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PERSONAL TAX

Payment by employer into funded retirement benefit scheme

The claimant taxpayer company announced the introduction of a retirement benefit scheme to be constituted by way of a trust. An employee's membership of the trust was to be at the discretion of the taxpayer. The taxpayer sent a letter to a director that it employed explaining what benefits would be payable to him. Subsequently, the scheme was established. The material provisions established that the member in respect of whom the taxpayer made a contribution to the scheme received no immediate realisable interest in his accumulated fund; his enjoyment of it would be dependent upon his surviving to his retirement age. Any attempt to convert his interest to his own account pending that event would result in its forfeiture. The Revenue and Customs Commissioners (the Revenue) decided that the taxpayer was liable to pay Class 1 national insurance contributions on certain payments in the form of the transfer of gilts made to the scheme. Whether it was so liable depended on whether the payments had been 'earnings… paid to or for the benefit of an earner' within the meaning of s 6(1) of the Social Security Contributions and Benefits Act 1992 (the 1992 Act). The taxpayer appealed to the Upper Tribunal (Tax and Chancery Chamber) against the Revenue's decision that it was liable for the payments. The Upper Tribunal allowed the appeal and found that the payments had not been 'earnings'. The Revenue appealed.

The issue on the appeal was whether the payments in the form of the transfer of gilts by an employer for the benefit of an employee to trustees of a funded unapproved retirement benefits scheme fell within the definition of earnings provided for in s 3(1)(a) of the 1992 Act as 'any remuneration or profit derived from an employment' so that the national insurance charging provision in s 6 of the 1992 Act applied. There was no dispute that the payments had been made for the benefit of the employee; the issue was whether those payments were earnings. Consideration was given to comparable definitions in, inter alia, the Income and Corporation Taxes Act 1988.

Decision:

The appeal would be allowed (Rimer LJ dissenting).

(1) Per Arden LJ: The term 'earnings' for the purposes of the 1992 Act was not limited by the principles established by the court for the purposes of income tax. The term 'earnings' did not, therefore, have the same inherent meaning as 'emoluments' and accordingly s 6(1) of the 1992 Act was to be interpreted and applied according to its tenor. It followed that the income tax principles, first, that a contingent entitlement to a benefit was not sufficient to trigger liability to income tax, and secondly that of convertibility, were not applicable to the construction of the 1992 Act.

(2) Per Arden LJ: Section 6(1) of the 1992 Act caught any payment which constituted remuneration or profit derived from an employment and which met the further condition that it was either paid direct to the employee or paid to a third party for his benefit. There was no requirement, under s 6(1), for the benefit to have vested with an employee, or the statute would have used the phrase 'earnings received by an earner'. Further, the natural meaning of the phrase 'paid to or for the benefit of an earner' treated a payment as having achieved the status of earnings when it was paid, and not when it was unconditionally received. It was therefore irrelevant for the triggering of the liability to pay class 1 contributions under s 6(1) of the 1992 Act that the payment had actually vested.

Accordingly, it followed that the appeal would be allowed.

(3) Per Ryder J: The words in s 6(1) falling to be construed were 'earnings… paid to or for the benefit of an earner'. Section 3(1) explained that 'earnings' included 'any remuneration or profit derived from an employment'. That collection of words was to be compared with the Sch E tax provisions under which an employed person was chargeable to tax in respect of his 'emoluments', an expression that s 131 of the 1988 Act explained 'shall include all salaries, fees, wages, perquisites and profits whatsoever'. Profit was understood to include the acquisition of a benefit in kind. The employee had received a present right to a future benefit. He would receive the benefit in some form at some time in the future. That did not mean that the employee had a proprietary interest in the assets of the trust. However, it was not necessary for an employee to receive a proprietary interest in order for a benefit to be treated as earnings as long the employee received a profit from it. There was no doubt that the payments made by the employer in the instant case were for the employee's benefit, and fell within s 6(1) of the 1992 Act. That benefit was not a benefit in kind nor was it contingent. It was a profit and was of a different character from a benefit in kind. It was not intended to be a benefit in kind. On that basis, the payment was caught by the plain meaning of s 6(1)(a) of the Act. The value of the benefit, the profit for the purpose of the charge, was the value of the gilts transferred, namely the value paid for the benefit of the employee rather than the value subsequently received.

Decision of the Upper Tribunal (Tax and Chancery Chamber) [2011] UKUT 78 (TCC) affirmed.

Comments - This is an important victory for HMRC because the majority of the CA (Arden LJ and Ryder J) upheld HMRC's long-held view (expounded in a 2003 Revenue Tax Bulletin) that the earlier case of Tullett & Tokyo Forex International Ltd v State for Social Security [2000] EWHC Admin 350 had been wrongly decided and that national insurance contributions were due when the employer made payments into a retirement benefit scheme. The CA has restored the decision of the First-tier Tribunal, which had somewhat surprisingly been overturned by the Upper Tribunal in 2011. The one disappointment for HMRC will be that Rimer LJ delivered a lengthy dissenting judgment. The substantive issue is largely of historical interest, since it seems to be accepted that Class 1A contributions would now be due on such payments.

Forde and McHugh Ltd v Revenue and Customs Comrs [2012] EWCA Civ 692

EIS conditions not satisfied

The taxpayer company was incorporated in December 2002, to provide consultancy and advisory services in relation to construction estimating, project management, quantity surveying and housing management services.

The directors, Mr and Mrs J, bought some land with planning permission to build a single storey dwelling in Florida and it was decided that the company would manage the project. The directors would, as clients of the company, pay it for the use of their time and expertise based on cost plus 5%.

The property was finished in April 2006, although by May 2006 only 60% of the construction cost had been demanded from the company.

Mr J subscribed for 86,000 £1 shares in the company in December 2004, and in January 2005 a claim for enterprise investment scheme was made. HMRC accepted the claim, but withdrew acceptance in December 2006 on the basis that 80% of the money raised by the share issue had not been employed within 12 months, as required by the legislation. HMRC also questioned whether the company was in the business of property development, which is a non-qualifying trading activity for enterprise investment scheme purposes.

Decision:

The First-tier Tribunal decided that the company had at no time had an interest in the Florida property and was therefore not engaged in property development. However, it was clear that 80% of the funds raised by the share issue had not been used within the appropriate time. On the other hand, if the money had been earmarked for use that would satisfy the law. In this instance, it could not be established that the money raised by the share issue had been committed for a specific purpose in that period.

The taxpayer's appeal was dismissed.

