessionary approach in the long term.

Further developments

The Bona Vacantia Division of the Treasury Solicitor's Department have with effect from 14th October 2011 withdrawn in full guidelines BVC17 ('Guidelines') and its concession from the Bona Vacantia website. A list of frequently asked questions has been compiled to help you understand the reasons behind this decision.

Note: These FAQs only relate to the Treasury Solicitor's position in respect of share capital distributions. They should not be taken as endorsing any particular course of action in winding up a company and dealing with its share capital or as providing legal advice. You should take your own independent professional advice.

1. Why remove the guidelines BVC17 ?

In the light of recent changes in the law following the introduction of the Companies Act 2006, it is now easier to reduce share capital and to restore a company to the register. In the light of this, the Treasury Solicitor Department's concession ('TSC') in this area is less relevant. Following a review the Bona Vacantia Division has therefore taken the decision to remove the Guidelines together with the TSC..

2. Do I need to contact TSol about a proposed share capital distribution of any amount?

No. There is no need to contact the Bona Vacantia Division regarding distributions of any amount made prior to dissolution as we will not attempt to recover them.

3. Does this mean that there is no Bona vacantia interest?

No. The right to recall unauthorised share capital distributions that the company had prior to dissolution would still vest in the Crown. However, the Treasury Solicitor will not now attempt to recover any distributions made prior to dissolution.

4. Does the removal of the TSC mean intervention is now more likely even for distributions less than £4000?

No. The Treasury Solicitor will not attempt to recover any unauthorised distributions of share capital of any amount made prior to dissolution.

5. What happens if the company has been dissolved prior to making any distribution?

Before a company is dissolved, members should ensure that assets owned by the company are dealt with and transferred out of the company's ownership. If this is not done, you cannot make any distributions or deal with any of the company assets after dissolution. Assets owned by the company immediately at dissolution will pass into the ownership of the Crown as bona vacantia. You cannot, therefore, make any distributions or deal with any of the company assets if the company has been dissolved.

6. What effect does this have on HMRC's ESC C16?

The TSC and HMRC's ESC C16 concession have always been completely separate. The TSC dealt with the potential bona vacantia interest in the former company's right to recall unauthorised share capital distributions. HMRC's ESC C16 concession relates to the tax treatment of distributions made in the course

of dissolving a company where there is no formal winding up. The removal of our guidelines and the TSC will have no effect on the ESC C16 or any other law or regulation on share capital distribution. You must seek your own professional advice as to the position.

7. I understand that the ESC C16 is to be removed and replaced with a statutory provision.

That is correct. In the recent decision of *R v HM Commissioners of Inland Revenue ex p Wilkinson* [2005] UKHL 30, the House of Lords' clarified the scope of HMRC's administrative discretion to make concessions that depart from the strict statutory position. In the light of that decision, HMRC is reviewing each of its published concessions. Where an existing concession exceeds the scope of that discretion, where it is appropriate to do so, its effect will be maintained by putting it onto a legislative basis.

Contributed in part by Francesca Lagerberg, Grant Thornton UK LLP

Allowable interest?

Mr Green and his wife Mitzi Anne Green owned land at Fryston Lane, Pontefract, West Yorkshire which accommodated a dilapidated and rundown caravan site. Mr and Mrs Green decided to clear the site and develop it for the rental and sale of retirement and mobile homes to be known as Oakland Hill Park Home Estate.

The company William Greens and Sons Limited (subsequently renamed Greens Park and Leisure Homes Limited) was formed by Mr and Mrs Green on 25 June 2002 for the purposes of undertaking the development of the site and future trading activities.

The development of the site and installation of its infrastructure, including utilities, roadways, drainage and bases for the new mobile homes, was estimated to cost approximately £1,000,000.

In June 2004 Lloyds TSB Bank Plc offered Mr and Mrs Green a personal overdraft facility of £1,045,000. The bank's offer of overdraft facilities included "any other account that may be opened as a replacement or substitution for it".

Mr and Mrs Green informed the bank that, at some stage, it was their intention to transfer the overdraft borrowings into the name of the company. This would have involved a transfer to the company of the development site by Mr and Mrs Green (failing which Mr and Mrs Green would have been in contravention of s 330 of the Companies Act 1985 in that the company would be borrowing to improve assets of a director of the company). In the interim the bank required a joint and several guarantee from Mr and Mrs Green, together with a debenture from the company and a chattel mortgage to allow the bank to lend against the value of the mobile homes. The bank already held a legal charge over a number of different freehold properties owned by Mr and Mrs Green personally, and the copy correspondence from Lloyds TSB Bank Plc produced to the Tribunal clearly indicates that Mr and Mrs Green preferred to retain the freehold ownership of the development site and the various other properties in their ownership which provided security for their existing borrowings with the bank.

