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PERSONAL TAX

P11D tips and points to watch (Lecture P711 – 12.35 minutes)

Taxation of company cars

Over the last few years there have been a number of changes affecting the taxation of company cars. Those relevant to the 2011/12 P11D are:

Electric cars (now known as zero emission cars) attract a zero benefit in kind for five years from 2010/11.

- Electric (zero emission) vans are similarly taxed at £0 for five years from 2010/11.
- From 6 April 2011 the cap of £80,000 on list price was abolished. [EIM23100, 23205]
- From 6 April 2011 all of the alternative fuel "discounts" were abolished. Cars are either taxed at the Table rate, or Table + 3% for diesel. Electric cars are dealt with separately.

Other changes

Section 54 FA 2009 amends the calculation of list price of a car for a disabled driver (who is a holder of a blue badge). The list price is taken as the list price (or notional list price) of an equivalent model with manual transmission when the driver's disability means that he is required to use an automatic car. This brings the computation of list price in line with the CO2 basis which already recognises this need. The change took effect from 2009/10. [EIM23011, 23137]

Section 58 FA 2010 introduced a new 5% rate of benefit in kind on cars emitting strictly no more than 75 g/km (this special rate will still be subject to the 3% addition for diesel vehicles). Currently, cars emitting no more than 100g/km are taxed at 10% of list price (or 13% for a diesel model). This new rate commenced on 6 April 2010 and runs for five years.

FA 2010 also restructured the legislation on electric cars to describe them as "zero emissions", defined as a car which cannot under any circumstances emit CO2 by being driven. Similar changes have been made to the terminology in relation to vans. [EIM22790, 28450]

Statutory Mileage rates

The statutory mileage rates for use of own car on business journeys were updated in April 2011 – an unexpected but welcome change. The main rate applying to the first 10,000 miles in a car or van is now 45p per mile (from 40p). The rate for miles in excess of 10,000 is 25p. Amended examples have been updated in EIM31350 to 31375. Other rates are unchanged.

Note that where employers have not increased the rate that they pay for mileage, employees will be able to claim additional deductions for tax purposes. You may wish to supply a copy of form P87 to the clients to pass on to staff.

Benefit in kind of health screening or medical checkups

Finance Act 2009 now resolved issues regarding the taxation of health screening benefits for employees from 2009/10 onwards by providing primary legislation to amend ITEPA 2003 as follows:

Section 55 FA 2009 inserts new S 320B into ITEPA which states that no liability to income tax arises in respect of the provision for an employee, on behalf of the employer, of a health screening assessment or medical check-up.

The exemption is qualified to limit it to one health screening in a tax year provided by any one employer or number of persons who are employers of the employee at the same time (so two check-ups – the second following a change of employment would still be exempt).

Health screening assessment is defined as and assessment to identify employees who might be at particular risk of ill health, and Medical check-up means a physical examination of the employee by a health professional for (and only for) determining the employee's state of health.

Section 55 makes similar changes to section 266(3) ITEPA which deals with the benefit arising through the provision of non-cash vouchers, and s 267(2) which deals with provision by way of credit token. Such a provision will remain taxable if the employee pays for it and is reimbursed by the employer as no exemption has been introduced into s 336. Guidance is provided in EIM21765.

FA 2010 - Subsidised meals for employees – salary sacrifice arrangements

Where a subsidised meal or canteen arrangement is available to employees but the cost of the meals taken is adjusted against the employee's salary through either a salary sacrifice arrangement or a flexible benefit package, the provision will no longer be tax free with effect from 6 April 2011.

This is implemented by section 60 FA 2010 which makes changes to s 317 of ITEPA 2003, by introducing a further condition on the tax free status of such arrangements. They must not be provided pursuant to either relevant salary sacrifice arrangements, or relevant flexible benefit arrangements. Both terms are defined, and such arrangements are caught whenever they were made.

New guidance on the amended canteen rules start at EIM21671

Fuel benefit scale charge

The fuel benefit scale charge increased to £18,800 for 2011/12. This is multiplied by the percentage used for the provision of the car, as adjusted for diesel or low emission cars.

Fuel only advisory rates – effective 1 March 2012

Car fuel rates are now updated regularly based on current average fuel prices. Employers would be wise to bookmark the page and check back regularly. Current rates are on http://www.hmrc.gov.uk/cars/advisory_fuel_current.htm and are based on average fuel prices of 133.4p per litre for unleaded petrol, 141.1p for diesel, and 73.9p for LPG. Previous rates are shown on

http://www.hmrc.gov.uk/cars/advisory_fuel_archive.htm

Table: rates effective 1 March 2012 until further notice

	Petrol	Diesel	LPG
Engine capacity	pence per mile		
Up to 1400 cc (1600 cc for diesel)	15	13	10
1400 – 2000 cc (1600 – 2000 cc for diesel)	18	15	12
Over 2000 cc	26	19	18

Beneficial loan rate

The rate applying to beneficial loans is 4.0% with effect from 6 April 2011. The rate for 2012/13 was confirmed on 14 February as 4%.

Trivial benefits

Under care and management powers, HMRC can exempt what are regarded as "trivial benefits". The Employment Income Manual has been updated to add "Repairs to employer provided bicycles" costing no more than £20 and provision of seasonal flu immunisations (but no others) are now deemed to be trivial benefits. See EIM21863.

Air miles and credit card points

New guidance has been introduced in EIM to reflect the provision of or access to air miles and credit card points in relation to employment.

EIM21618 - Particular benefits: air miles, credit card points etc.

In general, air miles, petrol tokens, credit card points etc. acquired by an employee are not taxable if they were acquired in the same way as applies to any other member of the general public, for instance by buying goods or services on which such benefits are given,

Provided the vouchers, air miles or points belong to the employee rather than the employer, they are not considered as being provided by reason of their employment even if the goods or services giving rise to them happen to be purchased as part of the employee's business travel or using a credit card provided by the employer.

Using the example of air miles, the benefit of the award of additional air miles will not be considered to be provided by reason of the employment even if the employee concerned only has the opportunity to be awarded those particular air miles because they're going on a business journey for which the costs are met or reimbursed by the employer. But this is subject to the condition that the air miles are awarded to the employee from the outset in just the same way that the provider would award them to any other customer buying the same ticket or product.

In those circumstances, there is no need for the employer - or indeed the third party supplier of the air miles or reward/ profile points - to report these items to HMRC, or for the employee in question to enter them on a tax return if he or she gets one,

However, there is a tax charge on such items, if they are provided by reason of the employee's employment.

This would be the case if the fact of the employment was a necessary antecedent condition to the receipt of air miles. An example of this would be where the employer purchased a block of air miles and distributed them to the employees, perhaps as part of an incentive scheme. Another example would be where there's an arrangement for a third party to provide petrol tokens or some other form of award points specifically to employees of a particular employer but not to other customers.

It is important to remember that the exact tax treatment will depend on the facts of a particular case.

Revised guidance on checking dispensations

The guidance regarding how much effort employers are asked to put into checking dispensations once granted has been amended and is of sufficient importance to make it worthwhile repeating in full :

EIM30059 - DISPENSATIONS: CHECKING AND AUTHORISATION OF EXPENSES PAYMENTS

After a dispensation has been granted, the extent of checking undertaken by the employer will depend upon the scale of the business. They will need to demonstrate that someone other than the employee incurring the expense is responsible for ensuring that the claim made by the employee:

- Relates to qualifying travel in the case of travel and subsistence expenses
- Does not include disallowable items. The rules in S336-9 ITEPA 2003 (see EIM31600 onwards and EIM31800 onwards) will apply, and
- Is not excessive.

Dispensations incorporating actual costs supported by receipts

An employer will normally require every item of expenditure to be vouched for his own benefit - to ensure it has been incurred, and for audit purposes. But this requirement should not be regarded as applicable for trifling expenditure such as small allowances for taxi fares. The employer should be able to demonstrate that regular checks will be undertaken to ensure that only allowable expenses are being reimbursed.

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Dispensations incorporating the advisory benchmark or bespoke scale rate payments

Detailed guidance on scale rate payments is at EIM05200 onwards. The employer needs to:

- Keep sufficient records to be able to demonstrate that the employee was entitled to the scale rate payment; the employee is engaged in qualifying travel and incurs an expense.
- Be able to demonstrate that regular checks are undertaken to ensure that the travel expenses rules are being followed.
- Regular checks

The checks should reflect the conditions outlined at EIM30055. The form and regularity of the checks will depend on the following factors:

The size of the workforce.

- The complexity of the workforce - This will be particularly relevant where the workforce consists of different sections performing different tasks where the entitlement to relief may vary.
- Uncertainty about whether employees will qualify for relief - Where the temporary workplace rules apply for example (see EIM32000 onwards), employees may qualify for relief at different times and for differing durations. This should be more closely monitored.
- Unpredictable or non-standard work patterns - where scale rate payments have been agreed for irregular working, the employer may want to check that the agreed conditions for breakfast or evening rates are being met.
- The employer has no previous experience in the management of an expenses regime - Where the employer has not previously paid expenses you may wish to insist on a larger or more regular sample check.
- There is evidence that the employer has failed to manage an expenses regime effectively in the past.
- The dispensation is part of arrangements such as new or updated Salary Sacrifice schemes and it may not be clear to the employee that the sacrificed sum represents reimbursed expenses.
- Any other risk factors identified by the Compliance Officer.

The check will need to:

- Incorporate a review of the completion of the time sheets and supporting receipts obtained and retained by employees sufficient to satisfy the conditions outlined in EIM05200 and EIM30055 and
- Be undertaken regularly during the year. This may be monthly, quarterly or half yearly depending on the number of factors present. The checks should involve a review of the receipts retained and claims made by a random sample of staff who should not be given prior notice before or during the period that they will be the subject of review. As soon as the review period is over, the employees should be under no obligation imposed by HMRC to retain their receipts. During any subsequent compliance visit the compliance officer would be able to ask to see details of the periodic checks and the employer should be able to clearly demonstrate that they have been undertaken.

In cases where a number of the factors listed above are present, involve a higher proportion of the workforce.

In smaller organisations where none of the factors outlined above are present, the directors may know all about the particular expenses incurred by employees, and there may be no need for checking at all.

For personal reasons, or reasons of confidentiality, the proprietors of a business, for example, the director/shareholders, may have a free hand in deciding what they take as expenses. If so, it will not usually be appropriate to give a dispensation for them, but other employees can still be included.

One man service companies and smaller employers

Where an employer seeks a dispensation for a one man service company, or in circumstances where the application is in respect of reimbursements to a controlling director/shareholder or where there is no one employed by the company who can check the expenses reimbursed, you should ensure that:

- Expenditure is independently vouched. This can be undertaken, for example, by an accountant or bookkeeper and
- Expenditure is allowable as a deduction from earnings (e.g. if necessarily incurred on travelling in the performance of the duties) and
- the Officer is satisfied that no additional tax is at risk,

There is no reason why a dispensation including actual expenses or benchmark rates should not be approved if these conditions are met. You should not refuse or restrict a dispensation just because it is being sought by a smaller employer.

Text added May 2010

You should, however, consider carefully the reimbursement of subsistence costs, for example, where an independent voucher cannot be supplied. In cases of this kind it is particularly important that it should be clear from the dispensation letter (see EIM30085) that the dispensation applies to a limited class of payments only and does not cover whatever the director decides to take as expenses.

Vouching of expenses

In some instances, lack of an independent voucher is not necessarily a bar to inclusion in a dispensation - for example, a subscription to an approved body under Section 344 ITEPA 2003 (see EIM32880).

Added May 2010

It is also likely that while undertaking periodic checks, the employer will find that employees have not, on occasion, been able to obtain or retain receipts for qualifying expenses incurred. The employer must monitor omissions to ensure that there are reasons for the lack of receipts, they are not persistent and do not occur throughout the workforce. They should also, where appropriate, be able to demonstrate any action that they have taken to overcome problems of this sort. Do not offer guidance on or incorporate in dispensation agreements minimum amounts that can be claimed without the submission of receipts.

The guidance on revoking a dispensation was revised in May 2010 (EIM30095).

New guidance on education as part of the duties of the employment

HMRC has revised guidance in EIM to reflect the outcome of the Banerjee case in the Court of Appeal. The following text has been added to page EIM32530 :

In the recent case of Revenue & Customs Commissioners v Dr Piu Banerjee ([2010] EWCA Civ. 843), the Court of Appeal accepted that a deduction for training costs incurred by an employee should be allowed if the employee was employed on a training contract where training was an intrinsic contractual duty of the employment (see also EIM32535 & EIM32546) and where any personal benefit, unlike most CPE courses, would be incidental and not therefore give rise to a dual purpose of the expenditure.

An example of situations where this might apply has been added EIM32546:

Example

A trainee doctor employed as a registrar on a training contract is required, as a stated contractual duty of the employment, to attend various external training courses. As part of the duties of the employment there is a mandatory requirement to maintain a national training number by attending a series of training courses and events. Failure to complete the course and obtain the qualification will mean that he cannot proceed to the next stage of his chosen profession.

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Attendance at the training events is an intrinsic part of the employment and one of the duties of the employment. The costs of travel to the events, course fees and other associated costs met by the employee are deductible.

Childcare tax scheme changes from 6 April 2011

You may need to report excess childcare vouchers or payments on the P11D. A brief outline of the issue follows, but there is more information in HMRC's Manuals at EIM16053 for vouchers, and at EIM21901 more generally.

The rules affect employers operating two types of scheme:

- Childcare vouchers
- Directly contracted childcare

Workplace nurseries continue to be a tax free benefit without limit provided conditions are met.

Affected employees

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

How it works

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

The relevant earnings amount is compared with the higher and additional rate thresholds of £35,000 and £150,000. The computation, however, allows for the deduction of the standard personal allowance from the total income plus expenses which would be deductible for tax. See EIM16056 for more details.

Table : tax free amounts 2011/12

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

Excess payments

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

Employer provided vans

Where a van is provided to an employee for both business and private travel, there is no charge to tax if the restricted private use condition is met in relation to the van for the year. Drivers who have unrestricted use of a company van are taxable on a benefit in kind of £3,000; there is a further taxable benefit of £550 if free fuel is provided for private motoring. This will normally be chargeable if the van accrues a benefit in kind and fuel is provided in the van, unless the driver is required to and actually does make good the cost of fuel used privately.

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The restricted private use condition is met for a tax year if :

(a) the commuter use requirement is satisfied throughout the year (or the part of the year on which it is available to the employee) or the extent to which it is not satisfied during that period is insignificant, and

(b) the business travel requirement is satisfied throughout the year (or the part of the year on which it is available to the employee).

The commuter use requirement is satisfied at any time if :

(a) the terms on which the van is available to the employee at the time prohibit its private use otherwise than for the purposes of ordinary commuting or travel between two places that is for practical purposes substantially ordinary commuting, and

(b) neither the employee nor a member of the employee's family or household makes private use of the van at the time otherwise than for those purposes.

The business travel requirement is satisfied at a time if the van is available to the employee at the time mainly for use for the purposes of the employee's business travel. Note if there is no business travel use the van is always taxable irrespective of the amounts of other use.

Double cab pickups are treated as vans if the load weight exceeds one tonne. The addition of a hard top reduces the load weight by a deemed 45kg.