Comments – There are a significant number of reliefs available in tax and Enterprise Investment Scheme relief is an important and well known relief. In order to obtain the relief it is essential certain conditions are met and the employment of the relevant proportion of the monies raised in the share issue is within the conditions that must be met. In this case as in a number of others that have appeared the condition was not met and consequently the appeal was dismissed.

Benson Partnership Ltd TC1760

Pension scheme - application for late election

A company director (C) had set up a personal pension plan in 1999. By April 2006 the value of the plan exceeded £4,000,000. In 2010 he decided to change the trustee of his pension plan. The new trustee advised him that he should have submitted an election under the Registered Pension Schemes (Enhanced Lifetime Allowance) Regulations, SI 2006/3261. C subsequently discovered that the previous trustee had failed to do this. In September 2010 he submitted a late election. HMRC rejected the claim on the basis that the time limit laid down by SI 2006/3261 had expired on 5 April 2009. C appealed, contending that he had a reasonable excuse because he had relied on the company (UB) which had been acting as the trustee of his pension plan to make the necessary application.

Decision:

The First-tier Tribunal accepted this contention and allowed his appeal, specifically distinguishing the previous decisions in Scurfield v HMRC (TC01379) and Platt v HMRC (TC01449). Judge Walters observed that in September 2004 C had specifically requested UB for an explanation of the changes to the taxation of pensions, that in 2006 he had met an employee of UB and had been given the impression that UB would make the necessary application, and that he had subsequently made a formal complaint about UB's handling of his case. In the light of his meeting and correspondence with UB, it had been reasonable for him to rely on UB 'to make the necessary notification in time on his behalf'.

Comments - FA 2004 made significant changes to the taxation of pensions with effect from 6 April 2006. SI 2006/3261 provided detailed transitional arrangements, intended to ensure that members of registered pension savings at 5 April 2006 in excess of the lifetime allowance were not disadvantaged. Anyone wishing to elect for an enhanced lifetime allowance had to do so by 5 April 2009, unless they had a 'reasonable excuse' for not doing so by that date (see SI 2006/3261, reg 12). In the previous cases of Scurfield (TC01379) and Platt (TC01449), the First-tier Tribunal upheld HMRC's view that the appellant did not have a reasonable excuse for failing to make the necessary election within the statutory time limit. In this case, however, Judge Walters took a more lenient approach, laying emphasis on the fact that the appellant here had specifically asked the company which acted as the trustee of his pension plan for details of the changes, and that at a meeting with one of the company's employees, he had been given the impression that the company would make the necessary election on his behalf.

When the rules were changed again with regard to fixed protection in April 2012 a much shorter time frame was given for making the appropriate claim. It will be interesting to see whether delayed claims come before the Tribunals in respect of that change but there is less likely to be leeway as the "new" pensions regime has now been existence since April 2006.

C Irby v HMRC TC1979

HMRC application under Family Proceedings Rules

The first respondent (the husband) was the former spouse of the second respondent (the wife). In 2006, the court heard an application for ancillary relief by the wife. One of the issues which impacted upon the determination of the wife's claim was the extent of the husband's potential tax liabilities. Accordingly, there was considerable evidence given in respect of the husband's tax affairs during the hearing. The applicant Revenue and Customs Commissioners (the Revenue) subsequently issued assessments for approximately £11·5m of unpaid tax for the years 2001–2008. The husband appealed the assessments. For the purposes of the tax appeal, the Revenue sought to have sight of and to be able to use transcripts of the divorce/financial proceedings and other documents which had been filed or brought into being for the purposes of the application and hearing. The husband refused to produce the requested information. The Revenue applied for an order for the release and/or production of the documents.

It contended that it was always in the public interest for the right amount of tax to be paid by taxpayers and that the documents were directly relevant to the matters in issue before the tribunal.

Decision:

As a general rule documents and other evidence produced in ancillary relief proceedings (now financial remedy proceedings) were not disclosable to third parties outside the proceedings save that exceptionally and rarely and for very good reason they could be disclosed with the leave of the court. The fact that evidence might be relevant or useful was not by itself a good enough reason to undermine that rule.

Having considered and balanced the competing public interests, there was nothing rare and exceptional about the instant case which took it outside the general rule. The husband was entitled to say that he had complied fully with the rules of disclosure and the confidentiality/privilege attached to the documents and other evidence produced thereby should not be breached. The Revenue had advanced no discernible compelling reason why the general rule should be relaxed in the instant case.

S v S (disclosure to revenue) [1997] 3 FCR 1 considered; Clibbery v Allan [2002] 1 All ER 865 considered.

The application would be dismissed.

Comments - In S v S, the Revenue had been refused permission to view certain documents, but in the similar subsequent case of A v A, it had been granted permission. HMRC has been inclined to take the view that the decision in A v A had superseded the earlier decision in S v S, applying the principles laid down by Lord Denning in Minister of Pensions v Higham [1948] 1 All ER 863. Coleridge J disagreed: he held that Wilson J's judgment in S v S remained good law, and rejected HMRC's application to view the documents which were at issue in this case.

RCC v Charman and anor [2012] EWHC 1448 (Fam)

Land Rover Discovery - whether a 'car'

Mr Timothy Jones is a mobile technician for Jaguar Land Rover who, by reason of his employment, has been supplied with a new Land Rover Discovery 4 2.7 TDV6 GS Auto. The provision of the Jaguar Land Rover roadside assistance service was put out for tender every three years. Until 2009 this service had been provided by Mondial Assistance UK ("Mondial"). Mr Jones had been employed by Mondial which provided him with a new Land Rover Discovery every year. From 2009 the AA successfully tendered for the contract to run the service and Mr Jones, who had been employed by Mondial for nine years, was transferred to the AA.

Although the AA continued to provide Mr Jones with a new Land Rover Discovery each year the tax treatment of the vehicle for tax purposes changed. Instead of the Land Rover Discovery being treated as a van for tax purposes, as it had been with Mondial, the AA notified HMRC that as from 27 September 2010 Mr Jones had a company car.

Mr Jones explained that the change in the in tax treatment of the vehicle, from a van to a car, was because HMRC had granted Mondial a "special dispensation" which had not been transferred when the Jaguar Land Rover contract was awarded to the AA in 2009.