The overdraft facility was therefore provided to Mr and Mrs Green personally rather than the company. Their intention was to provide the necessary funding for the company to develop the site and be reimbursed the interest they paid to the bank. Copy bank statements produced to the Tribunal showed that at the time the facility was made available in June 2004, Mr and Mrs Green's personal bank account (referred to as a 'corporate current account') was £963,858 overdrawn. It is not clear from the statements to what extent the overdraft may have been made up of the ongoing development costs of Oakland Hill Estate or personal expenditure by Mr and Mrs Green.

Decision:

At the time Mr and Mrs Green were offered overdraft facilities by Lloyds TSB Bank Plc there was clearly a substantial existing overdraft, part of which may or may not have related to the borrowings of the company. In any event, the borrowing was by way of overdraft in respect of which interest is specifically ineligible for relief under s 353(3). The fact that Mr and Mrs Green intended to transfer the borrowing to the company is not relevant. Plainly had Mr and Mrs Green set up the initial borrowing in the name of the company, relief would have been granted to the company in respect of interest payments on its borrowings. Whilst the Tribunal has sympathy for Mr and Mrs Green, its decision has to based on the facts as they existed and not on what they may or may not have intended. For these reasons therefore the appeal does not succeed and the assessments are confirmed

Comments – This case demonstrates the importance of getting the arrangements correct particularly where significant sums are involved – as the Tribunal stated its decision has to based on the facts as they existed and not on what they may or may not have intended.

William Green TC1502

Universal credit and the self-employed

The current Welfare Reform Bill paves the way for replacing a number of benefits and tax credits with universal credit. An article in January's *Tax Adviser* dealt with those aspects of the reforms most likely to be of interest to tax advisers, including the consequences for the self-employed business community.

To recap:

- Universal credit will be phased in between 2013 and 2018. From April 2014 no new claims for tax credits will be allowed. By 2018 it is intended that tax credits will be completely phased out and existing claimants will be migrated to universal credit.
- For most claimants there will be earnings disregards to protect earnings up to a certain level before benefit starts to be withdrawn. Above that level, universal credit will be withdrawn from earned income at a rate of 65p in every pound for non-taxpayers (76p in the pound for taxpayers and NI contributors because the 65% withdrawal rate will be applied to earnings net of tax and NI).
- The earnings disregards are broadly speaking more generous than in the current benefits system but less so than in tax credits.
- The chief beneficiaries of universal credit are likely to be low earners currently claiming a combination of benefits and tax credits which in aggregate produce a marginal deduction rate sometimes exceeding 80% or even 90%.
- Because the working hours rules in working tax credit (WTC) will no longer apply in universal credit, people who work for less than the prescribed hours for WTC (16 hours or 30 hours a week depending on their circumstances) will also benefit under universal credit.
- Taxpayers and NI contributors who claim tax credits but no other benefit are likely to be worse off under universal credit on the basis of current rates and thresholds, as they will move from a marginal deduction rate of 73% (tax at 20%, NI at 12% and tax credits withdrawal rate of 41p in the pound) to one of 76% on earned income. Benefit will be withdrawn pound for pound where unearned income exceeds certain limits.
- On current plans the self-employed are likely to be worse off under universal credit, partly because Department for Work and Pensions (DWP) rules take no account of trading losses or capital allowances in assessing self-employed earnings, and partly because of a proposal to impose on 'established' businesses a minimum income floor equal to the national minimum wage for reported hours worked.
- Universal credit will be assessed on a monthly basis, not by reference to the tax year as are tax credits. Thus there will be no 'protective claims' mechanism.

- In consequence, tax credit claimants are likely to be better off staying with tax credits for as long as possible, and those who become eligible for tax credits before April 2014 would be well advised to claim them before then, using protective claims where necessary.

The Commons debates on self-employment in universal credit

The Welfare Reform Bill has now completed its passage through the House of Commons and had its second reading in the House of Lords on 13 September. The CIOT Low Incomes Tax Reform Group (LITRG) provided both written and oral evidence to the Public Bill Committee in the Commons about our concerns regarding the self-employed. Separately we briefed the Opposition spokesman on welfare reform Stephen Timms MP (the last Financial Secretary to the Treasury under the Labour Government) at both Committee and Report stages.

In speaking to LITRG's briefings, Mr Timms pointed to the proposal for a minimum income floor and the flaws in the DWP measurement of income for self-employment. He emphasised how much worse off a low-earning self-employed person could be under universal credit than under WTC, using illustrative examples. He illustrated the problems of the minimum income floor for a business with fluctuating profits, or in temporary difficulties because of a bad debt, a succession of slow payers, or taking on a new employee, and tried to extract an assurance from the Minister that no earnings floor would be applied for the first few years of a business's life. He drew attention to the extra reporting burden that would result if a self-employed person had to work out their business results twice – once for HMRC and again for the DWP – using different rules, and to the inevitable temptation to under-declare working hours if the minimum income floor were based on reported hours worked.