The Employment Income Manual (EIM 22720) provides the following Table to assist employers. This considers the basis of provision and the actual use of the van and the resulting benefit in kind.

Availability	Actual use: comm.	Actual use: other	Charge
BU only	none/insignificant	none/insignificant	not chargeable
BU only	yes	none/insignificant	nil
BU only	yes	yes	full charge
BU/comm. only	yes	none/insignificant	nil
BU/comm. only	yes	yes	full charge
BU/comm./other	none/insignificant	none/insignificant	nil
BU/comm./other	yes	yes	full charge
comm./other only	yes	none/insignificant	full charge
comm./other only	none/insignificant	yes	full charge

More information : HMRC web area on vans, including guidance for both employers and employees is at http://www.hmrc.gov.uk/vans/

Van fuel

This is taxed if the van is taxed and any fuel is provided for private journeys. It is important to note that use for commuting journeys, although not triggering a tax charge on the van, will, if the van is taxable in any event, always produce a van benefit, so if reimbursement is sought, this must include the cost of fuel for commuting.

Mobile telephones

A single mobile phone provided by the company on which an employee can make private calls is tax free. If the phone is in the name of the employee this exemption does not apply, and the amounts paid must be apportioned between business and private use, remembering that the basic airtime charge will always be private if the phone is in the name of the employee.

Details: Computing the benefit in kind : HMRC manual

The employee will be taxable on the full cost of the provision of the phone, which may include a benefit for the handset cost at 20% of the cost. The bills paid on a taxable phone will give rise to a benefit in kind, but some apportionment of the bill may be possible for business calls, when billed over and above the line rental charges.

The following example is provided, and although in connection with an employee provided phone, is quoted in other parts of the manual.

"EIM 32951. A construction engineer often works out of the office on construction sites. She uses a mobile phone so that she can keep in touch with the office. The phone is mainly used for business calls.

The tariff for the mobile phone includes up to 10 minutes of free calls each month. In one month she pays £22, which is the rental charge only, because her total calls, all of which were business calls, amounted to 8 minutes. No deduction can be permitted because no expense has been incurred in making the business calls.

The following month she pays £28, which is £22 for rental and £6 for calls. Calls that are charged are paid for at a rate of 20p per minute. In the month she made calls totalling 40 minutes, of which 30 minutes were for business and 10 minutes were private. A deduction should be permitted for the cost of business calls. The amount that can be deducted is £4.50, which is 75% of the call charges, because 75% of the total call time was made up of business calls."

Recent change

HMRC has recently announced that the provision of a Smartphone – such as a BlackBerry or iPhone is now regarded as the provision of a mobile phone and is to be taxed as such from 2011/12. If you have reported benefits in kind in respect of a single smartphone provided by an employer then the Class 1A NIC can be recovered back as far as 2007/08. You will need to follow the process in Revenue & Customs Brief 02/12.

Internet access

Where an employer provides for Internet access (on a company contract) at the employee's home solely for work purposes, under a package where there is no separate billing or record of access calls, and no breakdown is possible between work and private calls, where private use is not significant (and private use does not affect the cost of the package) the costs of connection are exempt from tax under Section 316.

For tax purposes the cost of providing the telephone line to connect to the Internet is a separate matter from the contract between the ISP and the employer or employee. The treatment of the telephone line rental and call charges depends on who has contracted with the provider of the telephone line.

Where an employee is the subscriber for Internet access to his or her home, and the employer reimburses the employee for these costs, there is no scope for the exemption in Section 316 to apply, as the employer is not providing a benefit. Reimbursements are taxable as expenses payments. If the employee can show that some or all of the Internet costs related to use wholly, exclusively and necessarily in the performance of his duties, he may be entitled to a deduction under Section 336 ITEPA 2003.

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Where an Internet package, such as for Broadband access, provides unlimited access and no separate billing procedures to separate business use from private use, it is not possible for an employee to identify the business part of the cost. Consequently the position for these packages is the same as for similar mobile phone packages. If there is no identifiable cost that is wholly and exclusively for business use, no deduction will be due.

There is also guidance for employers about reimbursing internet access charges under the homeworking rules in Section 316A. This makes it clear that the payment of broadband bills for employees will only be regarded as additional costs incurred because of homeworking when the employee was not already paying for internet connection, or when the broadband speed had to be upgraded at additional cost because the employee was working from home. Only the additional costs incurred can be exempt under Section 316A. (EIM01475).

Contributed by Rebecca Benneyworth

Tax efficient cash extraction for entrepreneurs (Lecture B712 – 20.12 minutes)

With changing rates of tax next year and the start of a new year it is worth looking at the tax efficient extraction of cash from a company and the comparison between the extraction of profit from a company through the bonus and dividend alternatives.

Before looking at some of the calculations and figures which result from the new rates and allowances we need to remind ourselves of the figures behind those calculations

Personal tax rates and allowances for 2013/14:

- Additional rate of tax to reduce to 45% (from 50%);
- The dividend rate will become 37.5%; this equates to 30.55% of the net dividend
- The personal allowance will increase to £9,205
- Compared with the rate for 2012/13 (£8,105) this is an increase of £1,100, saving basic rate taxpayers £220 and higher rate taxpayers £440
- Higher rate threshold to fall by £2,125 (to £32,245) costing higher rate taxpayers £425 & bringing more individuals into the higher rate net
- The upper NI limit will continue to be aligned to higher rate threshold - But no word on lower limit!

With changes that are known about in respect of the forthcoming year it helps the tax efficient planning of extraction by deferring income into a future year where it is known that a lower rate of tax will be suffered by those individuals with income over £150,000. The Chancellor’s schedule of announcing changes early gives a lot of time for planning.

The crucial question becomes – Is the income needed? With an answer of no, deferral ensures that the income suffers the lowest possible tax. However what if the answer is yes? The shareholder in a private company can lend himself or herself money in 2012/13 that will be repaid by way of dividend in 2013/14. The timing of the payment and the year end needs to be considered to ensure that the repayment of the loan is in sufficient time to avoid the s455 tax charge biting. Where the individual is a director or employee the bonuses or the salary that would otherwise be paid at the end of the tax year can be deferred ever so slightly so they are received the other side of the 5/6 April line and therefore in the right year as far the rates of income are concerned.

Let's actually look at what the figures are!

Take first the bonus being paid to a higher rate taxpayer.

Profit	100.00
Employers NIC (13.8/113.8)	12.13
Gross salary	87.87
Tax and NIC at 42%	36.91
Retained	50.96

This gives an effective tax rate of 49.04% and applies in both 2012/13 and 2013/14

Take the same calculation applying to an additional rate taxpayer and compare the calculations for the bonus being paid on either side of the 5/6 April deadline.

2012/13

Profit	100.00
Employers NIC (13.8/113.8)	12.13
Gross salary	87.87
Tax and NIC at 52%	45.69
Retained	42.18

This gives an effective tax rate of 57.82%

2013/14

Profit	100.00
Employers NIC (13.8/113.8)	12.13
Gross salary	87.87
Tax and NIC at 47%	41.30
Retained	46.57

This gives an effective tax rate of 53.43%

The figures show the effective rates of tax through bonuses but as always it is worth comparing the rates suffered with dividends. To enable the comparison to be made let's look at the higher rate taxpayer and then again at the additional rate taxpayer in both 2012/13 and 2013/14

Dividends – Higher rate taxpayer

	Small co	**Medium co**	**Large co**
Profit	100.00	100.00	100.00
Corporation tax	20.00	25.00	24.00
Net dividend	80.00	75.00	76.00
HRT at 25%	20.00	18.75	19.00
Retained	60.00	56.25	57.00
Tax rate	40.00 %	43.75%	43.00%

Dividends – Additional rate taxpayer 2012/13

	Small co	**Medium co**	**Large co**
Profit	100.00	100.00	100.00
Corporation tax	20.00	25.00	24.00
Net dividend	80.00	75.00	76.00
HRT at 36.11%	28.89	27.08	27.44
Retained	51.11	47.92	48.56
Tax rate	48.89%	52.08%	51.44%

Dividends – Additional rate taxpayer 2013/14

	Small co	Medium co	Large co
Profit	100.00	100.00	100.00
Corporation tax	20.00	25.00	24.00
Net dividend	80.00	75.00	76.00
HRT at 30.55%	24.44	22.91	23.22
Retained	55.56	52.09	52.78
Tax rate	44.44 %	47.91%	47.22%

Putting these together in a summary table to get the overview:

Dividends – Additional rate taxpayer 2013/14

	Bonus	Small co	Medium co	Large co
Higher rate taxpayer	49.04%	40.00%	43.75%	43.00%
Additional rate taxpayer 2012/13	57.82%	48.89%	52.08%	51.44%
Additional rate taxpayer 2013/14	53.43%	44.44%	47.91%	47.22%

What are the ways of deferring income to 2013/14?

The ways of course depend on who you are and the relevant avenues open to you.

The owner- manager of a limited company:

- Dividends can be delayed so they are received after 5 April 2013
- Use loans from company to give cash flow in 2012/13 and repay with dividends after 5 April 2013

Don't forget to concentrate on getting the dividend procedure right because of the recent decision in PA Holdings Limited v HMRC where dividends were reclassified as employment income and of course the disguised remuneration provisions that were introduced by FA 2011.

The self-employed (alone or in partnership):

- Maximise pension contributions in 2012/13 – remembering to take account of any unused relief which is carried forward from earlier years – Don't forget the pensions annual allowance charge
- Consider investments in the Seed Enterprise Investment Scheme or the Enterprise Investment Scheme or Venture Capital Trusts
- Use trading losses against income before 2013/14
- Accelerate qualifying capital expenditure for capital allowances

Employees:

- Maximise pension contributions in 2012/13 – remembering to take account of any unused relief which is carried forward from earlier years – Don't forget the pensions annual allowance charge
- Consider investments in the Seed Enterprise Investment Scheme or the Enterprise Investment Scheme or Venture Capital Trusts
- Delay the receipt of any March 2013 bonuses until 6 April 2013 or later

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As always in recent years it is still beneficial to extract the remuneration from the company in the form of dividends but additionally this year provides an excellent opportunity to extract funds in a tax efficient manner by reducing the liability in the current year in the certainty that should the income be received in the 2013/14 year the top additional rate of tax will be reduced.

Contributed by Tony Jenkins

Emoluments from office or employment or distribution?

The appellant company, a manufacturing business, resolved to pay bonuses to its two controlling shareholders and directors ("the husband and wife") under a scheme which purported, through the use of dividends made by a specially formed company, to secure a corporation tax deduction as well as avoiding income tax and national insurance contributions ("NICs") liabilities via dividends. Under the scheme the appellant formed a UK resident unlimited company ("M") and made a £1,050,000 capital contribution to it, then subscribed 10,000 1p shares which carried the right to a priority dividend between nil to £1 million, payable on or shortly after 30 September 2004. The plan envisaged that if the appellant's sales for August and September 2004 reached or exceeded £1 million, the husband and wife would respectively receive £800,000 and £200,000 as their entitlement under the bonus plan, but if they did not they would receive the lower, so called "guaranteed", amount of £875,000. The 1p shares were then transferred to the husband and wife in the ratio 80/20 as the intention was that the bonus plan would be effected via the share rights of M.

Decision :

Following the decisions of the First-tier Tribunal ([2009] UKFTT 95 (TC), [2009] SFTD 209) and Upper-tier Tribunal ([2010] UKUT 251 (TCC), [2010] STC 2343) in Revenue and Customs Comrs v PA Holdings Ltd, but before the Court of Appeal judgment was handed down ([2011] EWCA Civ 1414, [2011] All ER (D) 237 (Nov)), the appellant conceded that the dividend payments by M were remuneration of the husband and wife for income tax purposes. Since, however, they were also dividends, and since TA 1988 s 20(2) provided that "no distribution which is chargeable under Schedule F shall be chargeable under any other provision of the Income Tax Acts", it contended, consistently with the tribunal decisions in PA Holdings Ltd, that that tie-breaker section precluded taxation of the dividends as remuneration, and thus eliminated any liability on the part of the appellant to deduct and account for tax under the PAYE machinery. After the hearing the tribunal decided to await the Court of Appeal's ruling, and hear further representations in the light of it, before issuing their decision.

TA 1988 s 20(2) was irrelevant and provided no exemption from PAYE liabilities. Furthermore dividends were simply earnings for NIC purposes. It followed that the appeal on both the PAYE and NIC issue would be dismissed; Revenue and Customs Comrs v PA Holdings Ltd [2011] EWCA Civ 1414, [2011] All ER (D) 237 (Nov) applied.

Appeal dismissed.

Comments – Following the decision by LJ Moses in the PA Holdings case in the Court of Appeal the circumstances in this case meant that the income would be treated as employment income. However as the more significant case was going through the judicial process the Tribunal quite correctly deferred their decision until the Court of Appeal decision. You should note that the Supreme Court has granted leave for PA Holdings to appeal against the Court of Appeal's decision although it may be some time before the case is actually heard in the Supreme Court.

Manthorpe Building Products Ltd v Revenue and Customs Comrs TC 1778

Benefit in kind or from joint ownership?

Mr Hall is a director and employee and shareholder of the Appellant company. On 17 April 2004 he purchased a BMW X5 motor vehicle with an invoice cost of £53,645. Some time during the company accounting year ending 31 December 2004, Mr Hall sold a 90% share of the car to the Appellant company for £48,636. The car remained available for Mr Hall's private use after the transfer. Mr Hall did not keep records of his business and private mileage. He made a 10% contribution towards the running costs of the car. He paid the company 10% of the total fuel costs of the car. No car or fuel benefit charge was reported to HMRC by the company on forms P11D/P11D(b) for the period 6 April 2003 to 5 April 2009. HMRC determined that the Appellant company was liable to pay class 1A National Insurance contributions in respect of car benefit and car fuel benefit in the sum of £19,726.42.

Decision:

The expression "made available" needs to be applied to the facts in the tax year in question, rather than to the point in time at which property titles were established, which might have occurred in a previous tax year. It follows from this, in the Tribunal's view, that the expression "made available" should be applied to the point in time at which the vehicle is used, rather than the point in time at which it is purchased, or the point in time at which a partial property title is transferred from the company to the employee or *vice versa*. If at the time of use of the car, the company owns 90% of the car and the employee owns 10%, that is the relevant circumstance to which the expression "made available" must be applied.

It is irrelevant how the circumstances of that joint ownership came to be established at some point in the past. The First-tier Tribunal therefore dismissed the appeal, holding that the company had made the car available to the director by virtue of his employment. Applying the principles laid down by Pumfrey J in Christensen v Vasili, [2004] STC 935, the fact that H owned 10% of the car did not avoid the liability to national insurance contributions.

Comments – This is the latest in a series of cases where the argument that the car is not available by reason of the employment but by reason of the joint ownership. The facts in this case with the 10% share are much nearer to the facts in Christensen v Vasili, where a 5% share was owned by the company rather than Samson Publishing Ltd v Revenue & Customs where the share was 50:50. However as clearly delineated by the tribunal judge the joint ownership argument would appear to be a non starter because at least a part of the car being made available.

GR Solutions Ltd v HMRC TC1928

Car benefit avoided?

Mr Baldorino (B) was a director of Atmosphere Management Ltd (AML). The case involved a number of benefits but a key issue related to the provision of a car. Arrangements were made for B to lease a car by having AML make the payments to the leasing company and for these to be debited to B's loan account. The loan account was repaid via a mileage charge and a dividend.