The entire boot area of the Land Rover was filled with racking and tool boxes which are bolted to the structure of the vehicle. In addition, although the rear seats and seat belt fittings are in place the seats are impossible to use as extra tool boxes have been securely fixed over them. Mr Jones explained that when he was employed by Mondial it had been possible to use the rear seats of the Land Rover but extra tool boxes had been fitted to the vehicles provided by the AA. Although it was technically possible for these to be removed, he is not permitted to do so by his employer. The modifications to the vehicle also include additional lighting, electrics and special control systems. Despite these modifications taking two days to fit using special lifting equipment and the services of trained electricians there is no fundamental alteration to the structure of the vehicle. This is because it has to be returned to Jaguar Land Rover for re-sale after one year when it is replaced by a new vehicle.

He objected to his Notice of Coding for 2011-12 which was determined by HM Revenue and Customs ("HMRC") on the basis of information provided by his employer that, despite the Land Rover having been specially modified to carry engine components and tools for his job, the vehicle, which is available for his private use, was a car.

Decision:

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

Comments - The First-tier Tribunal upheld HMRC's view that, despite the modifications, the Land Rover Discovery remained a car (on which car benefit was chargeable) rather than a goods vehicle. The Tribunal found that although the Land Rover Discovery supplied to J might have become primarily suited for the conveyance of goods or burden this was as a result of modifications and not because it was 'of a construction' for such a purpose. This demonstrates how the exact wording of the legislation can work against the taxpayer however unfair it may seem as in this case.

T Jones v HMRC TC1958

Charity Relief Cap

The Government has announced that the capping of income tax reliefs announced in the Budget will not apply to charitable contributions. Consultation will continue on the mechanics of applying the cap (25% of income or £50,000 whichever is the greater) to various other uncapped reliefs such as loan interest relief.

Vessel was not stationed – So successful SED

The taxpayer claimed seafarers' earnings deduction for the years 2001/02 and 2002/03 on the basis that the vessel on which he was working at the time, located to the west of Scotland or in the Asgard Norwegian Continental shelf, should be classed as a ship. HMRC said it was an offshore installation and the deduction was not due.

The vessel in question, the Regalia, was self-propelled and semi-submersible, having been originally designed as a subsea diving construction and installation unit.

Decision:

The First-tier Tribunal found that the Regalia was very versatile, navigating between different places. For the years involved, the activities carried out by the vessel entailed work on the top of the well, which meant it was involved in 'the exploitation, or exploration with a view to exploitation, of mineral resources by means of a well'. However, the fact that the vessel moved around so much led the tribunal to conclude that it was not stationed while working at the west of Scotland or Asgard and was therefore not an offshore installation in the relevant periods.

The taxpayer's appeal was allowed.

Commentary – This is one of a limited number of cases that deal with the Seafarers Earnings Deduction but illustrates that it is important to the relief that the relevant taxpayer is operating on the right type of vessel. In this case the taxpayer’s appeal succeeded.

John Davies TC1822

Remittance Basis Changes including the new Business Investment Relief

On 28 May HMRC issued a couple of documents with important guidance on Changes to the Remittance Basis. The first is a short information note running to 20 pages whilst accompanied by a more detailed guidance note running to 54 pages.

The guidance note focuses on:

- The higher remittance basis charge;
- The business investment relief for remittance basis taxpayers (including important information regarding the advance assurance procedure for qualifying investments)
- Sales of exempt property and
- Simplification of the remittance basis rules

Higher Remittance Basis Charge

The £30,000 Remittance Basis Charge (RBC) is payable by a taxpayer who is UK resident in a tax year, is not domiciled or not ordinarily resident in the UK, makes a claim to use the remittance basis and meets the 7-year residence test for the tax year.

From tax year 2012-13 a higher annual RBC of £50,000 applies if a taxpayer is UK resident in a tax year, is not domiciled or not ordinarily resident in the UK, makes a claim to use the remittance basis in 2012-13 or in later tax year and meets the 12-year residence test for the tax year.

Business investment relief for remittance basis taxpayers

Money or property that is, or that derives from, foreign income or gains of a remittance basis user, and is used, brought to or received in the UK is normally taxable as a remittance. From 6 April 2012 remittance basis taxpayers who bring their foreign income or gains to the UK and invest it in a target company may claim relief from the UK tax charge that would otherwise arise. The investment can be made in the form of money or other property derived from foreign income and gains.

In order for the foreign income or gains to qualify for relief from UK tax, the conditions that must be met are:

- the investment is a qualifying investment made in a target company, within 45 days of the foreign income and gains being brought to the UK
- the taxpayer must claim relief from UK tax under this provision as part of their Self Assessment tax return

Relief is not available where the investment is made, or where the foreign income and gains are brought to the UK, as part of, or as a result of, a scheme or arrangement whose main purpose, or one of the main purposes of which, is tax avoidance.

Prior to 2012-13, foreign income and gains of a remittance basis user which were brought to or received in the UK to make investments were regarded as remitted to the UK and liable to tax. From 2012-13 the business investment relief allows foreign income and gains from years in which a person was taxed on the remittance basis (before or after 2012-13) to be treated as not remitted to the UK when money or other property is:

- used by a relevant person to make a qualifying investment, or
- brought to or received in the UK to be used by a relevant person to make a qualifying investment.

This is called a 'relevant event'. The investor may be taxed on either the arising basis or the remittance basis in the tax year in which the investment is made and still benefit from the relief.

A relevant event is also treated as occurring when:

- proceeds from the disposal of all or part of a previous qualifying investment are re-invested in another qualifying investment;
- disposal proceeds from the sale of exempt property (see Section 3 of this Guidance) are used to make a qualifying investment; or
- all or any part of a tax deposit made in relation to the business investment relief is withdrawn by the depositor and used to make another qualifying investment.

A qualifying investment can be made by either:

- obtaining newly issued shares in, or
- making a loan (secured or unsecured) to

a target company. To qualify for relief there are two qualifying conditions that must be met - Conditions A and B.

Condition A

To meet the requirements for a qualifying investment, the investment must be made in an eligible trading company, an eligible stakeholder company or an eligible holding company.

The company in which the investment is made is referred to as a target company. An eligible trading company is a private limited company which is:

- carrying on at least one commercial trade, or
- is preparing to do so within two years of the date on which the funds to be invested were brought to the UK (this is the 2-year start-up rule) and
- carrying on a commercial trade is all or substantially all it does, or it is reasonably expected to do once it begins trading.