In replying the Minister (Chris Grayling MP) indicated that the detail would be set by regulations and would aim to strike a balance between encouraging people into self-employment and discouraging them from relying on receiving maximum benefit even if they never made any profit.

He did not take on board the point Mr Timms made that the tax system already disallowed loss relief where a business was not being carried on commercially, or that tax credits could deem people still to possess income of which they had artificially divested themselves in order to maximise their claim.

Mr Timms asked for an exemption for business capital such as bank loans from the DWP 'tariff income' rules, under which claimants with savings or capital between a lower and an upper limit have their entitlement progressively reduced on a sliding scale and withdrawn completely if capital exceeds the upper limit.

The Minister's conclusion was more encouraging:

'I am happy to accept the right hon. Gentleman's input on this. The issues are complicated and there are not simple, straightforward answers. We must do the best we can to get the dividing line right, so that we encourage enterprise and protect the taxpayer. That is where our focus lies. We will continue discussions with external groups, such as the Low Incomes Tax Reform Group, and work closely with HMRC to use its experience in shaping this. The DWP and HMRC are working closely to develop universal credit in its entirety.'

But the fact remains that on current plans the new system is likely to be far less encouraging of self-employment than the current one. We shall take every opportunity of influencing the officials charged with drawing up the regulations (an initial meeting has already been fixed) and we are preparing a briefing for the House of Lords.

Summarised from an article in Tax Adviser by Robin Williamson

Independent study on General Anti-Avoidance Rule (GAAR) published

In December 2010 Graham Aaronson QC was commissioned by the Exchequer Secretary to lead a study into a General Anti-Avoidance Rule (GAAR). He has set out his recommendation to the Government for the introduction to the UK tax system of a narrowly focused General Anti-Abuse Rule.

The recommendation is published in the final report of Mr Aaronson's eleven month review of the feasibility for the UK tax system of a GAAR. With the advice of a committee of tax experts, he has concluded that introducing a narrowly-focused GAAR would:

- deter abusive tax avoidance schemes
- contribute to providing a more level playing field for business
- reduce legal uncertainty around tax avoidance schemes
- help build trust between taxpayers and HM Revenue & Customs (HMRC)
- offer opportunities to simplify the tax system

However, it warns against the introduction of a broad spectrum general anti-avoidance rule.

The report recommends that a GAAR should initially apply to the main direct taxes – Income Tax, Capital Gains Tax, Corporation Tax and Petroleum Revenue Tax, as well as National Insurance contributions. It sets out in detail how a GAAR could be introduced, and includes an illustrative draft rule. It also includes a summary of the views of representative bodies in the tax sector.

The Government will consider the report in detail and the extent to which the proposals could add to HMRC’s existing legislative and administrative approaches and further reduce levels of tax avoidance. The Government will discuss the implications of the proposed rule with business and tax practitioners and respond fully at Budget 2012, setting out its plans for further, formal public consultation, if appropriate.

Avoiding pitfalls on issuing shares to employees (Lecture B689 – 14.43 minutes)

Why issue shares to employees?

Issuing shares to employees has become an integral part of the process of rewarding employees, especially as this can be done without the company using cash resources to provide a valuable benefit to key employees.

Employees can be incentivised because they share in the future growth of the company.

There can be attractive tax benefits arising from issuing shares to employees, but it is important to ensure that these benefits are available. The payment of dividends can be tax efficient, and there should be no NIC charge. Shareholders can benefit from a low rate of CGT when the shares are sold so long as the requirements for entrepreneurs’ relief (ER) are met.

Methods of issuing shares to employees

Shares can be issued to employees using a number of methods, each of which has their own tax implications and pitfalls. These methods include:

- An outright transfer of shares for market value
- An outright transfer of shares for less than market value
- An outright transfer using a share incentive plan
- An issue by the company of partly paid shares
- A grant of options under an approved plan
- A grant of options under an unapproved plan

An outright transfer of shares at market value

An employee can acquire shares from another shareholder (including an acquisition from an employee trust), or by subscription from the company. In the first instance, the vendor will have a capital gains tax liability (where ER may be available). Non-resident shareholders may not have a liability in the UK but would have to consider the position in the country in which they are resident.

If the shares are issued as a subscription from the company, there are unlikely to be any tax implications for the company or for the other shareholders, although there is a reporting requirement on Form 42 that must not be overlooked.