HMRC argued that B was liable to income tax under the company car rules. Under s.114 ITEPA, the car benefits rules apply if a car is made available to the employee by reason of his employment. S.117 provides that "a car or van made available by an employer to an employee ... is to be regarded as made available by reason of the employment unless (a) the employer is an individual, and (b) it is so made available in the normal course of the employer's domestic, family or personal relationships."

In *Stanford Management Services Ltd*, the FTT decided that even if there had been an agreement such that the company had acted as agent of the employee in leasing the car, the company still provided a car for its employee so that a benefit arose. The case of Whitby and another was also referred to in this case.

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Decision:

The Tribunal disagreed with the *Stanford Management Services Ltd* decision. It said that the legislative question was whether a car was made available to a person 'by reason of his employment'. If the car was made available because the company acted as the employee's agent in forming a contract between the employee and the lessor, it could well be that the car could not be said to have been made available by reason of the employment. The mere fact that the company had acted as the employee's agent in forming the contract would not determine the answer. Further, if the employer had acted as the employee's agent in leasing the car, then the car was not made available by the employer but by the lessor and the deeming of s.117 did not automatically cause the car to be treated as having been made available by reason of the employee's employment.

However, in B's case it seemed to the Tribunal that, from 2000 to 2006, the company had treated payments under the leases as its own liability without that right of recourse to B which would have existed if it had acted as his disclosed or undisclosed agent. That suggested that the company had not acted as B's agent in leasing a car; instead, the contract was made between the lessor and AML, and AML had made the car available to B. Since the company made the car available it was to be treated as made available by reason of B's employment as a result of s.117.

B's appeal was dismissed.

Comments – Despite the fact that the car benefit legislation has been around for many decades we continue to see cases on a regular basis that purport to be provision of a car but without the logical tax effects thereof. In this case it involves the acquisition of the car by the company The Tribunal did not consider that the company had not acted as B's agent in leasing a car where the taxpayer. They were content that the company had the car available.

Baldorino v HMRC TC1766

Bonus paid after retirement

Mr Bovey, formerly a senior civil servant employed with the Department of Trade and Industry ("DTI") which subsequently became the Department of Business, Innovation and Skills ("BIS") , retired in April 2007. In December 2007 he received a bonus payment of £6,500, from which tax was deducted. In his tax return he claimed that this should be treated as a compensation payment within ITEPA 2003, s 401, qualifying for relief under s 403. HMRC issued a closure notice ruling that the payment constituted earnings within s 62, and did not qualify for relief.

Decision:

The First-tier Tribunal dismissed the appeal against this decision.

Comments – It was quite clear from the evidence that the letter from BIS stated that the payment is the result of the Department's Pay Committee's final decision on 2007 SCS (Senior Civil Service) pay. It stated that the payment was a bonus, in recognition of excellent work undertaken by the Appellant. Simply because it was received after the employment ceased does not bring it within the s401 provisions. The appellant appeared in person – had he been represented by an advisor it is highly unlikely that such a clear cut case would actually have been heard by the Tribunal.

Philip Bovey TC 1920

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Compensation on loss of office

An individual (B) had been appointed as a sub-postmaster in 2000. In 2005 the Post Office decided to close his office (along with a large number of similar post offices). The Post Office paid B £77,905 as compensation. B did not include this payment on his 2005/06 tax return. HMRC issued an amendment treating it as taxable under ITEPA 2003 s 401 (subject to relief for the first £30,000 under s 403). B appealed, contending that he should be treated as a self-employed agent of the Post Office.

Decision:

The First-tier Tribunal rejected this contention and dismissed his appeal, holding that a sub-postmaster held an 'office' and the payment which B had received was taxable compensation for the loss of that office.

Comments - The decision contains a useful review of the tax treatment of sub-postmasters. The Tribunal upheld HMRC's view that, while a sub-postmaster is not an employee, he holds an 'office'. Accordingly the payment made to the sub-postmaster was taxable as employment income (and could not be treated as trading income of the company which operated the shop where the Post Office was located). This was the second hearing of the appeal, which had originally been dismissed by a different Tribunal judge in 2010 but had subsequently been remitted for rehearing.

B Bimson v HMRC (No 2) TC1911

Payment on cancellation of service agreement

A company appointed a new managing director (R) in 2005. In July 2007 he ceased to be managing director and was given the title 'commercial director'. In January 2008 he left the company under an agreement by which he received a termination payment of £77,731. The company treated £30,000 of this as free of tax under ITEPA 2003 s 403, and deducted tax from the balance. R appealed, contending that a further £30,000 should be treated as non-taxable compensation for the loss of rights under the company's enterprise management incentive scheme.

Decision:

The First-tier Tribunal rejected this contention and dismissed his appeal.

Comments - The director claimed that part of the termination payment which he received should be treated as non-taxable compensation for the loss of rights under the company's EMI scheme. The First-tier Tribunal upheld HMRC's view that the evidence, and particularly the terms of his contract, did not support this contention.

G Reid v HMRC TC1877

Whether an employee

A doctor arranged for a builder (C) to refurbish the clinic from which he practised. C did not include the income from this work in his accounts. Following an enquiry, HMRC issued assessments charging tax on this income. C appealed, contending that he should be treated as an employee of the doctor.

Decision:

The First-tier Tribunal found as a fact that the relationship between Mr Coffey and Dr Selvarajan was not one of master and servant and that the features of the relationship indicated that Mr Coffey was self-employed.

Comments - The Tribunal upheld HMRC's view that the agreement between the builder and the doctor was a contract for services, rather than a contract of service. The case examined a case which clearly arose from a lack of clarity of understanding between the parties as to the role of each. The tribunal naturally considered the factors involved in a determination of status and the relevant authoritative cases before arriving at its conclusion.

T Coffey (t/a Coffey Builders) v HMRC TC1888

Mobile phones for employees (Lecture P714 – 10.39 minutes)

Basic position

There used to be no limit on the number (or value) of mobile phones that could be loaned by an employer to an employee for private use. However, that not surprisingly all changed from 2006/07, since when the number of mobile phones that can be loaned without giving rise to a taxable benefit in kind has been restricted to one per employee and with no exemption for phones loaned to a member of the employee's family or household.

Planning

A way round this limitation would be for the employer to provide two mobile phones to the employee. Then make most of the personal calls from one phone and elect to have that treated as exempt, and the other phone used strictly for business calls is also exempt as there is no benefit.

If a voucher is used as a means of making a mobile phone available to an employee for private use, no charge to tax or NICs will arise if the benefit would have been exempt (i.e. under the one phone per employee rule above) if a voucher had not been used.

With so many developments in mobile phone technology it is important to consider the extent available of maximising the basic exemption, quite apart from following the above. As an example, the company may arrange for dual SIM phones as a means of reducing costs. These phones allow 2 SIM cards to be installed and operated simultaneously. The advantages of this are that the employee, as a business user, could use a cheaper local phone network (or Skype) when travelling on business in Europe but still be contactable by clients on their normal mobile number. The savings can be significant. If the employee is allowed to use the mobile for private calls within the usage limits of the contract, thereby not involving an additional cost, the complete tax and NIC exemption should apply. However, that is technically the position only if there is one mobile phone number as required by Section 319 ITEPA2003. It is therefore sensible to require the employee to only use one of the numbers for private calls (generally the one with the greater use). That provides tax and NIC exemption for the handset and the mixed use SIM.

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If that solution is impracticable, use could be made of a pay-as-you-go SIM to install in the phone for making private calls without the need to use the other SIM number. If the pay-as-you-go SIM is paid for by the company the tax charge on the employee is equal to the cost of that rather than the full cost of the contract on the second SIM. If however the employee has to payfor it then of course the cost to them can be minimised by limiting the private calls made.

Smartphones

Revenue & Customs Brief 02/12 brings a smartphone within the definition of a mobile phone which is exempt from the benefit in kind tax charge where only one phone is provided by the employer and there is no transfer of ownership

This is on the face of it a minor shift from HMRC as most employers will in any event have treated a smartphone as being within the definition of a mobile phone, but the wording of the Brief suggests that HMRC will be looking to keep up to date with developments in this field and always give the tax exemption in the right circumstances.

Initial effect of the change

The change is relevant to employers that have:

1. provided just one smartphone to their employees without transfer of ownership; and
2. treated that smartphone as a device that falls outside the meaning of 'mobile phone' for the purposes of the exemption in Section 319 ITEPA 2003; and
3. included entries in form P11D and form P11D(b) for the benefit of the availability and use of that smartphone and for the corresponding Class 1A NIC liability (or included the benefit in a PAYE Settlement Agreement)

Reassuringly from the compliance angle, HMRC say that instances where all three conditions above are satisfied will be rare, as in many cases employers and tax advisers have assumed that smartphones are already covered by the mobile phones exemption. Where employers have been aware of HMRC'sprevious view that smartphones are not 'mobile phones', employers are likely to have provided such devices in circumstances covered by the separate exemption in Section 316 ITEPA 2003 for supplies and services used in employment duties. This exemption applies to certain categories of asset where the sole purpose for providing it is to enable the employee to perform the duties of the job, provided that private use is not significant.

Background to the change

Since the emergence of smartphones into the consumer mobile phones market from around late 2007 onwards, HMRC has considered that they were to be treated in the same way as set out in its previously published guidance about personal digital assistants ('PDAs'). This view was based on the understanding that smartphones were not devices that are designed or adapted for the primary purpose of transmitting and receiving spoken messages and used in connection with a public electronic communications service.

HMRC now considers that its application of the legislation to smartphones is incorrect and it accepts that smartphones satisfy the conditions to qualify as 'mobile phones'. Developments in PDAs following the penetration of smartphones into consumer markets from late 2007 onwards mean that many modern consumer PDAs are now also likely to be smartphones, ***but the change in view will not apply to devices that are solely PDAs.***

HMRC say that it should be noted that there are many types of devices that have telephone functionality which do not qualify as mobile phones. The definition does not cover apparatus that is designed or adapted

for a primary purpose other than transmitting or receiving spoken messages, even if that apparatus is also capable of being used in this way.

HMRC have given examples of apparatus that does not fall within the definition of a mobile phone. They include satellite navigation devices, devices that are solely PDAs and tablet and laptop computers. In general, devices that use Voice Over Internet Protocol ('VOIP') systems to make and receive phone calls will not satisfy the primary purpose test.

Employers affected – action to take

1. Where they provide a smartphone in 2011/12, treat it in the same way as any other mobile phone. Only include a benefit on form P11D for any mobile phones/smartphones that are either over and above the first one provided to the employee or that are provided to a member of the employee's family or household rather than to the employee personally.
2. If a smartphone was provided for 2010/11 and years back to 2007/08 and the three conditions listed under "Initial effect of the change" above are satisfied, the employer may wish to seek repayment of the Class 1A NICs in relation to the benefit of the smartphone. The Revenue & Customs Brief 2/12 explains how to do this.
3. If the employer does provide a P11D for 2011/12 and it is completed as explained in 1 above, there is no need to provide HMRC with any additional information about smartphone provision in 2011/12.
4. HMRC will automatically sort out 2011/12 and deal with any revision to the 2012/13 tax code when HMRC process 2011/12 P11Ds completed on this basis.
5. However, if there are any affected employees for 2010/11 for whom the change of view on smartphones means the employer will not need to send a P11D for 2011/12 as there are now no benefits or expenses to report on it they are asked to send a separate list of the names and employees affected.

Contributed by Gerry Hart

Relief for loan to close company

An individual (N) agreed to lend £100,000 to a company (V) of which he was a director. He financed this loan by increasing the mortgage on his house, and claimed relief under what is now ITA 2007 s 392 for the additional interest he had to pay. HMRC rejected the claim on the grounds that although N was a director of V, he did not own any shares in V and thus did not have a material interest in V, within what is now ITA 2007 s 394. N appealed.

Decision:

The First-tier Tribunal allowed N's appeal, finding that he had a 50% interest in a company (P) which was associated with V, whose controlling director was a major shareholder in P and was P's main creditor, entitling him to receive the greater part of P's net assets if it were to be wound up. Judge Geraint Jones held that the effect of what is now s 394(4) was that N should be treated as having a material interest in V, as he was a significant loan creditor and was therefore a 'participator' in V within what is now CTA 2010 s 454.

Comments - ITA 2007 s 392 provides that interest paid on loans to acquire interests in close companies may qualify for tax relief, subject to specific conditions. ITA 2007 s 393 provides that such loans only qualify for relief if they meet 'either the full-time working conditions or the material conditions'. ITA 2007 s 394 defines a 'material interest'. HMRC rejected the claim on the basis that the claimant did not have a material interest in the company of which he was a director. However Judge Geraint Jones held that the claimant met the requirements of s 394(4), so that the loan qualified for relief.

A Nowosielski v HMRC TC1907

Income from overseas trust

Jarrod Frye lived in the United States as a student from 1988 to 1995. He then returned to the UK, initially only to join in with the fiftieth birthday celebrations for his father, Dr Michael Frye. In view of his mother's failing health, Jarrod Frye decided to remain in the UK. Jarrod Frye was one of the beneficiaries of a trust known as the Menelaus Trust, resident in Nassau, Bahamas. The settlor of this trust had been Jack Frye. The trustees were Leadenhall Trust Company Ltd, a company with a post box address in Nassau. He received a dividend of £159,559 from a Bahamian trust. He failed to declare this on his tax return, and HMRC issued an assessment charging tax on it.

Decision:

The First-tier Tribunal upheld the assessment and dismissed the appeal.

Comments - The Tribunal upheld HMRC's view that a substantial dividend from an overseas trust was chargeable to income tax, and rejected the appellant's contention that it should be treated as capital.

J Frye v HMRC TC1916

Income arising under a settlement where settlor retains interest

In three cases heard together the issue arose as to whether a settlor, who had an interest in a trust, could be assessed to income tax under TA 1988 s 660A(1) where the income arising under the trust consisted of payments made by the settlor.

In the first case the appellant ("R") paid interest to the trustees of the discretionary settlement, which was non-UK resident, in respect of a £1 million loan made to him by the trustees. R was also a member of the class of beneficiaries. HMRC charged income tax on the interest. R appealed on the basis that a person could not be both payer and payee for income tax purposes.

In the second and third case, the appellant ("K") and his wife were trustees of the UK resident settlement. Under the deed, K had an interest in possession in the settlement. In 1997 the trustees of the settlement purchased K's house for £265,000 and permitted him and his wife to remain in occupation as tenants at a rent of £3,000 per quarter. In July 2001 the trustees sold that property and purchased another property which K and his wife occupied as tenants of the trustees at a rent of £1,500 per month. HMRC issued assessments in relation to the rent paid to the trustees by K and his wife, and K appealed on the basis that under s 660A he could not be liable to income tax on rental income when he paid the rent himself. K also appealed in his capacity as trustee of the settlement on the ground that under s 660A, the rental income received by the trustees was taxable only on K and there was an overlap with his personal appeals under the same reference number as to his personal liability. It was not disputed that rent received by the trustees was chargeable to tax under Sch A.