In most cases it is obvious when a trade exists, but where there is doubt you will need to fully investigate the facts and consider case law. Further guidance on what is trade can be found in the Business Income Manual at BIM20050. For business investment relief purposes, there is an additional requirement that the trade should be commercial, that is, conducted on a commercial basis with a view to making profits. Trade also includes:

- any activity that is treated as if it were a trade for corporation tax purposes. This includes farming or market gardening, the commercial occupation of land (but not woodland) and the profits of mines, quarries and other concerns
- a business of generating income from land. This will include profits arising from the renting or leasing of land or property.
- a company carrying on research and development activities which are intended to lead to a commercial trade. However, preparing to carry out research and development activities is not itself a commercial trade for the purposes of the business investment relief.

The extension of the definition of trade to include generating income from land and research and development activities only applies for business investment relief purposes. It does not change the definition of trade for other tax purposes.

Condition B

In addition to making an investment in a target company, the relief is available provided that:

- no relevant person has either directly or indirectly obtained a benefit or become entitled to obtain a benefit, and
- there is no expectation that such a benefit will be received

which is related, directly or indirectly, to the making of the investment.

A benefit for these purposes can include anything (for instance money, in any form, property, capital, goods or services of any kind) that is provided to a relevant person. In particular it includes, but is not limited to, the provision of anything that:

- would not be provided by the company to the relevant person in the ordinary course of business, or
- would be provided but on less favourable terms, or
- would not be available at all in the absence of the investment.

However, a benefit for these purposes does not include anything that would be provided to the relevant person in the ordinary course of business on arms length terms.

Advance assurance procedure for qualifying investments

An individual intending making a business investment will be able to ask HMRC (after Royal Assent) for their opinion on whether a proposed investment can be treated as a qualifying investment under the Business Investment Relief provisions. The remittance basis user, or a person authorised to act on their behalf, may make this request using the CAP1 service (How non-business customers or customers with a query about non-business activities get advice on HMRC's interpretation of recent tax legislation). Where the investment is made by someone other than the remittance basis user, the remittance basis user will need to make the request.

There is significant guidance on other aspects such as:

- income or gains treated as remitted following certain events
- Ceasing to be an eligible trading company
- The extraction of value rule
- Appropriate mitigation steps
- Grace periods
- Mixed funds records
- Record keeping

Simplification of the remittance basis rules

There are two other changes which will simplify the remittance basis rules in the following areas:

- nominated income
- foreign currency bank accounts

Nominated income

If you claim the remittance basis and are liable to pay the Remittance Basis Charge you are required to nominate some of your foreign income and gains on your Self-Assessment tax return for that year. The foreign income and gains you nominate cannot be treated as remitted to the UK before any other foreign income and gains you have overseas, and there are special ordering rules to ensure this is the case. However from tax year 2012-13 onwards you can remit nominated income up to £10 for any tax year for which you made a nomination without becoming subject to the ordering rules. This means you will not need to keep detailed records of your nominated foreign income and gains in any tax year provided you nominate no more than £10 for that tax year.

Foreign currency bank accounts

If you have bank accounts denominated in a currency other than sterling, for tax years up to and including 2011-12, any withdrawals from the account are part disposals of chargeable assets for Capital Gains Tax purposes. Because of fluctuations in international currency exchange rates, a capital gain or loss can arise every time a withdrawal is made from such accounts. This could create the need for a significant number of detailed Capital Gains Tax calculations in a tax year. From 6 April 2012 the proposed change removes your foreign currency bank accounts from the Capital Gains Tax charge and you will no longer need to make these complex calculations.

Sales of exempt property: Taxation of assets sold in the UK

Exempt property is property which has been purchased overseas using foreign income and gains and brought to the UK, where certain conditions are met. If you bring exempt property to the UK and sell it (or otherwise convert it to money), for tax years up to and including 2011-12 the foreign income and gains are treated as having been remitted. For tax years 2012-13 onwards the original foreign income and gains will not be considered as remitted to the UK and the gain arising on the sale will not be treated as a UK gain, provided certain conditions are met.

Contributed by Tony Jenkins

Enterprise Management Incentives (Lecture P721 – 11.17 minutes)

The EMI share option scheme is a flexible and tax-efficient arrangement for rewarding key members of staff in small and medium-sized companies. The relevant legislation is found in Sch 5 ITEPA 2003. Para 5 Sch 5 ITEPA 2003 provides that an employee may not hold unexercised EMI options in respect of shares with a total value of more than £120,000. This limit is to be increased to £250,000 as soon as State Aid approval has been obtained. The restriction found in Para 6 Sch 5 ITEPA 2003, which stops further options from being granted until a period of three years has passed once the relevant limit has been reached, remains in place.

It is also planned that gains on shares acquired through exercising EMI options on or after 6 April 2012 should be eligible for entrepreneurs' relief. At present, such gains do not usually qualify for relief because, more often than not, the option-holder does not satisfy the 5% test. In addition, the one-year qualifying period condition is seldom met. The Government's intention is to remove the 5% shareholding and voting rights stipulation, but apparently they want to retain the qualifying period – it is hoped that they might also relax this latter requirement.

Contributed by Robert Jamieson

UK Residential Property held by Offshore Entities (Lecture P723 – 13.43 minutes)

The Chancellor announced in 2013 Budget several changes to the taxation of UK Residential Property. The changes relate to Stamp Duty Land Tax (SDLT) and Capital gains Tax (CGT). This was followed by the issuing of a Consultation Document in late May 2013 outlining the details of these new proposals.

The new rules introduce a new concept of the "Non-Natural Person" being any offshore company or collective investment or any partnership in which such entities are partners. For the new CGT charge this is extended to include trustees.

The new rules only apply to UK residential properties valued at in excess of £2,000,000.

SDLT Charge on acquisition

Where a non-natural person acquires a UK residential property for in excess of £2m the SDLT rate is 15%.

SDLT Annual Charge

From 6 April 2013 an annual SDLT charge will be levied ranging from £15,000 to £140,000 per year. The highest charge will be property valued at in excess of £20 million. The charge is levied on all UK residential property including property held for investment purposes, rather than as the beneficial owners' home. Certain exemptions will apply, but will be limited.

The rate of tax will be indexed up each year by the CPI and will be due on 15 April following the relevant year. There will also be a revaluation of the properties every 5 years with the first revaluation of in 2017.

CGT Charge

After 5 April 2013 any UK residential property disposed of by non-resident non-natural persons will give rise to a CGT charge. This will also include the sale of shares in any offshore companies holding such property. The charge may be avoided if the current Principal Private Residence Exemption applies, but this will be limited largely to beneficiaries of trusts.