As the employee is paying market value for the shares, there should be no income tax liability under employment related securities (ERS) legislation. However, there would be a stamp duty liability at ½% on an acquisition from another shareholder (but not on a subscription of shares). It should be noted, however, that the fiscal value for the shares cannot be agreed in advance of acquiring the shares.

If the individual borrows money to buy the shares loan interest relief should be available under s 392 ITA 2007, so long as the conditions in s 393 are met. The individual must either have at least 5% of the shares in the company or spend the greater part of his time in the actual management or conduct of the company (or an associated company).

An outright transfer of shares at less than market value

It should be borne in mind first of all that fiscal valuation is likely to be a lot less than a pro-rata valuation for the whole of the company because of the discount that would be applied to a minority interest.

Where an individual acquires shares at less than market value the tax position becomes more complex. An employee will be regarded as acquiring ERS unless the opportunity to acquire the shares arises from an individual and is made available "in the normal course of the domestic, family or personal relationships of that person" (s 421B ITEPA 2003). Gifts of shares between family members are not usually caught, but care should be exercised where the recipient is an employee of the company and other employees are given a right to acquire shares in the company on broadly similar terms at the same time.

If the shares are ERS an income tax liability will arise on the difference between the market value of the shares and the price paid for those shares.

Usually the company will get a corporation tax deduction subject to a number of conditions. A common pitfall is that corporation tax relief is not available where the company is under the control of another company that is not a non-close listed company. On the other hand, relief is not restricted to situations where shares are issued by the company to the employee.

There can be a PAYE and NIC liability on shares issued to employees at under value, where the shares are readily convertible assets (RCAs) (broadly where they can be converted to cash).

Where there is a PAYE liability the employee must make good that amount within 90 days, otherwise the PAYE will be treated as additional net pay.

Where the shares are not RCAs the company does not operate PAYE and there is no NIC liability. The employee reports the issue of shares on the employee shares pages of his own tax return.

Sale of employee shares

One aim of issuing shares to employees is to ensure that ER is available on a future sale of the shares. However, it can be difficult satisfying the personal company test (ie 5% shareholding) as employees are typically given very small shareholdings.

When an employee acquires shares there may be a difference between the restricted market value (RMV) and the unrestricted market value (UMV). Income tax may have been paid on the basis of the RMV when the shares were acquired, although it would have been possible to elect for the UMV to be used under s 431 ITEPA 2003. It is often good practice to make this election, but it should be borne in mind that the time limit is 14 days after the acquisition of shares.

This becomes relevant when the shares are sold, as the percentage difference between RMV and UMV on acquisition is applied to the sale proceeds, and that part of the proceeds will be subject to income tax rather than CGT. This applies also where the shares are exchanged for other shares, in which case the CGT element can be rolled into the new shares but the income tax element will give rise to an immediate charge to income tax.

Contributed by Paul Howard

VAT

Removal of LVCR from all goods imported in to the UK from the Channel Islands

From 1 April 2012, Low Value Consignment Relief (LVCR) will no longer apply to goods imported to the UK from the Channel Islands.

This ends the exploitation of LVCR which, in recent years, has been used on an increasingly large scale to sell low value goods to UK customers VAT-free, a purpose for which it was never intended. Most of this trade is from, or via, the Channel Islands. This reform will ensure that UK companies, especially small and medium sized enterprises, can compete on a level playing field with companies operating in the Channel Islands.

The Government's intention to take action to end the exploitation of LVCR was announced in Budget 2011 with the reduction in the threshold for LVCR, below which items are imported free of VAT, from £18 to £15. This new threshold came into effect on 1 November 2011 and will apply to goods from the Channel Islands until 1 April 2012. The removal of LVCR to all goods imported to the UK from the Channel Islands will have effect for purchases made on or after 1 April 2012.

Toolkits to help minimise common errors - update

HM Revenue & Customs has published an updated VAT Input Tax Toolkit effective from 1 June 2011. The update reflects a number of recent changes including the VAT treatment of assets used for business and non-business or private purposes and entertaining overseas customers.

Membership fees

A company (E) operated a chain of fitness clubs. It required new members to join for a minimum of twelve months. In some cases, members failed to make the agreed twelve payments. Such members were barred from using E's facilities within five days of failing to make an agreed payment, and E arranged for debt collection agencies to recover the outstanding amounts. Initially E accounted for VAT on these payments, on the basis that they were taxable consideration for supplies of membership services. Subsequently it submitted a repayment claim on the basis that, while it accepted that output tax was payable for the five-day period before access was barred, it should have treated the balance of the payments as non-taxable compensation for breach of contract. HMRC rejected the claim.

Decision:

The tribunal allowed E's appeal. Judge Khan held that the exclusion of a defaulting member from E's premises resulted in the cessation of E's supplies. Any subsequent payment did not relate directly to any supply of goods or services, and was outside the scope of VAT.