Decision:

A settlor of a settlor interested trust could be assessed to income tax on income arising under a trust under TA 1988 s 660A, even where that income consisted of a payment the settlor had made to the trustees. On a literal interpretation it would appear that 660A(1) was intended to apply to trust income which in the case of a settlor interested trust was "treated" as income of the settlor and not as income of any other person. Whilst that would not cause any difficulty in the case of income received from a third party, it appeared to lead to an absurd conclusion when the payment to the trust was made by the settlor himself. However, having considered whether the language of s 660A(1) admitted to an alternative construction which avoided the absurdity which could then be adopted in preference to the literal interpretation, the tribunal was not able to do so as it was constrained by the words of s 660A(1) itself.

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The present appeals fell within those cases in which the anomaly could not be avoided by any legitimate process of interpretation; IRC v Leiner (1964) 41 TC 589 and Ang v Parrish (Inspector of Taxes) [1980] STC 341 applied.

Although under TA 1988 660A(1) the rent received by trustees "is treated" as the income of the settlor and not as the income of any other person, the trustee remained the "persons receiving" the rent and was therefore taxable under TA 1988 s 21 without any entitlement to deduct trust management expenses. That was consistent with FA 600D(3) which specifically provided that "nothing in this chapter shall be construed as excluding a charge on the trustees by whom any income is received." The effect of s 660A was that K was also chargeable to tax on all, as opposed to the net, income of the trust which consisted of the rent he and his wife had paid to the trustees. As s 660A(1) referred to "income" as opposed to "profit" it followed that he was liable to tax on all of the rent paid to the trustees without deduction of trust management expenses. Given the absence of any restriction or qualification to the words "income arising under a settlement" s 660A(1) had to apply to all of the income arising under a trust and not just that which would not otherwise be chargeable to tax under the law relating to trusts. It followed that the appeals would be dismissed.

Appeals dismissed.

Comments – It would initially seem strange that a payment by the taxpayer can end up being assessed back on the taxpayer but that is the mechanism in s660A. This anomaly cannot be avoided in the circumstances outlined in the case. These provisions exist because it may be a third party who is paying the income and the provisions treat the income of the trust as that of the settler.

Rogge and ors v Revenue and Customs Comrs TC 1747

National Insurance - the UK extend new Social Security rules to Switzerland.

From 1 April 2012 EC Regulation 883/2004 will be extended to cover Switzerland. HM Revenue & Customs (HMRC) will now treat Switzerland as being another EU Member State for Social Security purposes.

If you go to live or work in Switzerland from 1 April 2012 then the new rules will apply to you and your employer. Depending upon the circumstances of your employment it may be that you continue to pay UK National Insurance contributions whilst you are there or that you have to start paying Swiss contributions instead. If you are working in the UK for a Swiss employer and are paying your contributions here then your employer may also have to start paying UK contributions.

The new rules also apply to self-employed people moving between the UK and Switzerland.

There are special transitional rules in the new Regulation. If you were subject to the legislation of the UK or Switzerland under the old rules in force before 1 April 2012, in the very similar EC regulations 1408/71, and the introduction of the new rules would change who you have to pay contributions to, then you may be able to carry on paying to the first country until there is a change in your circumstances. If you think this may apply to you, contact HMRC for advice.

HMRC's website contains guidance on Regulation 883/2004.

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Living in France but resident in the UK? (Lecture P712 – 11.08 minutes)

Broome v HMRC (2011) is yet another case on the meaning of 'residence' in the context of UK tax legislation.

The taxpayer (B) sold two non-main residence properties in 2000/01 at a profit. However, he claimed that he was non-UK resident for that tax year so that no CGT was due. HMRC disagreed with this contention and issued a CGT assessment on the basis that B was resident in the UK. B appealed against this.

B was born in England in 1949 and was UK-resident until leaving in 1977 to work overseas for a temporary period. He returned to live and work in the UK in 1980. In 1989, he married but the couple were divorced some 10 years later. B continued to occupy the former family home. Following his divorce and finding that there were difficulties in securing satisfactory access to the children, B decided to move to the south of France and, on 1 November 1999, he paid a substantial deposit on a property in Provence, on which he completed on 12 April 2000. Shortly after 1 November 1999, he moved to Spain (where he also owned property) and then to the USA before returning to France in order to open a French bank account and complete the legal formalities on the French property. B's furniture and personal possessions at his home in the UK were put into storage just over a year later and, on 1 June 2001, this property was rented out.

On 31 January 2001, B completed and signed his self-assessment tax return for 1999/00. In reply to Q9 (which asks about the taxpayer's residence status), B stated that he was not claiming to be non-UK resident, despite the fact that he was using his French address. The 2000/01 return was submitted on 16 January 2002 and again B confirmed that he was not claiming non-UK resident status. An amendment to this return, stating that B was non-UK resident, was not received by HMRC until 13 September 2005.

B sold his house in Provence on 24 June 2005. The declaration in the French tax return for the property disposal recorded that B considered himself to be non-resident for the purposes of the French regulations in force and that his primary residence was in England. For their part, the French tax authorities said that B was unknown to them and that he did not pay income tax in France while he lived there.

The taxpayer's records show that, over this whole period, the days spent by him in the UK amounted to:

2000/01	19
2001/02	27
2002/03	41
2003/04	41
2004/05	36

The relevant figure for 1999/00 was 103 days.

Unfortunately for B, the First-Tier Tribunal dismissed his appeal. They considered that the taxpayer must show, on the balance of probabilities, that his move abroad provided evidence of a settled intention to become non-UK resident and that he had established what they chose to call 'a real and closer connection to his new country of residence'. The Tribunal accepted that B was clearly making preparations physically to leave the UK before the start of the tax year 2000/01. In addition, they agreed that there was significant evidence that he intended to leave the UK for an indefinite period. Although it was persuasive, they did not consider the fact that B continued to give a UK postal address as evidence that he had *not* severed his ties with the UK. However, the fact that he had not originally claimed non-UK resident status in his 2000/01 tax return *was* considered significant. The Tribunal said that it would have been relatively straightforward for B to have been recognised as a resident of France and thus to have relinquished his UK status.

This case illustrates the considerable difficulty of giving up a taxpayer's UK residence when he does not establish residence in another jurisdiction. However, the Tribunal's decision seems to suggest that UK residence can only be lost if the individual secures residency status elsewhere. With respect, this cannot be correct. While undoubtedly difficult, it is not impossible to cease to be UK-resident and yet not to be resident in any other country.

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The Tribunal's comment that B could have relinquished his UK status 'had he wished to do so' by becoming resident in France fails to take into account the possibility that someone can be resident in two jurisdictions simultaneously. In all cases, however, the importance of establishing a proper paper trail cannot be overstated. At the very least, taxpayers must notify HMRC when they cease to be UK-resident and file tax returns on a sensibly consistent basis.

Interestingly, applying the draft statutory residence test which is now expected to become law on 6 April 2013, it appears that B would have been non-UK resident for 2000/01! While he has three connection factors (this assumes that he did not do substantive work in the UK and that he did not spend more time in the UK than in any other country), he nevertheless spent less than 45 days in the UK in the relevant tax year.

Contributed by Robert Jamieson

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CAPITAL TAXES

Private residence relief and 'living together' (Lecture P713 -11.29 minutes)

Married couples (and civil partners) benefit from favourable treatment for certain tax purposes. A good example is the no gain no loss CGT rule for inter-spouse disposals found in S58 TCGA 1992. Another one is the IHT exemption in S18 IHTA 1984 which is unlimited for transfers between spouses (although it is restricted to a cumulative maximum of £55,000 if the transferee is a non-UK domiciliary).

The principal private residence legislation includes a special provision for married couples. S222(6) TCGA 1992 states that there can only be one sole or main residence for both spouses, provided that they are 'living together'. In addition, any principal private residence nomination where there are two or more properties must be made by them both.

The meaning of 'living together' would appear to be clear and unequivocal on the face of it, but this will not always be the case. The term shares the income tax meaning (see S288(3) TCGA 1992) – S1011 ITA 2007 declares that spouses are treated as living together, unless they are separated:

(i) under a court order;

(ii) by a deed of separation; or

(iii) in circumstances where the separation is likely to be permanent.

In the recent case of *Benford v HMRC (2011)*, the First-Tier Tribunal had to consider whether the taxpayer (B) was separated from his wife for principal private residence relief purposes. In March 2005, B had purchased a property in Bracknell in his sole name. He sold it some six months later and made a profit of £50,000 on the deal. He claimed CGT exemption on the sale of the house on the basis that it had been his principal private residence during a period of separation from his wife (it was common ground that she had never occupied the property). HMRC subsequently raised a CGT assessment in respect of the sale under the discovery rules. B appealed. In this situation, the onus of proof is on the taxpayer to establish that, on the balance of probabilities, the property was occupied as his residence during the period when we owned it and that, during this time, he was separated from his wife in circumstances which were likely to be permanent. The Tribunal confirmed that a taxpayer's occupation of a property was a question of fact. Having considered the evidence, they found that B did indeed occupy the property during his period of ownership.

However, the Tribunal also noted the absence of 'convincing documentary evidence' to show that B lived in the property, as well as a lack of furniture and appliances in the house and a remarkably small amount of electricity used during the six months of his ownership (bills totalling just over £20!). The Tribunal held that there was insufficient assumption of permanence or expectation of continuity to turn such occupation into residence – in this context, see the Court of Appeal's decision in *Goodwin v Curtis (1998)*. In terms of whether B's separation from his wife was likely to be permanent, they concluded that B had not discharged the burden of proof required to demonstrate that he was permanently separated from his wife. It was therefore held that he should be treated as living with his wife for CGT purposes. As B's wife had never lived in the property in Bracknell, the matrimonial home was considered to be B's main residence. His appeal was dismissed.

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This finding emphasises the need for taxpayers to provide satisfactory evidence in support of claims or assertions in enquiry cases. The burden of proof before the First-Tier Tribunal is on a balance of probabilities. The concept of 'living together' is not always straightforward and can sometimes be counter-intuitive. For example, if one spouse is resident in the UK but the other is non-UK resident, they may still be treated as living together for tax purposes, assuming that they are not separated. Some care is often needed to ensure that a couple satisfy the statutory definition of 'living together' in the relevant tax year.

Contributed by Robert Jamieson

Whether a transfer of a business to a company

A married woman (R) had acquired a large house in Belfast, which was divided into flats and let to tenants. In 2004 she transferred the house to a company. She claimed relief under TCGA 1992 s 162. Following an enquiry, HMRC issued a ruling that no relief was due, on the grounds that the property was an investment and was not a business.

Decision:

The First-tier Tribunal dismissed R's appeal. Judge Huddleston held that 'where an individual asserts that a business arises, there is a presumption that unless proof of sufficient activity is established, that it is not a business. That onus of proof rests on the appellant.' On the evidence, R's activities were 'normal and incidental to the owning of an investment property', and did not constitute a business.

Comments - TCGA 1992 s 162 provides for rollover relief where a person transfers a business to a company as a going concern. The First-tier Tribunal upheld HMRC's view that the letting of flats to tenants was not a business, so that the transfer of the house to a company did not qualify for relief under this provision. This case demonstrates the importance (which applies to a number of tax provisions) of proving that the relevant asset is a business rather than the passive holding of an investment.

Mrs EM Ramsay v HMRC TC1871

Capital payment for goodwill?

The taxpayer operated a newsagent's business in partnership with his wife, son and daughter-in-law. In 2000, the business agreed to take on a subpost office and this was incorporated in the newsagent's shop. The partnership was incorporated in 2002, and was paid £70,400 for the transfer of goodwill to the company. The taxpayer was appointed subpostmaster and arranged for the salary to be paid in to the partnership's account.

In 2004, Post Office Ltd decided to close the subpost office and paid the taxpayer compensation of £89,545. The taxpayer was advised by Post Office Ltd that the part of the payment which related to compensation for loss of office would be taxable under ITEPA 2003, s 401 subject to the £30,000 exemption.

The compensation was paid into the company's accounts and the taxpayer did not include any of it on his personal self-assessment tax return. The company accounts included a chargeable gain of £59,545, being the total compensation less the exempt amount.

HMRC opened an enquiry into the company's accounts and raised a discovery assessment on the taxpayer in October 2006. The taxpayer appealed.

Decision:

The First-tier Tribunal agreed that the £89,545 was a payment for loss of office which should have been shown on the taxpayer's self-assessment tax return. However, by concession in previous years, HMRC had agreed to income from Post Office Ltd being shown on the company accounts and returned that way. They must therefore have known about the payment well before raising the discovery assessment. The taxpayer had not tried to hide the payment, and if HMRC had queried the capital gain in the company accounts at the time they would have been aware that further income was assessable on the taxpayer.

The tribunal concluded that the taxpayer had not been negligent in any way. He arranged for the payment to go through the company in the same way as previous payments from Post Office Ltd had been dealt with in the past. The payment was compensation for loss of office and, as a result, could not form part of the company's accounts, which meant that the capital gains tax assessment should be disallowed. HMRC were out of time to raise a discovery assessment.

Comments – Payments received by sub-postmasters relating to the closure of their office are often misunderstood particularly because when they received income from the office before closure it was dealt with different people in different ways. This case demonstrates the importance of determining what is received and therefore what taxation treatment follows from that.

M Singh TC1544

Holiday lettings and business property relief (Lecture P715 – 7.31 minutes)

Judgment was handed down on 14 December 2011 by the First-Tier Tribunal in the interesting case of *Pawson v HMRC (2011).*

The dispute concerned a holiday cottage in Suffolk which was owned as to one-quarter by the deceased (Mrs P). Mrs P's personal representatives argued that the bungalow, which was regularly rented out and which could accommodate up to 11 people, qualified for business property relief. HMRC refused to accept this claim and their arguments had a familiar ring: the property was, in reality, an investment (however it might have been treated for income tax purposes) and Mrs P had done nothing more by way of the provision of services than would be consistent with the protection of the family investment.

There were no particularly unusual features about the facts of this case, but the Tribunal's decision was that they considered the letting of a holiday cottage to holidaymakers to be what they called 'a serious undertaking earnestly pursued' and so they held that it represented a business for the purposes of the relief. The test propounded by the Tribunal was that an intelligent businessman would, in this context, regard the ownership of a holiday letting property as a business rather than an investment – it was far too active an operation to fall under the latter heading. The constant need to find new tenants and to provide services over and above those which were necessary for the bare upkeep of the property would cause it to be regarded as a business asset to be exploited.

This is certainly a move away from the more traditional viewpoint expressed by Tribunals on this subject in the past and is therefore extremely welcome.

Contributed by Robert Jamieson

SDLT - apportionment of consideration

A woman purchased a house in 2010. She paid £258,000. The purchase agreement attributed £250,000 to the house and land, and £8,000 to chattels. In her SDLT return, she declared SDLT of £2,500 (at 1%). HMRC discovered that, of the amount attributed to chattels, £800 was attributable to 'fitted units' in the garage. They issued an amendment on the basis that these units were part of the land, so that the total consideration attributable to the house and land was £250,800 and the SDLT rate was 3%. The purchaser appealed.

Decision:

The First-tier Tribunal dismissed her appeal, finding that 'the worktop was fixed to the house' and that it was 'just and reasonable to apportion £250,800 of the consideration paid to the house and the garage worktop and units'.