The calculation of the gains and losses will be based on normal rules with no relief for any increase in value prior to 6 April 2013. Gains and losses will be pro-rated for any non-residential use of the property or period of non-residential use. The rate of tax has yet to be determined.

Conclusion

Current structures will need to be examined closely to determine the cost of unravelling existing structures prior to 6 April 2013 as against the cost of the liabilities going forward.

The details of these new rules have yet to be finalised but they are unlikely to be withdrawn.

Contributed by Paul Bramall

CAPITAL TAXES

EIS and reinvestment relief

A company (S) had a subsidiary company (B) that operated a football club and had suffered financial difficulties. In 1999 S's controlling shareholder (O) subscribed for further shares in S. S applied for authority to issue EIS certificates to O. HMRC rejected the application on the grounds that B owed money to O, that S's subscription had been used to repay that debt, and that the subscription was an arrangement within TCGA 1992 Sch 5B para 13.

S appealed, contending that payments which had previously been described as loans should instead be treated as having been made on capital account. The First-tier Tribunal reviewed the evidence in detail, rejected this contention, and dismissed the appeal, finding that O had previously made significant loans to B. Although certain payments by B to O were repayments of sums which had been misappropriated by a former employee of B, the relevant payment made by B to O in December 1999 had been a repayment of the loans and was 'a repayment of debt' which fell within Sch 5B para 13(2)(b). The tribunal specifically rejected S's contention that the payment should be apportioned, observing that 'there was only one subscription for and issue of shares. All the shares comprised in that single issue are “the” shares to which para 13(2) (b) refers.'

Decision:

The Upper Tribunal upheld this decision, observing that 'Parliament should be taken to have wished to legislate such a strict set of conditions to be satisfied in order to claim EIS reinvestment relief. Use of such conditions greatly simplifies and facilitates the policing by the revenue authorities of the proper use of the relief and operates as a clear safeguard against the possibility of abuse.'

Comments - The Upper Tribunal upheld the First-tier Tribunal decision that because part of the share subscription had been used to repay loans which the director had previously made to the club, none of the amount subscribed qualified for relief under TCGA 1992 Sch 5B. The return of capital provisions are definitive – despite appealing the taxpayer did not demonstrate that the provisions did not apply.

Segesta Ltd v HMRC (Upper Tribunal)

Whether house used as principal private residence

A married couple lived together in a house which they had owned for several years. The husband (H) had also inherited a house from his father, which his stepmother occupied as her residence until she died in May 2007. H subsequently gave his wife a joint interest in this house. In October 2007 the couple sold it to the owner of a neighbouring property. They claimed private residence relief. HMRC issued an amendment charging CGT on the sale

Decision:

The First-tier Tribunal dismissed the couple's appeal. Judge Staker observed that 'occupation of a property, or merely staying in a property, is not sufficient on its own to make the property a residence for private residence relief purposes. It must be occupied in such a manner that it becomes a person's home.'

Comments - TCGA 1992 s 222 provides relief from capital gains tax on the disposal of a private residence which has been the 'only or main residence' of the person making the disposal. The First-tier Tribunal upheld HMRC's view that this disposal failed to qualify for relief.

Judge Staker's comments are self-explanatory. The importance of the property actually being a residence rather than just another property owned by the taxpayer is crucial as is demonstrated in yet another Tribunal decision.

MJ & Mrs BA Harte v HMRC (TC01951

Lettings relief - Another important aspect of the PPR relief

The CGT reliefs available in respect of a property that qualifies as the only or main residence are valuable but often misunderstood. One of these is the lettings relief and it is worth looking into this further. Even if a person has moved out of their owned only or main private residence before 31 March 1982, the person will still qualify for the exemption from capital gains tax for the last three years of ownership under TCGA 1992, s 223.

It is worth looking at this through examination of a particular query "A property owner moved out of his main private residence before 31 March 1982 and the property has been commercially let to tenants since then. Only or main residence relief is given for the last 36 months of ownership, but clarification is given regarding entitlement to capital gains tax lettings relief.

We are aware that even if a person has moved out of their owned only or main private residence before 31 March 1982, the person will still qualify for the exemption from capital gains tax for the last three years of ownership under TCGA 1992, s 223. Does the same principle apply for lettings relief? For example, if the property was purchased and occupied as the owner's only or main residence before 31 March 1982, and was then let prior to that date and not subsequently reoccupied as a private residence by the owner, is there an entitlement to capital gains tax lettings relief on sale?

What is the answer?

Letting relief is available if two conditions are met.

First, a qualifying gain must accrue to an individual (as it does in this case). Secondly, the dwelling-house in respect of which that qualifying gain arises, must, at any time in the individual's period of ownership, have been let by him as residential accommodation. In this context, an individual's period of ownership excludes any period before 31 March 1982 (TCGA 1992, s 223(7)). This rule qualifies the second condition so that the premises in respect of which the qualifying gain has arisen must have been let at some time after 31 March 1982 in order for the second condition to be met (and in this case this condition is met). Hence the taxpayer is entitled to letting relief.

The amount of the letting relief is the lowest of £40,000, the amount of OMR relief, and the amount of the chargeable gain arising by reason of the letting that is not otherwise relieved. The amount of OMR relief in this case is a fraction of the qualifying gain as the dwelling house has not been the taxpayer's only or main residence through his period of ownership. TCGA 1992, s 223(2) provides that the numerator of the fraction comprises the length of the part of the period of ownership during which the dwelling-house was the taxpayer's only or main residence, plus the last 36 months of the period of ownership; the denominator comprises the length of the period of ownership. The taxpayer's period of ownership excludes any period before 31 March 1982 when quantifying the numbers in the fraction (TCGA 1992, s 223(7)).

However, excluding periods of ownership before 31 March 1982 for quantification purposes does not mean the gain ceases to qualify for OMR relief. It merely means that, when quantifying the numerator and denominator in the fraction described above, one starts counting on 31 March 1982. Although the period of ownership for quantification purposes is taken to begin at 31 March 1982, residence before that date can give rise to a qualifying gain. This is because TCGA 1992, s 223(7) limits the period of ownership only for the purpose of quantification (TCGA 1992, s 223), not for the purpose of qualification (TCGA 1992, s 222). At CG64943, HMRC state that this will be so even if no part of the dwelling house has been used as its owner's only or main residence at any time after 31 March 1982. So in this case, the amount of OMR relief is ascertained by reference to the final 36 months of the period of ownership only.

The amount of the gain arising by reason of the letting is ascertained by reference to the period between 31 March 1982 and the beginning of the final 36-month period.