Comments – VAT is a tax on a supply of goods or services and ultimately in this case there were no supplies being made.

Esporta Ltd v HMRC TC01475

© Reed Elsevier (UK) Limited

Businesses are separate

The taxpayers, a married couple and their son, owned a farm with a farmhouse. Mrs F began running a bed and breakfast business in 1975 and was not involved in the farm. It operated independently from the farm and always traded below the VAT threshold. Mrs F had her own bank account and all the expenses of running the bed and breakfast business were funded by her, including the costs of cleaning, her accountant and advertising. Her husband and son had no involvement in the bed and breakfast business.

Following a VAT inspection, HMRC decided that there were sufficient financial, economic and organisational links between the farm business and the bed and breakfast business for them to be treated as one entity.

The taxpayers appealed.

Decision:

The First-tier Tribunal considered the evidence and found that the only factors in favour of the two businesses being treated as one were that the bed and breakfast business shared the use of the farmhouse and that there were no cross-charges for the use of the shared facilities or utilities. The judge noted that Mrs F had started the business for 'entirely legitimate' reasons and that she ran it herself separately from the farm. She met the direct costs of the business herself, and if she was not available, the business closed.

The tribunal concluded that HMRC 'could not have been reasonably satisfied that there was an artificial separation of the farming and bed and breakfast businesses' and that they were not closely linked either financially, economically or organisationally.

The taxpayers' appeal was allowed.

Comments - Separation of businesses can create VAT problems. The key challenge, said Neil Warren, independent VAT consultant, 'is to stand back and look at a proposed arrangement and ask whether it is a genuine split made for commercial reasons, or an attempt to avoid paying output tax on the income of one or both parts of the business, i.e. through trading below the VAT limits'. He warned that if an arrangement is flawed, 'HMRC could seek to treat it as a belated registration (and seek output tax arrears) rather than issue a direction from a current or future date'. It is therefore crucial to ensure that all transactions are properly dealt with on an arm's length basis, for example, recharging any shared overheads incurred by one of the parties.

A, D and J Forster TC1319

Proportionate penalty unfortunately

The taxpayer, a barrister, was one day late in submitting his VAT return and paying the tax for the January 2011 period.

He explained this was because he had been staying away from home, due to a work commitment, and was unable to use the HMRC online system because he did not have his username and password with him.

The Revenue issued a default surcharge in respect of the payment, based on 5% of the VAT due.

The taxpayer appealed. He claimed that, although he accepted the tax was paid late, the penalty was unreasonable. He cited the decision in *Enersys Holding UK Ltd (TC335),* in which the penalty was deemed to be excessive and discharged.

HMRC said they had previously issued two default surcharges, which had later been withdrawn; the taxpayer claimed he could not remember receiving them.

Decision:

The First-tier Tribunal said the taxpayer knew the deadline for submitting his VAT return and payment. It was his responsibility to ensure he met this date, even if he was away from home. He did not have a reasonable excuse for the delay.

As to the penalty, the tribunal did not consider it to be disproportionate, even though the tax was only one day late.

The taxpayer's appeal was dismissed.

Comments - Independent VAT consultant Neil Warren noted that the key point in the *Enersys* case was a surcharge of £131,000, against the taxpayer for being one day late with his VAT payment, was deemed by the tribunal to be 'wholly disproportionate to the gravity of the offence' and 'not merely harsh, but plainly unfair'.

Mr Warren added, 'It would be very difficult for any similar conclusion to be reached in relation to a penalty of £1,112.'

Mark Kelly (TC1439)

Financial services retail distribution review **(Lecture B690 – 16.12 minutes)**

The Retail Distribution Review

The retail distribution review (RDR) is a new set of rules which will be brought in by the Financial Services Authority on 1 January 2013. Information about it can be found on the FSA website at http://www.fsa.gov.uk/pages/About/What/rdr/index.shtml. The FSA offers the following summary:

The RDR aims to ensure that:

- *consumers are offered a transparent and fair charging system for the advice they receive*
- *consumers are clear about the service they receive; and*
- *consumers receive advice from highly respected professionals.*

To achieve this we have published new rules that will require:

- *advisory firms to explicitly disclose and separately charge clients for their services;*
- *advisory firms to clearly describe their services as either independent or restricted; and*
- *individual advisers to adhere to consistent professional standards, including a code of ethics.*

These changes will come into effect on 31 December 2012 and will apply to all advisers in the retail investment market, regardless of the type of firm they work for (banks, product providers, independent financial advisers, wealth managers, stockbrokers).

Advisory and product provider firms should start to evaluate their business models now and make the necessary changes to meet our requirements.