Comments - FA 2003 s 55 provides that where the chargeable consideration is not more than £250,000, the rate of SDLT is 1%. However, where the chargeable consideration is more than £250,000, the rate is 3%; and this is charged on the whole of the consideration, not just on the top 'slice' as with income tax. FA 2003 Sch 4 para 4 provides that where only part of the total consideration is attributable to a land transaction, the consideration 'shall be apportioned on a just and reasonable basis'. Where a house is advertised for a price slightly above this £250,000 threshold, it has become quite common to seek to avoid the additional tax by attributing part of the consideration to chattels which are not chargeable to SDLT. In this case, however, the Tribunal upheld HMRC's view that some of the items which the relevant solicitor had treated as 'chattels' were actually fixed items, which in law had become part of the land and remained chargeable to SDLT. The result was that the Tribunal upheld HMRC's contention that the appropriate rate of SDLT was 3%, rather than 1%.

Miss G Orsman v HMRC TC01921

ADMINISTRATION

Honest belief over payment a reasonable excuse

The taxpayer set up a tax payment arrangement under TMA 1970, s 108 which he believed related to all the tax due from him during the period that he was trading, i.e. 2 February 2009 to 16 October 2009. The arrangement began in April 2010 at a rate of £60 a month. He did not realise that his trading period straddled two tax years, and that the payment arrangement covered only the year to 5 April 2009. As a result, he did not pay the tax due for 2009/10 on 31 January 2011 and incurred a 5% late payment surcharge. He appealed, claiming that it was 'unfair and unreasonable' for HMRC to impose a penalty in light of the factual background.

Decision:

The First-tier Tribunal accepted the taxpayer's arguments, and noted that the taxpayer had kept up with the payments due under the arrangement made in April 2010. Given that the taxpayer 'honestly believed' that the arrangement covered the whole amount of the tax due, the tribunal judge said this constituted a reasonable excuse and discharged the surcharge.

The taxpayer's appeal was allowed.

Comments – This was an appeal determined by Judge Geraint Jones without a hearing and demonstrates the importance of the belief of the Tribunal in the integrity of the taxpayer.

S Stuart-Turner TC1539

Bank's failure is not an excuse

The taxpayer paid his tax due on 31 January on 27 March and incurred a late payment surcharge of 5%. He claimed he had a reasonable excuse for paying late as his bank had failed to make the transfer of funds he requested to enable him to pay the tax. He said that he had adequate money to pay HMRC, but the bank had not carried out his instruction.

While expressing some sympathy, HMRC said this did not amount to a reasonable excuse.

Decision:

The First-tier Tribunal agreed with HMRC that a 'responsible person who was taking his payment obligations seriously' should have organised his finances so that he could pay his tax on time. The actions of the bank were to some extent within the taxpayer's control and he should have made more effort to ensure the funds were transferred.

The taxpayer's appeal was dismissed.

Comments – Whilst there is no statutory definition of a “reasonable excuse” there is published HMRC guidance and a number of decisions from the Tribunal and the higher courts. A shortage of funds does not usually constitute a reasonable excuse save in some closely prescribed circumstances.

D Clark TC1566

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No funds was a good reason

The taxpayer company made several of its monthly PAYE payments late in the year 2010/11. HMRC sent it a letter in May 2010, warning the company that it may be liable to a penalty if it made more than one late payment in the year. Then in June 2011, HMRC issued a penalty notice, charging 3% of the late paid PAYE.

The company appealed.

It accepted that the payments had been late but said it had a reasonable excuse as its only customer, TNT, changed its payment terms over the relevant period. These caused the taxpayer severe cashflow problems which took some time to resolve. TNT subsequently reversed the change.

Decision:

The First-tier Tribunal noted that the company had contacted HMRC about its cashflow difficulties and the effect they would have on the company's ability to make its PAYE payments on time. He found as a fact that as a result of these discussions, the company believed it could make late payments. That the company had relied on this agreement constituted reasonable excuse.

However, in addition to this, the changes made by TNT to its payment terms were beyond the taxpayer's control, and therefore also amounted to reasonable excuse, according to the tribunal judge.

The taxpayer's appeal was allowed and the penalties were set aside.

Comments – It is becoming increasingly important with the automated penalty regimes that evidence is gathered for appeals to the Tribunals. This case demonstrates very well how the penalty can be raised within the new structure for penalties for late paid PAYE and the lack of flexibility for HMRC can cause real problems in addition the cash flow problems that the business might already be suffering. Gather the evidence and reap the benefit!

Northern Bulk Transport Ltd TC1621

Reasonable excuse – Circumstances beyond control

The taxpayer appealed against a surcharge for the late payment of her self-assessment income tax. She put forward as reasonable excuse that she had taken a 50% pay cut as a result of the recession, her husband was an alcoholic who had lost his livelihood and been close to a nervous breakdown, the couple had debts of £85,000 that they were trying to manage and that they had ultimately separated, leaving her to look after their two children, work full-time and control the debt.

With regard to the tax, the taxpayer had contacted HMRC in February to try to make a time-to-pay arrangement, but the department took more than a month to contact her, and it was not until June that an arrangement was agreed.

Decision:

The First-tier Tribunal accepted that the taxpayer's chaotic domestic problems constituted reasonable excuse. Separating from her husband and having to take on sole responsibility for childcare, etc. were unforeseeable difficulties and outside the control of the taxpayer. The tribunal judge noted that the taxpayer had tried to agree a time-to-pay arrangement before the surcharge trigger date of 28 February.

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The taxpayer had a reasonable excuse and her appeal was allowed.

Comments – This case is a perfect demonstration of when matters are completely beyond the taxpayer's control. The circumstances were so stacked against the taxpayer but even in the circumstances she had the thought to communicate with HMRC to attempt to plan the payments. This demonstrates how if a taxpayer takes appropriate action the Tribunal and Court system will attempt to deal with the taxpayer fairly.

S Cornes TC1701

Penalty for failure to submit P35

A woman (B) with two employees failed to submit her P35 in time, and HMRC imposed penalties of £500. She paid £100 but appealed against the balance of £400, contending that the penalty was unfair.

Decision:

The First-tier Tribunal dismissed her appeal. Judge Poole specifically disapproved the decision of Judge Geraint Jones in Hok Ltd v HMRC FTT [2011] UKFTT 433 (TC), TC01286, and held that while the penalty was 'harsh', it was neither 'plainly unfair' nor disproportionate.

Comments - Judge Poole specifically disapproved the controversial decision of Judge Geraint Jones in Hok Ltd v HMRC (which is currently under appeal to the Upper Tribunal).

Ms N Bailey v HMRC TC01881

Tax treatment of share-based payments for leavers (Lecture B714 – 6.41 minutes)

It will be recalled that the PAYE treatment of post-P45 cash termination payments was changed with effect from 6 April 2011. Rather than applying PAYE at the basic rate (which had been the position for many years), employers are now required to use a special '0T' code. This deducts PAYE as if the employment was continuing and the employee did not have a personal allowance. Taxable payments in excess of £12,500 (1/12 x £150,000) therefore suffer a 50% withholding, which normally means an over-deduction.

Following concerns about how the '0T' code would work in the context of share-based payments, HMRC announced just before the change was due to take effect last year that employers should continue to use the 'BR' code for all post-P45 payments which involved shares.

HMRC have now decided to remove this exclusion so that the '0T' code has to be applied, with effect from 6 April 2012, to all taxable termination payments (including share-based ones) where the P45 has already been issued. Apparently, HMRC found that many payroll administrators favoured the simplicity of applying a single tax code to all post-P45 remuneration – operating the 'BR' code for share-based payments and the '0T' code for the rest was problematic, especially when these payments were made simultaneously.

This result is not an ideal arrangement. Employers may have to sell more shares than is strictly necessary in order to cover their PAYE liabilities and the ex-employees, who have suffered too much tax, will need to reclaim the overpayment through the self-assessment procedure.

Where termination arrangements are being settled in the next month or so and they include a share-based element, there is likely to be a timing advantage in receiving the share-based payment before 6 April 2012. However, for 6 April 2012 onwards, there will be little reason to delay the receipt of share-based payments until after the issue of the P45, although in practice the timing of these may well be governed by the share scheme rules and other administrative factors. Indeed, it will be sensible in these circumstances to hold back the issue of the P45 until all outstanding remuneration has been paid or provided to the leaver in order to avoid the necessity of using the ‘0T’ code.

Contributed by Robert Jamieson

Application to amend grounds of appeal

An accountant began in business in 1981 with no goodwill and transferred his business to an associated company in 2003. However, due to the indexation revaluation rules in s 35(2) Taxation of Capital Gains Tax, the base cost of the goodwill on disposal has to be taken as the market value of it as at 31 March 1982. Mr Wilden claimed this was £516,940. HMRC considered it to be £75,000 and issued the closure notice on that basis. HMRC issued an amendment to his self-assessment, increasing the CGT liability on the disposal, and he appealed, contending that the amendment understated the valuation of the goodwill of his business at March 1982. He subsequently applied to amend the grounds of appeal to include a contention that the valuation of the business at the date of disposal was excessive. HMRC opposed the application

Decision:

The First-Tier Tribunal granted it. Judge Mosedale held that 'neither the delay nor extra costs are grounds on which leave to amend the grounds of appeal should be refused'.

Comments - TMA 1970 s 31A(5) requires an appellant to specify his grounds of appeal. The accountant here applied to amend his grounds of appeal against an amendment charging CGT. HMRC opposed the application, considering that it was a delaying tactic. However, the First-tier Tribunal granted the application. It is interesting to note the wide discrepancy between the two parties in respect of the valuation of the goodwill at 31 March 1982 bearing in mind the business only came into being in 1981.

G M Wildin v HMRC TC1782

Careless completion

The taxpayer had two jobs during 2008/09. The first was with CS and the second with Liberty. Her employment with Liberty ended in October 2008.

She submitted her tax return, but failed to complete an employment page for each position. She also did not include a lump sum she had been paid from Liberty.

HMRC opened an enquiry into the return and said that the failure to include the lump sum constituted carelessness on the part of the taxpayer. Had she read the related guidance, this might have helped her realise that she should have completed the second employment page, as well as disclose the lump sum. HMRC imposed a penalty of £2,053. This was set at 15% of the tax due because of the taxpayer's prompted disclosure.

Decision:

The First-tier Tribunal said that the taxpayer had not taken sufficient care when completing her return to ensure that she included all her income from Liberty. As well as her P45, she had her payslips and clear HMRC guidance to help her complete her return. In total, the omission of the lump sum amounted to 20% of her gross earnings. However, the tribunal noted that she had acted promptly to correct the return after the enquiry was opened. In conclusion, the tribunal agreed with HMRC that the taxpayer's behaviour had been careless and it confirmed the penalty at 15%.

The taxpayer's appeal was dismissed.

Comments – This was a “cut and dried” decision demonstrating that careless behaviour will result in penalties

R Hook TC1576

Lack of care

In 2003, the taxpayer, who had taken early retirement, was employed by D as an agency driver. The company correctly used code BR on the taxpayer's earnings. In 2005, the taxpayer left D, but returned to work for D after a few months. Initially, D continued to use the BR code, but at the start of 2006/07 changed it to 503L. HMRC issued a notice of coding in May 2006 showing code BR, but this was not operated by D. The result was that the taxpayer underpaid tax for 2006/07 and 2007/08.

The company said that it had installed a new payroll system around the time of the code error. HMRC accepted that it had taken reasonable care to deduct the correct amounts, but had made an error due to a lack of familiarity with the new system.

The department therefore issued a direction under Income Tax (PAYE) Regulations 2003, reg 72 to collect the outstanding tax from the taxpayer.

The taxpayer appealed, saying the company had not taken reasonable care in dealing with his PAYE liability.

Decision:

The First-tier Tribunal agreed with HMRC's decision, saying the employer had acted in good faith, so the taxpayer appealed to the Upper Tribunal (Tax and Chancery Chamber). The Upper Tribunal remitted the case to the First-tier Tribunal for reconsideration.

At the second hearing before the First-tier Tribunal, the tribunal judge noted that the incorrect code 503L had been instigated with no authority and before the new payroll system was installed. No computer error appeared to be involved and the mistake would not have happened if proper care had been taken. D did not take reasonable care, although it had not acted in bad faith. However, this did not excuse the failure to follow the instructions in the new system's training manual.

The taxpayer's appeal was allowed.

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Comments - The Income Tax (PAYE) Regulations, SI 2003/2682, reg 72 provides that, where there has been an underdeduction of tax, HMRC may direct that the employer is not liable to pay it, and may seek to recover it from the employee instead, provided that one of two conditions were satisfied. The Tribunal held that neither condition was satisfied in this case. One unusual procedural aspect to this case is that a different Tribunal judge had previously dismissed the appeal. It appears that the Upper Tribunal had subsequently remitted the case for rehearing by a different judge, but it is unfortunate that the Upper Tribunal has not publicly released its decision, and that Judge Mitting makes no specific reference to this.

T J Blanche TC1697

Penalties on under declared restaurant takings

This is the latest instalment in a long-running saga.

HMRC had issued assessments on the controlling director of a company which operated an Indian restaurant, on the basis that he had received undeclared income which represented undisclosed remuneration from the company. The assessments included rent which the company had paid on behalf of the director, benefits in kind, and amounts in respect of takings which HMRC considered had been abstracted by the director without appearing in the company's records. The director (K) appealed, accepting that he was liable to tax on the rental income and the benefits in kind, but contending that there had been no undeclared takings.

The General Commissioners upheld the assessments in principle but reduced them in amount, finding that there had been undeclared takings but that the amount assessed was excessive. The Commissioners determined the amount of undeclared takings by applying a mark-up to the amount of meat which the company had purchased, and determined the amount of undeclared remuneration in amounts varying from £15,000 for 1992/93 to £71,000 for 1998/99.

The director appealed to the Ch D, which upheld the assessments in principle but reduced the amount of each assessment by £5,000 ([2004] STC 669). Following this decision, HMRC imposed penalties totalling £41,332 on K under TMA 1970 s 95.

K appealed to the General Commissioners, who upheld the penalties in principle but reduced them to £6,000, holding that they should apply the criminal standard of 'proof beyond reasonable doubt', and finding that although HMRC had shown that K had negligently understated income from property and benefits in kind, HMRC had not proved that he 'negligently understated income in respect of remuneration'.

HMRC appealed to the Ch D, contending that the Commissioners had misdirected themselves as to the standard of proof, and should have applied the normal civil standard of the balance of probabilities. The Ch D accepted this contention and remitted the case to the Commissioners for rehearing ([2008] STC 2880). Mann J observed that in 1983, the Keith Report of the Committee on the Enforcement Powers of Revenue Departments had 'assumed that a civil penalty system for dishonesty in relation to income tax required proof only to the civil standard', and that this reasoning had been applied in subsequent VAT cases in which 'it was plainly assumed that the civil standard of proof applied to the income tax regime'. It was 'sensible that the same standard of proof should apply' to income tax and VAT, and 'for the reasons given in the Keith Report and referred to in the cases, that standard should be the civil standard'. The CA rejected an application by the director to appeal against this decision ([2009] EWCA Civ 399) and the First-tier Tribunal reheard K's appeals against the penalties relating to suppressed takings.

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Decision:

Lady Mitting reviewed the evidence in detail and upheld the penalties in principle, directing that they should be imposed at the rate of 40% the evaded tax, resulting in penalties totalling £19,616 on this source (in addition to the £6,000 imposed by the General Commissioners).