For example, assume that the taxpayer disposes of the premises on 31 March 2013 making a qualifying gain of £372,000. He will for calculation purposes be treated as having owned the premises since 31 March 1982 (i.e. 372 months). The amount of the gain that is exempt by virtue of OMR relief is 36/372 x £372,000 = £36,000; the amount of the gain attributable to the letting is 336/372 x £372,000 = £336,000. He will be entitled to OMR relief of £36,000 and letting relief of £36,000 (this being lower than £40,000 and £336,000) and so his chargeable gain will be £300,000.

Extracted from Readers Query – Taxation Magazine

ADMINISTRATION

Alternative dispute resolution (Lecture P 722 – 12.05 minutes)

Introduction

The ADR is a pilot operation which now includes individuals who are in dispute with HMRC, as well as SMEs. In addition, the pilot now covers all of the UK in what is phase 2 of the pilot.

The purpose of the ADR pilot is to test whether deadlocked enquiries can be settled informally by the appointment of an HMRC facilitator. The appointed facilitator has no prior involvement with the dispute and acts as a buffer between the individual/SME under enquiry and the investigating HMRC officer. The objective of the facilitator is to get the dispute settled quickly and amicably, between all parties, in a cost effective manner as indeed is often attempted in other matters outside the tax world.

It must be appreciated lurking behind the ADR pilot is a resource problem. ADRs are undoubtedly being piloted partly due to a backlog of cases awaiting a hearing by the tax tribunals. The lawyers Pinsent Masons report a backlog at 31 March 2012 of 23,815 cases compared to 18,151 cases at 31 March 2011. That's a worrying annual increase of 31%.

Main points of ADRs under the pilot

- To register your wish to participate you can now apply online via HMRC's website.
- The ADR team has the capacity to handle around 250 cases, with 10 facilitators available for SMEs and 6 available for individuals.
- Only cases which have not gone formal (assessments have not been raised, nor a Closure Notice issued) will be considered for acceptance into the pilot. 60% of applications have been accepted so far during phase 2.
- The ADR team will consider accepting disputes involving both direct and indirect taxes.
- Participation in the ADR pilot is voluntary and non-statutory, so an individual/SME can withdraw at any time.
- The ADR team will advise the individual/SME whether their dispute has been accepted into the pilot within 30 days.
- A Memorandum of Understanding (MOU) is then issued to the individual/SME to sign and date. The MOU commits the applicant to respond to the facilitator within 15 working days when information is requested and to agree to attend meetings, or participate in telephone conference calls, if necessary.
- The pilot is due to close at the end of July 2012.

Cases potentially suitable for ADR pilot

HMRC say these may involve any of the following features:

- Facts that are capable of further clarification
- Disputes that might benefit from obtaining more suitable evidence
- Factual and/or technical matters in which there is legitimate scope for any party to obtain a better understanding of the other's arguments
- Issues which are capable of further mediation and settlement by agreement within the framework of the Litigation and Settlements Strategy (LISS)

Cases not suitable for ADR pilot

HMRC say these may involve any of the following features:

- Cases which cannot be legitimately settled within the parameters of the LISS other than by litigation
- Issues which require clarification in the wider public interest. These might include matters of industry-wide application
- Issues linked to or involving co-ordinated appeals issues ("Stood behind" cases) e.g. 'Compound Interest' type disputes
- Cases that could only be resolved by an HMRC departure from its established technical or policy view

HMRC has usefully given examples of suitable cases for ADR treatment.

Case 1 - Restoring communication

You think that an apportionment you have been using is correct but the HMRC officer disagrees. HMRC wants to get further information but the relationship between you and/or the taxpayer and the HMRC officer has broken down. In this case a facilitator may be able to help restore communication and enable the dispute to be resolved by ensuring that the information that is required is obtained or if the information is not available or relevant then an alternative route can be explored.

Case 2 - Clarifying the facts

A case where the dispute is about the rate of VAT that should be charged on a supply. The rules have previously been established and the dispute has arisen because not everyone is clear on the facts relating to the case. For any number of reasons the HMRC officer may not have been able to convey their position to you. The facilitator may be able to assist in explaining the position, ensuring that both sides are applying the law correctly and thereby resolving the dispute.

Case 3 - Obtaining more suitable evidence

This is really more aimed at the unrepresented taxpayer, but could apply where he is your client. An HMRC officer believes that your valuation is incorrect and wishes to instruct the District Valuer for an agreed valuation. The HMRC officer wishes to raise assessments using the value he thinks is correct if you do not agree to an agreed valuation with the District Valuer. You believe that the value that the HMRC officer is considering is not correct but you are not clear of the role of the District Valuer. You also have concerns about the Compliance Check process and are confident in your own position. A facilitator may be able to clarify the position on both sides, ensure that the correct people are being contacted and through open discussion establish if an agreed valuation is required. With new information you and the HMRC officer may be able to come to agreement, an agreed valuation may be obtained or at the very least the positions of the parties should be clarified.

Case 4 - Issues capable of further mediation

A case where there are both corporation tax and VAT issues. The HMRC officers have prepared a business model on the information they had at an earlier stage in the Compliance Check. You are unsure as to what information they have used but you are certain that the model is based on incorrect assumptions. Despite requests the HMRC officers have not elaborated on the basis of the business model. The Compliance Check has stalled due to the level of profits that the business model states the taxpayer should have returned. A facilitator may be able to ensure that the assumptions around the business model are correct or not. The method of the model can be clarified for you and any incorrect assumptions remedied by the HMRC officers. This could provide a way for the Check to progress or be resolved.

Case 5 - Obtaining a better understanding of the arguments

A case that has been open for a long time and you and your client keep receiving information requests from the HMRC officer. You are not sure why the information is required and are reluctant to supply all the information because the events happened a while ago and the information is all in storage. At the outset the taxpayer and/or their representative could see why information was being requested but the Compliance Check appears to them to have lost focus and direction. A facilitator could help the parties come together, establish where the Check is going and what level of information is required to resolve the dispute.

Contributed by Gerry Hart

General Anti-Abuse Rule **(Lecture B725 – 14.12 minutes)**

A consultation document has been published on 12 June 2012 on the introduction of a General Anti-Abuse Rule (GAAR). The Government agrees with the recommendation by Graham Aaronson QC to introduce a rule which is targeted at artificial and abusive arrangements. It agrees with the report's conclusion that introducing a 'broad spectrum' general anti-avoidance rule would not be beneficial for the UK tax system.