Although there is more to it than this, one of the essential changes will be a requirement for independent financial advisers to charge clients for their services rather than being remunerated by commissions from the providers of insurance, loans and investment products. Traditionally most IFAs would make most of their money in commissions, and usually customers had only a hazy idea of how much their adviser made out of any transaction. The idea is that fees will be more transparent and will make it less likely that an adviser will give advice that pays the highest commission rather than finding the best return for the client.

The significance for VAT

VAT has traditionally been simple for IFAs because the majority of what they do is exempt from the tax. They may provide some taxable services, but they won't reach the registration threshold. If annual taxable turnover stays below £73,000, a trader who deals mainly with the public has no incentive to register for VAT – it has to be better not to charge output tax on the few taxable services provided (to people who couldn't recover it) and not to recover input tax on any expenditure at all. The simplicity of not being registered for VAT is an added bonus.

Because their taxable services are probably well below £73,000, IFAs haven't had to worry about the technical borderline between what is taxable and what is exempt. A short-cut way of expressing this borderline is 'all commissions are exempt, fees might be taxable'. As long as most income is commission, and total fees are below £73,000, there can't be a problem – it isn't necessary to be sure what is taxable and exempt, because the taxable part cannot be high enough to trigger registration.

The RDR means fees will replace a lot of commissions. Suddenly it will be necessary to know what's exempt and what's taxable, and to be able to show HM Revenue & Customs that the taxable part of the business is still below £73,000.

The short-cut has worked reasonably well in the past, but it isn't the technical rule. The exempt services that IFAs are likely to offer are intermediary services:

- while acting as an insurance agent or broker;
- in relation to loans and investments.

Intermediary services are related to an underlying transaction that is going to happen between two other people – an insurer and an insured, a lender and a borrower, an investor and an OEIC. Even if the transaction falls through, helping someone who wants to do a deal is exempt.

The technical rules

The technical exemptions are in VATA 1994 Sch.9:

Group 2 item 4:

The provision by an insurance broker or insurance agent of any of the services of an insurance intermediary in a case in which those services

(a) are related (whether or not a contract of insurance is finally concluded) to any such provision of insurance or reinsurance as falls, or would fall, within item 1, 2 or 3; and

(b) are provided by that broker or agent in the course of his acting in an intermediary capacity.

Items 1, 2 and 3 cover insurance and reinsurance contracts, which means that all broking business of insurance agents is covered.

The notes to Group 2 contain an extensive definition of what is covered and what is not covered by item 4:

(1) For the purposes of item 4 services are services of an insurance intermediary if they fall within any of the following paragraphs

(a) the bringing together, with a view to the insurance or reinsurance of risks, of

(i) persons who are or may be seeking insurance or reinsurance, and

(ii) persons who provide insurance or reinsurance;

(b) the carrying out of work preparatory to the conclusion of contracts of insurance or reinsurance;

(c) the provision of assistance in the administration and performance of such contracts, including the handling of claims;

(d) the collection of premiums.

(2) For the purposes of item 4 an insurance broker or insurance agent is acting "in an intermediary capacity" wherever he is acting as an intermediary, or one of the intermediaries, between

(a) a person who provides any insurance or reinsurance the provision of which falls within item 1, 2 or 3, and

(b) a person who is or may be seeking insurance or reinsurance or is an insured person.

(3)Where

(a) a person ("the supplier") makes a supply of goods or services to another ("the customer"),

(b) the supply of the goods or services is a taxable supply and is not a zero-rated supply,

(c) a transaction under which insurance is to be or may be arranged for the customer is entered into in connection with the supply of the goods or services,

(d) a supply of services which are related (whether or not a contract of insurance is finally concluded) to the provision of insurance in pursuance of that transaction is made by

(i) the person by whom the supply of the goods or services is made, or

(ii) a person who is connected with that person and, in connection with the provision of that insurance, deals directly with the customer, and

(e) the related services do not consist in the handling of claims under the contract for that insurance, those related services do not fall within item 4 unless the relevant requirements are fulfilled.

(4) For the purposes of Note (3) the relevant requirements are

(a) that a document containing the statements specified in Note (5) is prepared;

(b) that the matters that must be stated in the document have been disclosed to the customer at or before the time when the transaction mentioned in Note (3)(c) is entered into; and

(c) that there is compliance with all such requirements (if any) as to

(i) the preparation and form of the document,

(ii) the manner of disclosing to the customer the matters that must be stated in the document, and

(iii) the delivery of a copy of the document to the customer, as may be set out in a notice that has been published by the Commissioners and has not been withdrawn.

(5)The statements referred to in Note (4) are

(a) a statement setting out the amount of the premium under any contract of insurance that is to be or may be entered into in pursuance of the transaction in question; and

(b) a statement setting out every amount that the customer is, is to be or has been required to pay, otherwise than by way of such a premium, in connection with that transaction or anything that is to be, may be or has been done in pursuance of that transaction.