Comments - This is an important case as the CA rejected an application for leave to appeal against the High Court decision, suggesting that they agreed that the standard of proof with regard to penalties is the civil standard rather than the criminal standard. Somewhat surprisingly, HMRC has failed to cite the High Court decision in several more recent cases concerning appeals against penalties. With regard to the quantum of the penalties on the suppressed takings, the First-tier Tribunal reviewed the evidence in detail and directed that they should be imposed at the rate of 40% of the evaded tax on the underdeclared takings. The result is that, after fighting a long rearguard action, the director now has to pay penalties of £25,616, rather than the £6,000 imposed by the General Commissioners.

TI Khawaja v HMRC (No 2) TC01878

Negligence

The claimant company was a manufacturer and distributor of silicon memory products. The defendant was a firm of accountants. The claimant employed the defendant under a contract to provide tax advice regarding a discretionary bonus scheme concerning the making of National Insurance payments (the scheme). That advice was given in either 1997 or 1998. Between 2000 and 2003, the Revenue and Customs Commissioners (the Revenue) made demands for National Insurance from the claimant. In that period, the defendant advised the claimant to make protective payments in order to prevent ongoing exposure to interest on unpaid National Insurance. In June 2003, the Revenue issued a claim against the claimant for unpaid National Insurance. In October 2009, the claimant made a payment of £104,096·34 to the Revenue, representing unpaid National Insurance and interest.

In May 2011, the claimant commenced proceedings against the defendant, seeking to recover that sum. It contended that the defendant had been under a continuing duty to advise the claimant of any change in the law, which it alleged had happened in 2003, and that the defendant had negligently and/or in breach of contract failed so to advise, causing damage to the claimant. It contended that the defendant was in breach of an implied term that it would exercise reasonable care and skill in providing advice and acting as the claimant's tax advisor. The deputy master held that the defendant was entitled to summary judgment on the grounds that the claimant's claims were barred by limitation. He held that, as the defendant had not been under a continuing duty to advise the claimant as to whether the scheme was effective in law once it had been put in place, the contract claim was time barred. He further held that the claim in tort was also time-barred, as the claimant had incurred a liability to pay interest to the Revenue when it had failed (by, at the latest, 1998) properly to account to the Revenue for National Insurance. Furthermore, the deputy master held that the claimant could not take advantage of the extended limitation period provided for in s 14A of the Limitation Act 1980, which set out the means of calculating the starting date for any action for damages for negligence. The claimant appealed.

The claimant submitted that the deputy master had erred in: (i) construing the contract and holding that the defendant was not under a continuous contractual duty to advise the claimant that the scheme had failed, and had erred in holding that the claim in contract was time-barred. He contended that the limitation period in contract had commenced in August 2009, when the claimant had obtained advice from tax counsel, rather than when the defendant had given its advice; (ii) holding that the claim in tort was time-barred, since the primary limitation period in tort had commenced when it had accepted liability for the payments made to the Revenue in October 2009, as it was only then that it had sustained actual damage; (iii) using the wrong test in determining whether the claimant had possessed relevant knowledge under s 14A of the Act, in determining that issue prior to trial, and hence had been wrong to hold that the claimant could not take

advantage of the extended limitation period provided for by the Act. Consideration was given to Khan v RM Falvey & Co [2002] All ER (D) 361 (Mar), which made it clear that a claimant could not defeat the statute of limitations by claiming only in respect of damage which occurred within the limitation period, if he had suffered actual damage from the same wrongful acts outside that period (the Khan v Falvey principle).

Decision:

First ground

On the claimant's case, the defendant's contractual duty had been breached in or around 2003: it should then have advised that there was a material change in the law and/or that the scheme had failed. The advice which the defendant was alleged to have failed to give thereafter was the same advice that it was alleged should have been given in 2003. Therefore, the relevant contractual duty had been breached in 2003 and thereafter there had been a failure to remedy the existing breach, not the commission of a further breach.

The deputy master had been correct in holding that the claimant's claim for breach of contractual duty was time-barred.

Second ground

The cause of action for negligence in tort would not be complete until the claimant incurred loss or suffered damage in respect of which the duty was owed.

With regard to the claim in tort, contrary to the claimant's submissions, the claimant's liability to pay National Insurance to the Revenue had been in no sense contingent on the Revenue succeeding or failing in a tax tribunal. On the evidence, in the instant case, the existence of the Revenue's power to waive or remit interest did not prevent there being an actual liability. Consequently, the claimant had suffered loss and damage for the purposes of its claim in negligence before May 2005, in other words, more than six years before the claim form had been issued. The claim in tort fell foul of the Khan v Falvey principle and would therefore fail.

The claimant's claim in tort was time-barred.

Third ground

It was well-established that in order to take advantage of the extended period of limitation provided for by s 14A of the act, the claimant had to show that he did not have the knowledge referred to in that section. All that was required was sufficient knowledge.

On the evidence, the knowledge test in s 14A(10) of the Act had been satisfied in the instant case well before 11 May 2008. It was clear that the claimant had considered from 2003 onwards that it had cause to complain of unsoundness in the initial and ongoing advice either given or not given by the defendant about the viability of the scheme. The claimant had known with sufficient confidence to justify embarking on the preliminaries to the issue of a writ, and had known that there had been a real possibility of the damage having been caused by some flaw or inadequacy in the defendant's advice. Further, on the evidence, there was no other compelling reason why the issue of knowledge ought to have been disposed of at trial.

The claimant had no real prospect of succeeding in showing that it only acquired relevant knowledge for the purposes of s 14A of the Act after May 2008.

The claim would be dismissed.

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Comments - Section 14A(10) of the Limitation Act 1980 provides, so far as material: "For the purposes of this section a person's knowledge includes knowledge which he might reasonably have been expected to acquire: (a) from facts observable or ascertainable by him; or (b) from facts ascertainable by him with the help of appropriate expert advice which it is reasonable for him to seek; but a person shall not be taken by virtue of this subsection to have knowledge of a fact ascertainable only with the help of expert advice so long as he has taken all reasonable steps to obtain (and, where appropriate, to act on) that advice."

This case is a good demonstration of how long negligence cases can go for. Many tax professionals have little experience of negligence cases and how they are dealt with. They become a battleground for the parties involved with very unpleasant experiences for the parties directly involved. The most important lesson is that it is very easy to make mistakes and those mistakes will continue for a very long time. It highlights the importance of review procedures, limitation of liabilities in engagement letters and professional indemnity insurance.

Integral Memory Plc v Haines Watts [2012] EWHC 342 (Ch)

Negligence (another case!)

The claimant company, P, brought a claim against the defendant accountants' firm for negligence in respect of tax advice it received from the defendant. As a result of that advice, P bought assets and purchased shares in companies and hived up the assets. P contended that the defendant's negligent tax advice led to adverse capital gains tax consequences so that an extra £1·3m was likely to be payable and £1·3m of capital losses had been used up and would not be available for offsetting against future gains. P subsequently went into liquidation and transferred substantially all of its assets into a company, Inhealth UK Holdings Ltd (IHUK). P applied to the High Court to substitute IHUK as the claimant in the proceedings. The defendant resisted that application contending that the result of the transfer to IHUK was that P could no longer show any loss from the original alleged negligence and that since IHUK could only sue for P's losses, not its own, the action was not sustainable. The defendant applied to strike out the action. The master declined that application. The defendant appealed against that decision.

The issue for consideration was whether IHUK could maintain a claim for loss in circumstances in which P had assigned its cause of action and had assigned all of its assets to IHUK.

Decision:

It was settled law that where a wrong had been committed in relation to property and loss was capable of arising as a result, the fact of an assignment, whether gratuitous, for part value, or for full value, did not mean that the assignor no longer could be said to have suffered loss. The loss flowing could and should be treated as a loss of the assignor, which the assignee could recover. It followed that a gratuitous transfer of underlying assets did not remove a loss in the hands of an assignor. The assignee could maintain a claim for loss notwithstanding the transfer of the underlying property, whether for full value or not.

Applying settled principles to the instant case, the loss which P could have claimed immediately before the transfer of the property did not disappear on, and as a result of, the transfer. It followed that IHUC could recover what P would have been able to recover.

The defendant's attempts to argue that P's principal loss had gone failed. The amendment to substitute IHUK would be allowed.

The appeal would be dismissed.

Comments – The second negligence case in the same month demonstrates how important it is to get matters right first time. The argument raised by the defendants about the lack of loss was unsuccessful. It is an illustration of the type of argument that will be used to defend the position of the defendants. As mentioned previously the procedures to prevent negligence in the first place are important and there for this reason.

Pegasus v Ernst & Young [2012] EWHC 738 (Ch)

Simple record keeping applications for mobile devices

To help small businesses with record keeping on the go, the commercial software industry, following consultation with HM Revenue & Customs (HMRC), are producing simple record keeping mobile applications for businesses below the VAT threshold. These applications may help you with maintaining good records and include links to HMRC guidance related to record keeping that you may find useful. The majority of these applications are free.

The companies listed below have advised HMRC that they have commercial mobile applications for record keeping that meet the HMRC specification. This list is not exhaustive and it is probable that other software houses associated with mobile application development will also be developing applications. The list will be updated as necessary on a regular basis.

Please note that the inclusion on this list of any trader or trade organisation does not imply any support, recommendation or certification of their software by HMRC.

HMRC has not carried out any testing of the listed applications and do not carry out any form of security testing of developer products or services. Customers are encouraged to ask their suppliers for information about the security aspects of the products and services they provide.'

Business Tax Dashboard

HM Revenue and Customs (HMRC) Business Tax Dashboard is an online service aimed at smaller businesses. You must have enrolled to use either HMRC's Corporation Tax or Self Assessment online service before you can set up a dashboard. You can use your dashboard to see the tax position for your business across different business taxes. It brings together information from your HMRC online services.

<u>What is a Business Tax Dashboard?</u>
If you run a business, HMRC's Business Tax Dashboard will give you an overall picture of your tax position including payments you have made and amounts you still owe. You will be able to see either Corporation Tax or Self Assessment information, depending on the type of business you have. You can also view information on VAT and PAYE for employers, if you have set up your business for these online services.

You can see the overall position for each tax as well as more detailed information, such as any:

- tax you owe
- repayments HMRC owes to you
- payments you have made
- interest on any late payments
- penalties you have incurred
- direct debit payment plans

You can also use this online service to make changes to some business contact details, including your address, telephone number and email address.

What periods does the dashboard cover?
You can use the dashboard to view information as follows.

- Corporation Tax – information for accounting periods from 1 October 1993 onwards
- Self Assessment – information for the tax year 1996-97 onwards
- PAYE for employers - information for the tax year 2010-11 onwards
- VAT - information for the current date and previous 15 months

Who can use a Business Tax Dashboard
Any business can use a Business Tax Dashboard but you will need to have enrolled for HMRC Online Services before you can set one up. You do this through the HMRC website. You have to be enrolled under the same account (User ID) for each tax you want to include in your dashboard.

If you have enrolled for Corporation Tax and Self Assessment under the same account you will only be able to see your Corporation Tax position on the dashboard. You can still view your Self Assessment tax position separately from the 'At a glance' page within the Self Assessment online service.

A dashboard may not be appropriate for your business if:

- You prefer to manage your liabilities for each tax separately
- Your business is part of a group of companies. Business Tax Dashboard is for small businesses and lets you see the tax position for one company only.

If you don't use a Business Tax Dashboard you can still see the position separately for each tax using the relevant HMRC online service.

The option to set up and use a dashboard isn't currently available to agents. Agents can still view their client's tax position for Corporation Tax and Self Assessment using the relevant online service. HMRC are looking to provide an agent dashboard, and access to view their client's PAYE for employers and VAT tax position, at a later date.

PDF- whether a valid return

A firm of solicitors submitted its partners' returns electronically in January 2011, and attached a PDF file with the partnership return. HMRC formed the opinion that the submission of an electronic PDF did not comply with the notice given under TMA 1970 s 12AA, and imposed penalties under TMA 1970 s 93A.

Decision:

The First-tier Tribunal allowed the firm's appeal. Judge Hellier held that 'the documents produced by HMRC do not prescribe the use of third-party software as the only way to make an electronic return. The best that can be said is that they prescribe the making of a return via the internet as constituting an electronic return'. Accordingly, the PDF which the firm had submitted 'was an electronic return for the purpose of section 12AA'.

Comments - This appears to be an important precedent, because the First-tier Tribunal specifically rejected HMRC's contention that the submission of a PDF did not meet the requirements of TMA 1970 s 12AA. Judge Hellier also observed that even if a PDF was not a valid return, the partnership had a reasonable excuse for considering that it was valid, so that there was no justification for HMRC's attempt to impose penalties.

Fitzpatrick & Co (Solicitors) v HMRC TC01932

BUSINESS TAX

Business Tax Simplification (Lecture B711 – 17.23 minutes)

Following a review of small business taxation by the Office of Tax Simplification (OTS), a number of recommendations were made prior to Budget 2012,to simplify the UK's tax system for small businesses. The OTS recommendations were in the following three areas:

1. Simpler income tax for the smallest business;
2. Disincorporation relief; and
3. HMRC administration.

The Government published a number of documents in response to the OTS's final report on small business tax, including a consultation document on small business tax simplification.

The OTS and HMRC documents can be downloaded from the HM Treasury website (www.hm-treasury.gov.uk/ots_smallbusinessreview.htm).

Simpler Income Tax for the Simplest Small Business

HMRC's consultation document deals with two main areas of simplification, the cash basis and simplified arrangements for certain business expenses.

1. Cash basis

A voluntary cash basis is proposed in respect of unincorporated businesses (e.g. general partnerships of individuals) carrying on trades, professions or vocations. Key features include:

- An upper limit for entry to the cash basis in line with the VAT threshold (£77,000 for 2012/13);
- Businesses would be allowed to continue using the cash basis until receipts for the tax year exceed £150,000 (in which case the normal tax rules would apply from the start of the following year);
- Individuals involved in more than one unincorporated business would generally only be eligible for the cash basis if all those businesses are also eligible for, and use, the cash basis.
- New businesses - two options are being considered on how the cash basis would operate for new businesses eligible to use it:

  (a) 'Open' choice - the business would be able to choose between the cash basis and the normal rules; or

  (b) 'Default' basis - the cash basis would apply by default, unless the new business elected to use the normal tax rules instead.
- Existing businesses - the normal tax rules would continue to apply to existing businesses, unless they actively choose to switch to the cash basis.
- The cash basis would operate by reference to the tax year. Thus before using the cash basis for the first time, an existing small business would need to bring its period of account (i.e. for the purposes of applying the normal tax rules) to an end on 5th April.

- Transitional adjustments may be required for existing businesses switching to the cash basis, or where a business switches from the cash basis to using the normal rules (e.g. in respect of debtors and creditors, stock, etc).

- Business receipts would be counted as income of the tax year in which the income is received.

- Business expenses would be taken into account when paid.

- Allowable expenses would include certain capital expenditure, so no capital allowances would be available;

- Business losses would be carried forward against subsequent profits, but no 'sideways' loss relief would be available against other income sources.

<u>2. Simplified arrangements for certain expenses</u>

The HMRC consultation document includes proposals to simplify the expenses rules for small businesses, where the cash basis is chosen. It is also proposed that unincorporated businesses using the normal tax rules could choose to use any of the simplified expenses rules introduced.