The proposed GAAR aims to target artificial and abusive tax avoidance schemes (those that the report refers to as 'egregious', 'very aggressive' or 'highly abusive contrived and artificial') which, because they are often complex and/or novel, could not have been contemplated directly when formulating the tax legislation. The GAAR will apply to counteract, on a just and reasonable basis, the tax advantage that would otherwise be obtained. The GAAR is intended to have narrower application than most general anti-avoidance rules found in other jurisdictions.

The new GAAR should not affect what the report describes as 'the centre ground of tax planning'. The consultation document (Annex B) includes some examples of the types of schemes that the government considers should fall within the GAAR.

The key elements of the document are:

- A preamble which states that the GAAR has effect for the purpose of counteracting tax advantages arising from tax arrangements that are abusive.
- Arrangements are 'tax arrangements' if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements.
- Tax arrangements are 'abusive' if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action, having regard to all the circumstances including:
    - the relevant tax provisions,
    - the substantive results of the arrangements, and
    - any other arrangements of which the arrangements form part.
- The definition of 'tax advantage' is intended to have a very wide meaning, to cover any form of tax benefit (for example, increasing deductions or losses or debits, decreasing income or gains or credits, timing advantages, repayments of tax etc.)
- The abusive tax advantage would be counteracted on a just and reasonable basis.
- In any dispute or litigation proceedings, HMRC would normally expect to consider the application of the GAAR and the particular relevant tax rules in parallel, or to be argued in the alternative i.e. HMRC does not first have to prove, or agree with a taxpayer, that the tax advantage in question has arisen.
- It should be for HMRC to show that the key requirements for the GAAR to apply are met and that the counteraction is reasonable and just. The usual civil standard of proof would apply.
- Relevant evidence of material which is in the public domain at the time arrangements are entered into or established practice at that time should be available to a tribunal or court in considering whether or not the GAAR applies. This addresses concerns that the GAAR might otherwise be used by HMRC in an attempt to counteract arrangements where official material, or evidence of widespread practice, could demonstrate that the arrangement was not at the relevant time regarded as abusive.

Administration

- The GAAR should, as far as possible, operate within existing self- assessment regimes (where the relevant tax operates within such a regime). Tax recovered under the GAAR should be treated as tax which should have been self-assessed in the relevant return of the taxpayer, and all of the usual consequences of the SA regime should follow.
- The GAAR will operate within the existing administrative rules for non-SA taxes and existing NICs processes as far as possible. This means that existing penalty provisions and their criteria would apply as they do at present.
- There should be no formal statutory clearance process in relation to the GAAR. This is in line with the recommendations of the report. However, the report suggested that existing statutory clearance procedures could be expanded to enable confirmation to be sought regarding application of the GAAR. This has been rejected on the basis that there is a risk that HMRC's costs would increase considerably if additional clearances were sought under existing statutory provisions in order to obtain a clearance for the GAAR.

Advisory panel

- The report's recommendation that an Advisory Panel, including member from within and outside HMRC, should be established has been accepted.
- The Advisory Panel would draw its expertise from a range of individuals, who will not necessarily be the same on each occasion. At least one of the independent (non-HMRC) members should, wherever possible, have experience relevant to the arrangement. For example, if the arrangements concerned an insurance business, at least one of the Panel members should have experience relevant to insurance.
- The Advisory Panel should provide opinions and not deliver binding decisions, in line with the recommendation of the report. The process would work as follows:
  - Stage one: written notification to a taxpayer that a designated HMRC officer considers that the GAAR may apply, with reasons and proposed counteraction), and inviting a written response.
  - Stage two: written response from the taxpayer.
  - Stage three: if the taxpayer provides a written response, the designated HMRC officer must consider the response. If the officer is still of the view that the GAAR may apply, he or she must refer the matter to the Advisory Panel.
  - Stage four: the Advisory Panel will give its opinion to HMRC and to the taxpayer.
- If the Panel considers that HMRC has not delivered sufficient information to demonstrate that the GAAR should apply then that should be the opinion of the Panel. If the Panel considers that the taxpayer has not provided sufficient information to demonstrate that HMRC should not proceed further, then that should be its opinion.
- The Advisory Panel should produce a periodic report containing a digest of key principles emerging from the opinions delivered, which can subsequently be incorporated into GAAR guidance. It would also contain statistical information such as the number of referrals, the areas of legislation covered, and the outcome of opinions given.

Guidance

- Guidance will be provided on how the principles underpinning the GAAR should operate. The most practical and workable solution would be for the Advisory Panel to have responsibility for reviewing and approving the guidance, with the drafting work handled within HMRC.
- The Court or Tribunal must take the guidance into account in considering any issue in connection with the GAAR.

The consultation period ends on 14 September 2012.

Contributed by Tony Jenkins

New Code of Practice 9 – the CDF (Lecture P724 – 12.39 minutes)

The old regime
Pre 2005 this worked relatively well, with good case selection and management by HMRC. It was therefore unusual not to be able to convince a potential client that there was a case to answer.

The case known as Gill and Gill (*R v Gill and another, 2003 STC 1229*) changed all that. The Gills contended that the action taken against them under Code 9 amounted to a criminal case, as they were accused of serious fraud, yet the Police and Criminal Evidence Act 1984 provisions were not applied. Instead, they were not cautioned, were required to self-incriminate, were subject to what HMRC accepted was a criminal penalty and therefore did not receive a fair and unbiased trial. The court agreed, but they were still jailed for their tax misdemeanours!

The need for change
The inevitable consequence of Gill was that all Code 9 meetings with the taxpayer present had to be formally tape recorded. In addition, the client had to be formally cautioned and advised of his rights. In effect, the case was worked under criminal processes in order to achieve the end result of a full disclosure leading to a financial settlement, which inevitably led to difficulties and less flexibility.

This led to CIF – the Civil Investigation of Fraud – as the next version of Code 9. To get round the Gill problem, as soon as HMRC had decided to issue Code 9, the possibility of criminally investigating with a view to prosecution was dropped. This led to advisers and clients viewing Code 9 as less serious – no real threat of prosecution even if the tax payer failed to cooperate at all. Inevitably this led to tension, poor quality disclosure reports (if one was received at all) and too many cases where cooperation was lacking.

A National Audit Office report into CIF cases in December 2010 recognised these problems, which led to consultation on a new procedure the following July, with the CDF – the Contractual Disclosure Facility – being launched on 31 January 2012.