(6)For the purposes of Note (3) any question whether a person is connected with another shall be determined in accordance with section 839 of the Taxes Act.

(7)Item 4 does not include

(a) the supply of any market research, product design, advertising, promotional or similar services; or

(b) the collection, collation and provision of information for use in connection with market research, product design, advertising, promotional or similar activities.

(8) Item 4 does not include the supply of any valuation or inspection services.

(9) Item 4 does not include the supply of any services by loss adjusters, average adjusters, motor assessors, surveyors or other experts except where

(a) the services consist in the handling of a claim under a contract of insurance or reinsurance;

(b) the person handling the claim is authorised when doing so to act on behalf of the insurer or reinsurer; and

(c) that person's authority so to act includes written authority to determine whether to accept or reject the claim and, where accepting it in whole or in part, to settle the amount to be paid on the claim.

(10) Item 4 does not include the supply of any services which

(a) are supplied in pursuance of a contract of insurance or reinsurance or of any arrangements made in connection with such a contract; and

(b) are so supplied either

(i) instead of the payment of the whole or any part of any indemnity for which the contract provides, or

(ii) for the purpose, in any other manner, of satisfying any claim under that contract, whether in whole or in part.

Group 5 item 5

The provision of intermediary services in relation to any transaction comprised in item 1, 2, 3, 4 or 6 (whether or not any such transaction is finally concluded) by a person acting in an intermediary capacity.

Items 1, 2, 3, 4 and 6 cover most lending and investment business, which again means that intermediary services in relation to loans and investments are covered by the exemption.

Again, the notes to Group 5 contain a great deal of detail:

(5) For the purposes of item 5 "intermediary services" consist of bringing together, with a view to the provision of financial services

(a) persons who are or may be seeking to receive financial services, and

(b)persons who provide financial services, together with (in the case of financial services falling within item 1, 2, 3 or 4) the performance of work preparatory to the conclusion of contracts for the provision of those financial services, but do not include the supply of any market research, product

© Reed Elsevier (UK) Limited

design, advertising, promotional or similar services or the collection, collation and provision of information in connection with such activities.

(5A) For the purposes of item 5 a person is "acting in an intermediary capacity" wherever he is acting as an intermediary, or one of the intermediaries, between

(a) a person who provides financial services, and

(b) a person who is or may be seeking to receive financial services, unless the financial service in question is the grant of credit and he is also making supplies of services comprising the management of credit to the grantor, or prospective grantor, of the credit.

(5B) For the purposes of notes 5 and 5A "financial services" means the carrying out of any transaction falling within item 1, 2, 3, 4 or 6.

What is not covered by exemption?

Advice, without a transaction, is taxable. So is the service of managing someone's investments. That's where the short-cut has traditionally been used. Intermediary services are usually paid for by a commission on the resulting transaction. If the work is not intended to lead to a sale – it is purely advice – the IFA may charge a fee instead, and that may be taxable.

Crucially, it's the service that determines the VAT treatment, not the manner of payment. So if IFAs charge a fee for intermediary services – which they will have to do a lot more in future – the income is still exempt and doesn't count towards the £73,000. Pure advice and management will remain taxable as they were before, but in many cases won't approach the threshold.

Because there will be more fees, the short-cut 'total fees are way below the threshold' may not apply. HMRC is working with trade bodies such as the Personal Finance Society to develop guidance for IFAs on identifying the borderline and the records they need to keep.

One of the trickier areas in VAT is where two things are sold together. If someone comes for advice and ends up buying a product, what is the fee for? If they come for a product, an IFA usually gives them some advice first – does that make the resulting commission taxable? The answer, as with so much in VAT, is 'it depends'. That's why the guidance, when it's finalised, will be essential reading.

The long standing principle of the *Card Protection Plan* case is that it depends on the objectives of the customer. If something is 'an aim in itself' for the customer, it will have its own VAT liability. If something is merely ancillary or incidental to something else which is a main and independent aim of the purchaser, it will take on the VAT liability of that main aim. Applying that principle to this situation:

- if a customer definitely wants a financial product and the IFA helps to choose one, the advice is probably incidental to the transaction, and the service is exempt whether it is remunerated by a fee from the customer or a commission from the provider;
- if a customer wants general financial advice without a transaction in mind, and does not proceed to a transaction, there is nothing that can be exempt and the service must be taxable (and also must be remunerated by a fee, if at all);
- the situation is on the borderline if the customer is not sure whether a product is needed or not, takes general advice, and then proceeds to a transaction. The draft guidance below suggests that this can be regarded as a single exempt supply of 'arranging', because in the end the customer really wanted a transaction – they just didn't know it until they had had the benefit of the advice.