Standard mileage rate for business use of cars and motorcycles

- Fixed allowances for business mileage would replace all relief for actual expenditure on purchasing, maintaining and running a motor vehicle.

- The proposed rates are:

  Cars – 45p per mile for the first 10,000 miles, and 25p per mile thereafter;
  Motor cycles - 24p per mile

- Other types of motor vehicle (e.g. vans) could be treated in the same way as machinery, or the fixed mileage rate allowance could be used in the same way as for cars.

- A record of the number of business miles per year would need to be maintained, in order to calculate the allowance.

Flat rate expenses for business use of home

- Taxpayers who carry out core business activities at their home for at least 25 hours per month would be able to claim a flat rate deduction for business use of home.

- The level of deduction would depend on the time spent on qualifying business activities:

  25-50 hours per month – Rate of £8 per month
  51-100 hours per month – Rate of £16 per month
  101 or more hours per month – Rate of £24 per month

- Alternatively, it is proposed that a flat rate deduction could be claimed of £16 per month, regardless of the extent of the business use of home, provided that qualifying criteria are satisfied.

Flat rate adjustment for personal use of business premises

- For small business operators who live on their business premises, a flat rate adjustment is proposed, which would be excluded from total costs to reflect private use.

- The proposed amounts are:

  Single person – Rate of £350 per month
  2 persons – Rate of £500 per month
  More than 2 persons – Rate of £650 per month

The above HMRC consultation ends on 22 June 2012.

Disincorporation relief

The OTS published its report on disincorporation relief in February 2012. The proposed relief would enable a company holding internally generated goodwill, plus land and buildings, and machinery and plant used exclusively for the trade, to pass to an unincorporated structure with no tax charge arising on the company, and no tax charge on the shareholders, as a result of the transfer of those assets.

The OTS proposed that the target for the relief should be very small companies that no longer require a corporate structure for commercial reasons, and that the proposed relief would only apply to a trading company. The OTS also recommended that the relief be available for a time limited period of up to 5 years, subject to a formal review as to whether the relief should be made permanent.

The Government announced that it is to consult on ways of making it easier for companies to become unincorporated. The consultation document is awaited at the time of writing.

HMRC administration

HMRC published 'Making tax easier, quicker and simpler for small business', which sets out a number of changes aimed at making tax as simple and straightforward as possible for small businesses:

- *Simpler income tax for smaller businesses* - see above.

- *Making disincorporation easier* - see above.

- *Improving PAYE for small business* - HMRC considers that the proposed introduction of Real Time Information from October 2013 will help small and medium-sized enterprises who are employers, by streamlining PAYE reporting through linking it to the employer's normal payroll activity.

- *Making the tax system more transparent* – HMRC's new 'Business Tax Dashboard'is intended to offer a quick and easy way for businesses to see how much tax they have already paid, and how much they still owe.

- *Integrating income tax and NICs* - it was announced in Budget 2012 that a detailed consultation will take place on integrating the operation of income tax and National Insurance.

Personal service companies and IR35

The Government announced on Budget Day (21 March 2012) that it proposed a number of measures affecting personal service companies and the IR35 legislation. One such proposal is to require office holders/controlling persons who are "integral to the running of an organisation" to have PAYE and National Insurance contributions deducted at source by the organisation by which they are engaged.

The changes are to be introduced in Finance Bill 2013, subject to consultation. The consultation document is still awaited at the time of writing.

Contributed by Mark McLaughlin

Can you accelerate a deduction?

C was a landscape gardener who claimed a deduction of £110,000 for the year ended 30 April 2006 for services carried out by an associated company, Wild Bill Ltd (WB). The company had been incorporated on 15 March 2006 and had been set up to carry out some form of consultancy work in the landscaping/grounds maintenance business. WB had issued an invoice for £59,000 on 30 April 2006 and 51,000 on 1 May 2007. HMRC contended that relief for the £59,000 should be spread over the period from 15 March 2006 to 30 April 2007 and that the £51,000 should be deducted in the year ended 30 April 2008. C appealed arguing that the whole amount should be allowed in the year ended 30 April 2006.

Decision:

The Tribunal agreed with HMRC. The Tribunal noted that the purpose of creating and rendering the two invoices, as disclosed in the minutes of a meeting with HMRC in October 2009, was to transfer money across to WB, so that it would be taxed at a lower rate than 40%. That, unfortunately for the Appellant, is a tax avoidance or mitigation manoeuvre which does not work.

C's appeal was dismissed.

Comments – This case is a good demonstration of the importance of correctly applying accounting principles to determine the correct profit. It is also a demonstration of how overt methodologies being used to transfer profit from one entity to another to reduce the rate of tax that will be suffered will not necessarily be allowed.

Craig v HMRC TC1786

A tale resulting in some expenditure being allowed

Christopher Huhtala (H) was a self employed journalist and an author. He used a a live-aboard motor cruiser called the "Caratania", normally moored on the Thames, to obtain material for a book. In 2006 he decided to write a book about Port Grimaud in France. The book has still not been completed, but is at an advanced stage of work. He moved the boat to France and lived on it while it was moored at Port Grimaud. He claimed a deduction of £10,000 in computing his profits being 'expenditure for moving, mooring and living on the boat in the South of France', being approximately one-half of the total expenditure incurred.

HMRC rejected the claim on the basis that the expenses were not incurred "wholly and exclusively for the purposes of the trade." The First-tier Tribunal agreed. It concluded that the expenditure had a duality of purpose. H appealed to the Upper Tribunal which remitted the case to a different Tribunal because the first Tribunal had failed to consider whether a proportion of any expense was deductible (s.34(2) ITTOIA 2005).

At the new hearing, HMRC's central argument was that during the period that H was living on the boat in France, he needed somewhere to live, so that the boat also served a dual purpose of satisfying his personal need for accommodation. HMRC relied on *Mallalieu v Drummond* in which the House of Lords held that a barrister could not claim expenses incurred in the replacement and cleaning of items of clothing which she wore in court, on the basis that these were ordinary articles of apparel which could be worn in everyday life. HMRC also relied on *MacKinlay v Arthur Young*, in which it was held that a firm of accountants could not claim a deduction for removal expenses that it reimbursed to partners who were required to relocate to work in an office in a different part of the country. HMRC's alternative argument was that the expenses were of a capital nature.

Decision:

The Tribunal decided that the expenses incurred in transporting the boat to Port Grimaud were wholly and exclusively for the purposes of the trade and were therefore allowable. However expenses relating to ownership of the boat more generally were not allowable. The cost of mooring the boat was also an inherent

and integral aspect of ownership of the boat. As the ownership of the boat served a dual purpose, the cost of mooring it also served a dual purpose, on *Mallalieu v Drummond* principles.

The other expenses were those that a prudent boat owner would want to undertake in any event. Most of them were general improvements to the boat. In addition to making the boat safe for the trip to France, they made the boat as a whole safer, and would also be of benefit to H when using the boat on the Solent. The Tribunal found that these expenses served a dual purpose, and were therefore not eligible expenditure.

The Tribunal rejected HMRC's argument that the costs relating to the moving of the boat to France were capital expenses. Those expenses did not result in H acquiring or improving any asset. The boat was moved to France temporarily, not in order to make it more valuable as an asset, but simply because it was needed there for a limited period for purposes of H's trade.

The appeal was allowed in relation to the claimed expenses of £6,317 for transport of the boat from the UK to France, of £182 for a crane in France to put the boat in the water, and of £55 for maritime charts, but otherwise the appeal was dismissed. Another allowable expense would have been the cost of insuring the boat while en route from the United Kingdom to France. However, there was again no clear documentary evidence of this cost.

Comments – Although the history of this case is longer than the book which has not yet been published, this case demonstrates the importance of the nature of an expenses being incurred wholly and exclusively for the purpose of the trade. It is also a good example of a change to the law as a result of ITTOIA 2005 in that if an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade.

Huhtala v HMRC TC1775

Actor passes the wholly and exclusively test in part

Mr Tim Healy, a professional actor who lived in Cheshire with his wife Denise Welch, accepted a role in Billy Elliott at the Victoria Palace theatre. In April 2005 he rented a flat which was just over a mile from the theatre. He claimed a deduction of £32,503 in respect of the rent of the flat, and also claimed deductions of £8,174 in respect of travelling (by taxi) and subsistence (meals in restaurants). HMRC rejected the claim and he appealed.

Decision:

The First-tier Tribunal allowed the appeal in part. Judge King found that Mr Healy had rented the flat 'wholly and exclusively in connection with his profession as an actor'. However the expenditure on restaurant meals was not wholly and exclusively for the purpose of his profession, and he had not submitted sufficient evidence in support of his claim for taxi fares, so these items were not deductible.

Comments – When the case involves a "celebrity" it is always much easier to remember the principles involved. The case examines the key principle of whether an expense has been incurred wholly and exclusively for the purpose of the trade or vocation. Although the rent at £875 per week seems a large figure it is not the quantum that is relevant but whether the expenditure has been incurred wholly and exclusively and the Tribunal concluded that it had. He was not seeking a home in London.

Loss relief: restriction for farming

A surveyor (H) purchased a herd of deer in 1990. He disposed of the deer in 2004. In 2002 he claimed that he had made losses in a trade of deer farming which should be set against his income as a surveyor. Following an enquiry, HMRC issued a closure notice stating that the restriction laid down by what is now ITA 2007 s 67 applied, and that no loss relief was due for 1996/97 and subsequent years.

Decision:

The First-tier Tribunal dismissed H's appeal against the notice, finding that the farming trade had never been profitable, so that 'the restrictions on the use of farming losses therefore apply for the tax year 1996/97 and subsequent years'.

Comments - ITA 2007 s 67 provides that if a loss is made in a trade of farming or market gardening, it may not be relieved against general income if a loss (calculated without reference to capital allowances) was made in the trade in each of the previous five tax years. The First-tier Tribunal upheld HMRC's contention that this provision applied here, so that the surveyor was not able to continue claiming relief for his farming losses against his other income.

M Howes v HMRC TC1874

UK consortium relief

A UK company (P) claimed consortium relief in respect of losses incurred by a UK branch of an associated Netherlands company. HMRC rejected the claim on the basis that the effect of ICTA 1988 ss 403D and 406(2) was that P was not entitled to relief for these losses. P appealed, contending that the relevant provisions of ss 403D and 406(2) contravened EC law. The Upper Tribunal directed that the case should be referred to the CJEU for a ruling on the interpretation of Article 49 of the TFEU.

Decision:

Advocate-General Kokott expressed the Opinion that it was a restriction on the freedom of establishment 'for a Member State to prevent the surrender of the losses incurred in that Member State by a resident permanent establishment of a non-resident company to a resident company by way of group relief where any part of those losses, for the purposes of any foreign tax, is in any period deductible from or otherwise allowable against non-domestic profits of the company or any other person'. In such a situation, a Member State was required to disapply such a provision 'for the benefit of the taxpayer who is claiming group relief'.

Comments - As was widely expected, Advocate-General Kokott upheld the company's contentions and held that the UK legislation contravened the EC Treaty. It seems likely that the CJEU will follow her Opinion.

Philips Electronics UK Ltd v HMRC (CJEU Case C-18/11)

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VAT

Payments in advance

In October 2007, the taxpayer business began providing training courses on emergency medicine for postgraduate doctors. The students were required to pre-pay for the courses, because the taxpayer did not otherwise have the finance to organise the events. Courses were run only if there was sufficient support, although it had not been necessary to cancel any. The director of the business said the aim of the business was to meet a need in the market rather than be commercial. He had not taken any payment, but the accounts were in profit.

The director claimed that on accounting principles the payments could not be recognised as income until the relevant courses had taken place. He contended that on this basis the business did not reach the threshold for VAT registration until November 2008. HMRC said the threshold was reached in September 2008.

Decision:

The First-tier Tribunal decided that accepting the payments gave rise to a binding agreement. There was no evidence to the contrary and it seemed unlikely that courses could have been cancelled at any time without proper reasons. Furthermore, a payment would be in respect of the course for which it was paid even if no contractual obligation existed to provide the course. The judge said that a payment was 'in respect of a supply if it is in consideration of a supply'. No legal obligation was necessary provided there was a direct link.

The taxpayer's appeal was dismissed.

Comments - This case illustrates an important difference between VAT regulations and direct tax rules, according to Neil Warren, independent VAT consultant. He explained that 'in the case of normal accounting procedures, the advance payments would be treated as deferred income when received in July 2008 and included in the profit and loss account relevant to when the courses were held, i.e. October 2008. But the advance deposits made by the delegates created a supply for VAT purposes and needed to be included in the VAT registration test'.

Bromley Emergency Training and Development Ltd TC1728

The principle of 'abuse'

An accountancy firm advised a group of companies to enter into a complex scheme with the intention of only accounting for VAT on its profit on 'demonstrator cars', rather than on their full sale price. Four associated 'dealership' companies sold various 'demonstrator cars' to three associated 'captive leasing companies' under leaseback arrangements. The 'captive leasing companies' assigned the benefit of the lease agreements and the underlying cars to a Jersey bank (S) in return for a substantial 45-day loan facility. A month after these transactions, another associated company (PD) entered into an agreement with S to acquire its car hire business. This was treated as a transfer of part of S's business as a going concern, and therefore as outside the scope of VAT. PD then sold the cars to arm's-length customers under the second-hand margin scheme, only accounting for VAT on its profit margin. HMRC issued assessments on the basis that the scheme was an 'abuse', applying the principles in Halifax plc v C & E Commrs. They also imposed misdeclaration penalties.

Decision:

The First-tier Tribunal allowed the companies' appeals but the Upper Tribunal reversed this decision, holding that 'the transactions in this case were an attempt to obtain a tax advantage contrary to the purpose of the relevant provisions and in circumstances where the essential aim of the transactions was to secure that tax advantage. The transactions therefore involved an abuse of law.'

Comments - The Upper Tribunal reversed the First-tier decision and upheld HMRC's view that the transactions were an abuse of law, within the Halifax principles, and should be redefined so that VAT was chargeable.

HMRC v Pendragon plc (and related appeals) (Upper Tribunal)

Advance payment: goods not supplied

A company reclaimed input tax on the purchase of a large quantity of plant and machinery which had never been delivered. HMRC rejected the claim but the tribunal allowed the company's appeal.

Decision:

Judge Khan declined to follow the QB decision in Pennystar Ltd v C & E Commrs [1996] STC 163, and held that the effect of Sale of Goods Act 1979 s 18 was that 'where there is an unconditional contract for the sale of specific goods, as we have here, which are in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of delivery is postponed, provided the goods are in a deliverable state. For this purpose, an unconditional contract means that the contract must not have any conditions of any sort and the goods must be in such a state that the buyer can take delivery'.

Comments - In Pennystar Ltd, the VAT Tribunal had held that a company could reclaim input tax on some computers which it had paid for but not received, but the High Court reversed this decision, holding that the company had never acquired ownership of the computers and that there had been no supply. HMRC have frequently cited this case as authority for rejecting claims to input tax on goods that have been paid for but not received. However, Judge Khan declined to follow the Pennystar decision, and held that the effect of the Sale of Goods Act was that the company had acquired ownership of the goods and thus was entitled to reclaim input tax on them.

David Peters Ltd v HMRC TC1819

Expenditure on estate intended for use as a hotel

A company (M) was incorporated in 1999, and purchased a large estate which included an 18th-century mansion house. M registered for VAT in 2007 (backdated to October 2004), and opted to tax the estate. It reclaimed substantial amounts of input tax relating to work carried out on the estate. HMRC rejected the claim on the basis that the work did not relate to any business. M appealed, contending that it had incurred the expenditure with the intention of using the mansion house as a hotel.

Decision:

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The Tribunal reviewed the evidence in detail and allowed the appeal in part, finding that in October 2004 M had had the intention of using a stable block as a hotel, but that it had not had such an intention with regard to the main house until 1 January 2006.

Comments - Input tax is only deductible if the expenditure incurred with the intention of making taxable supplies. The facts here were somewhat complex, but the First-tier Tribunal found that when the company first incurred expenditure, it did not intend to use the mansion house as a hotel: it only formed that intention at a later date. The case demonstrates the importance of submitting adequate evidence to support a claim to input tax.

Macaw Properties Ltd v HMRC TC1863

Construction of gym and spa at leisure centre

A charity (GS) provided recreational and sporting facilities at a 54-acre site. A subsidiary company (GL) supplied bar and catering services. In 2007 the companies' directors decided that GL should finance the construction of a spa, which would include a gym which would be operated by GS. GL reclaimed input tax on the work. HMRC rejected the claim on the basis that the relevant supplies had actually been made to GS rather than to GL. GL appealed.

Decision:

The First-tier Tribunal allowed the appeal in principle, holding that GL was occupying the land under a licence from GS, and that there was a direct and immediate link between the supplies made to GL and the supplies made by GL, so that it was entitled to reclaim the input tax (subject to the partial exemption provisions).

Comments - HMRC rejected the input tax claim on the grounds that the supplies had actually been made to the charity which provided recreational and sporting facilities, rather than to its associated company which provided catering services and was intended to operate the spa. However, the First-tier Tribunal took a commonsense view of the transactions and allowed the company's appeal, holding that there was a direct and immediate link between the supplies which it received and the supplies which it made.

Gosling Leisure Ltd v HMRC TC1866

Input tax claim allowed

Harewood Castle on the Harewood estate was substantially renovated with the help of a grant from English Heritage. It had been dangerous and dilapidated, and the aim was to make the building safe, not to restore it. On completion, it was to be used as an income-generating asset of the estate. For example, it could be rented out for use by film and TV production companies, as well as forming part of the attractions for visitors to the estate. The estate claimed the input tax on the cost of the project.

HMRC said that the intention was to rent the castle out to a charitable trust, as well as use it for other taxable purposes. Therefore, the input tax on the renovation costs would be residual and only partly reclaimable as far as partial exemption is concerned, because of the mixed use.

Decision:

The tribunal accepted that the taxpayer intended only to make taxable supplies from the castle through the estate, and not rent it out to a trust, and that the work carried out had been to allow the castle to be used as an income-generating asset. The input tax on the renovation should therefore be repaid.

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The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said 'the challenge with partial exemption is to establish a "direct and immediate link" between expenditure and income. In the case of input tax incurred before actual supplies are made, as in the case of a building renovation project, it is the taxpayer's intentions that are relevant, i.e. is the intention to make only taxable or exempt supplies from the building, or both? If the intention subsequently changes so that, for example, actual exempt supplies are made, rather than intended taxable supplies, the input tax originally claimed will be adjusted under the payback and clawback provisions'.

The Harewood Estate TC1789

Whether partnership bound by option to tax

A married couple acquired a farm in 1967. In 1987 they arranged for a newly-incorporated associated company to convert part of the farmland into a golf course. In June 1990 the couple registered for VAT as a partnership, and opted to tax the golf course. In February 1991 the couple entered into a partnership agreement with their two sons to operate a golf club on the course. In 2001 a VAT officer inspected the partnership records and formed the opinion that the partnership had failed to abide by its option to tax the golf course. HMRC issued a ruling that the option was irrevocable. The partnership appealed, contending that the option had only been made by the couple who owned the land, and did not bind the separate partnership formed in 1991 which included their sons.

Decision:

The First-tier Tribunal rejected this contention and dismissed the appeal, but the Upper Tribunal remitted the case for rehearing by a different judge. Judge Bishopp observed that the First-tier Tribunal's decision clearly implied that there had only been one partnership, to which the sons had been admitted in 1991, but the decision did not explicitly state this.

Comments - HMRC considered that there had been only one partnership, which had made the option to tax in 1990 and had admitted two additional partners in 1991. The partnership appealed, contending that there had been two separate partnerships and that the partnership which had been formed in 1991 was not bound by the 1990 option. The Upper Tribunal remitted the case to the First-tier Tribunal to make a specific finding of fact.

Wrag Barn Golf & Country Club v HMRC (Upper Tribunal)

Self-drive car hire business: input tax on cars

A sole trader (C), who carried on a car hire business and a chauffeuring business, reclaimed input tax on six cars, four of which had been purchased under finance agreements. HMRC rejected the claims and imposed misdeclaration penalties. C appealed. The Tribunal reviewed the evidence in detail and allowed the appeal in respect of the four cars which had been purchased under finance agreements, finding that they were to be used primarily for a business of self-drive car hire, so that the effect of VAT (Input Tax) Order, SI 1992/3222, Article 7(2F) was that the tax was deductible. However, the Tribunal dismissed the appeal with regard to the other two cars (a Mercedes and a Lamborghini), finding that the Mercedes had not been 'intended for use primarily for self-drive hire' and that C had not produced a VAT invoice with regard to the Lamborghini. (The Tribunal also upheld the misdeclaration penalties with regard to these two cars.)

Comments - SI 1992/3222, Article 7, provides that input tax is not normally reclaimable on the purchase of a car, unless specific conditions are satisfied. Article 7(2F) provides that input tax may be reclaimed if the person to whom the car is supplied primarily intends to provide the car for self-drive hire. The Tribunal accepted the appellant's evidence that he intended to provide four of the six cars in question for self-drive hire, so that the input tax on their purchase was reclaimable. However the Tribunal upheld HMRC's rejection of the other two claims, finding that the appellant had primarily purchased the Mercedes for his own use, and that he had not produced an invoice with regard to the alleged purchase of the Lamborghini. The Tribunal also upheld the misdeclaration penalties which HMRC had imposed with regard to these two cars.

S Collins (t/a Unique Vehicles) v HMRC TC1915

Addressing zero rated VAT Anomalies (Lecture B713 – 20.00 minutes)

Catering

a) Hot food

Under Schedule 8 Group 5 any supply in the course of catering is excluded from zero rating and is therefore standard rated.

Under Note 3 of the same Group...

A supply of anything in the course of catering includes:

(a) any supply of it for consumption on the premises on which it is supplied; and

(b) any supply of hot food for consumption off those premises;

and for the purposes of paragraph (b) above 'hot food' means food which, or any part of which:

> *(i) has been heated for the purposes of enabling it to be consumed at a temperature above the ambient air temperature; and*
>
> *(ii) is above that temperature at the time it is provided to the customer.*

From **1 October 2012** it is proposed that VAT will apply at the standard rate to all food that is at a temperature above ambient air temperature at the time it is provided to the customer, with the exception of freshly baked bread. **The reason it is above the ambient air temperature becomes irrelevant.**

There is significant debate on these proposals but if the rules come in as planned it will have a major impact on many clients.

Greggs has already seen £30m wiped off its share value following the Budget announcement. 'The chain bakes products in its stores meaning that they are sometimes sold to customers while still hot, but they are not stored in heated cabinets or marketed as hot snacks,' the *Financial Times* said. The *Daily Mail* reported that 'the take-away tax will add 18p to the price of a 90p hot sausage roll, 50p to a medium Cornish pasty and £1 to a supermarket rotisserie chicken'.

The National Association of Master Bakers warned that the move 'could very well see the demise of many more small bakers shops in the High Street' due to loss of custom. 'Customers visit their local bakers for pies and savoury product, as opposed to more expensive meats for their main meals, especially during the current economic climate. A 20% increase will cause even more problems for the craft baker and their business,' it said.

We should obviously make clients aware of this change and the impact it will have on their business, both from an accounting and profitability perspective. The main accounting issue I see is how the clients keep a record of whether a sausage roll was warm or cold at the point of sale. Clients with heated cabinets will obviously have less issues as they will definately have to account for VAT on anything sold from that cabinet. Clients which simply bake and then sell from an unheated cabinet will have to prove that the item had cooled before it was sold. An HMRC officer may take the view that if the sausage roll is baked on the

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premises then it is a standard rated sale unless the client can prove it was cold at the point of sale – after all standard rating is the default unless the client can prove zero rating applies.

With the new penalty regime in full swing it will be important that clients retain supporting evidence where they zero rate food which is baked on the premise. If they have set bakings during the day it would be useful to keep a record of the timings and approximate quantities. Anything coming out of the oven at 11am is more likely to be "cold when sold" than something coming out of the oven at midday.

To date there have not been any cases before the Courts on the subject of when or whether a product is above ambient temperature – going forward this is bound to change!

b) Premises

On-premises consumption of food is standard-rated as catering, whereas off-premises consumption of cold food is zero-rated. A number of cases have challenged the definition of premises and HMRC is trying to regain the ground lost on these so that food sold for consumption at tables and chairs outside a cafe or in shared eating areas in a shopping centre or airport or elsewhere will be standard-rated. This is to be achieved by defining premises so as to include **'any area set aside for the consumption of food by that supplier's customers, whether or not the area may also be used by the customers of other suppliers'**. As with the other legislative proposals tabled, HMRC is consulting on whether the changes will meet their objectives.

Sports Nutrition Drinks

Legislation is to be introduced with effect from 1 October 2012 which provides for the standard-rating of 'sports nutrition drinks' (case law currently holds that some drinks in this category are not regarded as beverages, and are therefore not excluded from zero-rating).

From that date, sports drinks that are marketed as products designed to enhance physical performance, accelerate recovery after exercise or build bulk, and other similar drinks, including syrups, concentrates, essences, powders, crystals or other preparations of such drinks will be standard-rated.

Listed buildings

The Schedule 8 Group 6 Items 2 and 3 zero-rating provisions for approved alteration work carried out on a listed building used as a dwelling, for relevant residential purposes or for relevant charitable purposes is to be removed from 1 October 2012. This will put alteration work on the same footing as repair work, ie, standard rated.

Once the zero rate is removed owners of listed buildings will face increased costs if they wish to carry out approved alterations. HMRC's removal of the zero rate may itself have unintended consequences. It may result in listed buildings being left deliberately empty as residential renovations and alterations to buildings left empty for two years qualify for the reduced rate of VAT, ie, delaying work could mean only 5% VAT rather than 20% VAT.

Schedule 8 Group 6 Item 1 is also being amended so as to remove the 60% substantially reconstructed rule. Currently zero-rating is available on the first grant of a major interest in a property that has been substantially reconstructed, defined as one where 60% of the reconstruction work was approved alterations. Zero-rating will remain available for the grant of a major interest in a building that has been reconstructed from a shell.

Transitional relief will apply to contracts for approved alteration work entered into prior to 21 March 2012 or to reconstructions where at least 10% of the reconstruction (calculated on the basis of cost) has been completed by 21 March 2012. Anti-forestalling measures will also apply.

Self storage

The rent of land, including clearly defined lockable storage space, is currently exempt from VAT but with an option to tax. Budget 2012 proposals will exclude the provision of self-storage facilities from exemption from 1 October 2012 other than in certain limited circumstances.

Anti-forestalling provisions are also being introduced to counter the effect of pre-payments made on or after 21 March 2012 for storage facilities to be used after 1 October 2012.

HMRC has also fired a warning shot across the bows of storage providers who sell insurance: if they seek to value shift between the standard-rated storage charges and the VAT exempt insurance HMRC has said the government will consider introducing the higher rate IPT on the insurance.

Chair rent

It seems HMRC are fed up with these cases which in the main they tend to win. Legislation is to be introduced with effect from 1 October 2012 to ensure that the provision of chairs in a hairdressing salon to a self-employed stylist is standard-rated. This will be achieved by adding the provision of such chairs in a salon (together with related services) to the list of supplies which are excluded from exemption under VATA 1994, Sch 9, Group 1 Item 1.

Holiday caravans

The supply of residential caravans is zero rated if the test of 'residential' — currently determined by the size of the caravan — is met.

Essentially if the caravan can be legally towed by a normal family car it will be standard rated. If it exceeds the size limit for towing it can be zero rated. This has led to many static holiday caravans being zero rated which is against the principle of what HMRC are hoping to achieve.

With effect from 1 October 2012, the zero-rating of caravans will apply only to those caravans which are designed and constructed for continuous year round occupation and meet BS3632. This effectively means that all holiday caravans (not just mobile caravans) will be standard-rated.

VAT Retail Schemes: technical note (Lecture B715 – 14.18 minutes)

The Tribunal has heard a dispute about the operation of retail schemes. The decision starts with a useful review of the background to these schemes, including the reason for their existence, the law under which they are operated, the basis for assessments raised by HMRC, and the jurisdiction of the Tribunal to hear appeals.

Where a trader applies to change a retail scheme retrospectively, HMRC will allow this only in exceptional circumstances. The Tribunal only has a supervisory jurisdiction in respect of such a decision. On the other hand, where a trader has incorrectly operated the retail scheme that should be applied, HMRC can raise an assessment to collect the tax that ought properly to have been calculated under that retail scheme.

The appellant had last been visited before the retail schemes were revised by HMRC in 1997. When an officer visited in 2008, he concluded that the retail scheme calculations were an incorrect application of Apportionment Scheme 1: they used net figures instead of gross figures in working out the VAT, and did not include an annual adjustment. The officer raised an assessment for £10,417.

The trader’s brother, who had an accountancy degree and acted as the bookkeeper, acknowledged that he had made mistakes in operating the retail scheme. However, he argued that he had been trying to operate Direct Calculation Scheme 1, not Apportionment Scheme 1. The apportionment scheme was not appropriate because the business had a turnover of more than £1m (although that would also rule out Direct Calculation Scheme 1). If the direct calculation scheme was used, an overpayment of some £9,160 had been made, and the trader made a claim for that amount. The HMRC review confirmed the original decision, and the trader appealed.

The Tribunal had to consider what ought to happen when a trader has made two errors – operating incorrectly a retail scheme he is not authorised to use. It concluded that the argument was not about whether the trader could retrospectively change the retail scheme in use; rather, it was about whether an assessment fairly reflected the output tax that should have been accounted for, given that the trader had made those two separate mistakes. As the assessment was itself based on Apportionment Scheme 1, which was not appropriate, HMRC should have taken into account all the circumstances in deciding what the fair result

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would be. This would include the fact that the trader achieved a very low mark-up on the main standard rated sales (fuel) and a higher mark-up on zero rated items (groceries and sandwiches).

The Tribunal decided that the appeal against the assessment should be allowed in principle. It was not possible to give a ruling on the precise monetary result, because no evidence had been produced about the reliability of the mark-up data which underpinned the voluntary disclosure and reclaim. The parties were invited to go away and discuss those data in the light of the ruling that HMRC should be considering a fair result rather than a formulaic approach to the outcome of the calculations.

First-Tier Tribunal (TC01865): Munaf Patel t/a Cleggs Lane Service Station

Contributed by Mike Thexton

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