Draft guidance

The latest draft of guidance that the Personal Finance Society is working on with HMRC is set out below. It gives an indication of the areas in which IFAs are likely to have to amend or develop procedures in order to be able to show that they are charging VAT on the right things, or more likely staying below the threshold, after 31 December 2012.

© Reed Elsevier (UK) Limited

VATINS5350 – Services of an insurance intermediary: The Retail Distribution Review

New regulatory rules come into force in January 2013 following the FSA's Retail Distribution Review (RDR). The key objectives of the RDR are to:

- improve the clarity with which firms describe their services to consumers;
- address the potential for adviser remuneration to distort consumer outcomes; and
- increase the professional standards of advisers.

The new rules require advisers to move away from receiving commissions paid by product providers to fees agreed with customers in respect of all packaged investment products, including those involving life insurance, but do not apply to protection only insurance or to charges for trading in securities.

The new rules apply to all product distributors and providers across the retail investment market involved in advised sales; whether they are acting independently or restricted in the products they are able to provide by being either in-house advisers or tied agents acting for particular product providers. They also apply to advised sales via fund supermarkets and other platforms.

VATINS5355 – Services of an insurance intermediary: VAT and the Retail Distribution Review

An adviser's role in the retail investment market will normally involve them entering into arrangements with the customer under which they:

1. gather information about the customer;
2. carry out research to find suitable investment options;
3. provide the customer with reports, financial health-checks, forecasts;
4. advise the customer as to the best investment options;
5. implement the agreed options by arranging transactions in securities or insurance; and in some cases
6. monitor the customer's ongoing position to ensure that the products continue to meet the requirements of the customer, especially where the customer's circumstances are changing; and
7. rebalance the customer's product portfolio to ensure that it continues to meet the customer's requirements as circumstances change.

Subject to meeting the evidence requirements outlined in VATINS5656, where at stage 4 above the customer agrees to the adviser taking forward the proposed investment options by arranging transactions for them which are exempt under Article 135(1) (a)-(f), the services outlined above will be exempt intermediation and no VAT will be due on any charges made to the customer.

If the adviser is able to provide evidence that the customer has agreed to the adviser arranging transactions in exempt investment or insurance products but for some reason the adviser fails to eventually bring about the sale of any exempt products, then any charges for the services provided up to that point will be exempt.

Where the arrangement is aborted, as outlined above, but the adviser continues to provide taxable advice services under a new agreement with the customer, this represents a new supply for VAT purposes and VAT should be charged on all fees for the services provided after the original arrangement is aborted

Where the customer wishes to receive an advice-only service that doesn't require the adviser to arrange any exempt transactions, then the service of the adviser will be taxable. This includes the provision of general financial advice, tax planning, financial health-checks, reviews and reports. VAT will also apply to any charges made by advisers in circumstances where stages 1 to 4 of the services outlined above are carried out and the customer decides they do not wish to proceed further.

© Reed Elsevier (UK) Limited

VATINS5355 – Services of an insurance intermediary: The Retail Distribution Review – other services

Investment Management - Where advisers provide investment management advice, often referred to as a portfolio advice service or advisory management, where the adviser suggests particular transactions to a customer and the customer decides whether to proceed; charges for this advice are taxable but any separate charges for the arrangement of the transactions are exempt.

However, where an adviser provides discretionary investment management service in which the adviser's discretion is used to decide the investment strategy and transactions are arranged without referral back to the customer; this is currently a taxable service in the UK (but this may be subject to change as it is currently the matter of a reference to the CJEU in the case of Deutsche Bank).

Introduction to a discretionary investment manager - Where an adviser charges a fee for making an introduction to a discretionary investment manager to take over the management of the customer's investment portfolio or part thereof, this fee will be taxable.

Ongoing advice -Where an adviser charges separately for ongoing advice, such as an annual financial health-check or report on investment performance (possibly with the intention of keeping in touch with the customer or keeping the adviser's records updated) which does not involve the arranging of an exempt transaction, this charge will be taxable. Where an adviser's ongoing advice service includes 'rebalancing' of a portfolio (i.e. buying or selling products to bring the portfolio in line with an agreed investment plan) and the transactions involved are exempt, the ongoing advice service will be exempt.

VATINS5356 – Services of an insurance intermediary: The Retail Distribution Review - Evidence

An adviser will need to keep sufficient evidence to support the tax treatment applied to the services supplied. This evidence may take the form of letters of engagement or other agreements/contracts with the customer which are entered into at the time the services to be supplied are agreed. Such evidence should be supported by information reported in Retail Market Activity Returns or similar regulatory documents. If an adviser claims that the customer had agreed to an exempt transaction being arranged but is unable to evidence this and no exempt transaction was carried out, VAT will be due on that supply.

Contributed by Mike Thexton