The CDF
As the name suggests, this procedure requires a formal contract between HMRC and the tax payer. The terms are, broadly, that HMRC undertakes not to prosecute but only if the tax payer admits to the misdemeanours and makes a full disclosure.

The disclosure is in two parts:

1. The outline disclosure – despite the name being suggestive of a brief disclosure, this must be far more detailed than in the past, with written disclosure of each individual fraud, when they happened, who was involved, how they were undertaken and what financial rewards resulted. This must be done within a mere 60 days.

2. The formal disclosure – except in straightforward cases, this will involve a very thorough examination of the client’s affairs and finances leading to a detailed full disclosure report, as has been the case for Code 9 cases for many years.

In both scenarios various signed documents must be provided, being a statement of worldwide assets and liabilities at a date(s) to be agreed with HMRC; a statement of bank/credit cards; a certificate of full disclosure; and a formal letter of offer leading to a contract settlement.

Unlike with CIF, the immunity from prosecution only applies if the client fully maintains his side of the bargain. So a failure to enter into the CDF contract, or a failure to make a complete outline or formal disclosure, can still lead to a criminal investigation. The latter can also lead to a case for breach of contract.

Tax payers can ask for the CDF at any time, there is no need to wait for HMRC to issue a Code 9 letter. Whilst there is no guarantee that HMRC will agree to Code 9 being issued, it is hoped that this will not happen otherwise the entire system will fall into disrepute.

The Liechtenstein Disclosure Facility as a potential alternative
Contrary to popular belief, the LDF remains very much open (until 2016) and can be used even if there is no current connection to that jurisdiction. It cannot be used if Code 9 has already been issued but many clients in a Code 9 situation can be routed through the LDF rather than asking for the CDF. Like the CDF (assuming no hiccups) it provides immunity from prosecution, but unlike the CDF it does not encompass a great deal of involvement by HMRC – it is a disclosure, not an investigation. It is also likely that the tax, interest and penalties will be less than under Code 9.

Advisers should, therefore, try and determine if they have any clients who could benefit from the LDF. The LDF works in fraud cases but there is no need to identify fraud in the first place, just a UK tax problem and a relevant overseas asset. For example, a UK resident but non domiciled client may have a Swiss bank account or other overseas investments and have made errors with the remittance basis – which is of course a complex beast – and can therefore use the LDF. Clients ought to be discreetly canvassed.

Contributed by John Cassidy of PKF

Conditions for making a discovery assessment met

The appellant participated in a widely marketed scheme which sought to create and distribute capital losses to UK individuals. In his 1998–99 self-assessment tax return, which was submitted late in February 2003, the appellant - upon the advice of counsel - disclosed in the “white space” information about the scheme and the fact he was entitled to a loss. Upon realising the appellant's return included a claim for losses under the scheme, HMRC issued a discovery assessment against him under TMA 1970 s 29. The appellant appealed and the following issues arose for consideration: (i) whether there was a discovery by HMRC; and (ii) if so whether the conditions in TMA 1970 s 29(4) - negligent conduct on the appellant's part or anyone acting on his behalf; there being no allegation of fraud - or sub-s (5) - an officer could not have reasonably have been expected on the information made available to him to have been aware of the insufficiency of tax—were met.

Decision:

For the purposes of a discovery assessment under TMA 1970 s 29, it was not necessary for there to be new facts or a changed view of the law. Therefore, the fact that an HMRC officer might have had sufficient evidence to reach a conclusion that there was an insufficiency of tax sooner than he did, did not preclude him from reaching that conclusion and making a discovery at a later date; Hankinson v Revenue and Customs Comrs [2011] EWCA Civ 1566, [2012] STC 485 applied; and Scorer (Inspector of Taxes) v Olin Energy Systems Ltd [1985] 2 All ER 375 distinguished.

It was for HMRC to establish that either of the conditions in TMA 1970 s 29(4) or (5) applied as without evidence of fraud or negligent conduct, or of information to fulfil the test of non-awareness, there would be no basis to conclude that either subsection applied. On the facts the condition in sub-s (4) was not met as the appellant did not engage in negligent conduct. He acted as a reasonable taxpayer exercising due diligence would have done: given the nature of the scheme he took proper and appropriate advice in relation to the preparation and disclosure on his tax return. Even though the return was submitted late, the insufficiency of the tax was attributable to the failure of the scheme and not the lateness of the return. Turning to the condition in sub-s (5), the only information was that included in the “white space”, as advised by leading tax counsel, at the time the enquiry window closed, and the hypothetical officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the insufficiency of tax. Accordingly the condition in sub-s (5) was fulfilled and HMRC were entitled to raise the discovery assessment.

It followed that the appeal would be dismissed; Revenue and Customs Comrs v Household Estate Agents Ltd [2007] EWHC 1684 (Ch), [2008] STC 2045 applied; County Pharmacy Ltd v Revenue and Customs Comrs; Morris v Revenue and Customs Comrs [2005] STC (SCD) 729 not followed; Revenue and Customs Comrs v Lansdowne Partners Ltd Partnership [2011] EWCA Civ 1578, [2012] STC 544; and Charlton v Revenue and Customs Comrs [2011] UKFTT 467 (TC), [2011] SFTD 1160 considered.

Appeal dismissed.

Comments – The nature of tax avoidance is that it relies on a methodology using the fine detail of the law to create or utilise a "loophole". It naturally follows that when disclosed the disclosure is not immediately transparent and often is extremely opaque. Naturally with any system of self assessment therefore provisions have to exist to allow discovery to be made by the taxing authorities. Thus the provisions in s29 become important and accordingly the importance of whether the conditions have been met to prevent HMRC making a discovery assessment.

Sanderson v Revenue and Customs Comrs TC1902

6 New Taskforces on Market Traders, Taxi Firms, Property Rentals and Restaurants

HMRC has launched six more compliance taskforces. These will investigate: market traders in London; taxi firms in Yorkshire and East Midlands; property rentals in East Anglia, London, Yorkshire and the North East; and restaurants in the Midlands. According to HMRC, these teams are expected to recover more than £23 million in evaded taxes.

Six new taskforces launched this week by HM Revenue & Customs (HMRC) are expected to recover more than £23m from tax dodgers.

The taskforces will target traders who do not pay the right amount of tax in:

- Indoor and outdoor markets in London
- Taxi firms in Yorkshire and East Midlands
- Property rentals in East Anglia, London, Yorkshire and the North East
- Restaurants in the Midlands

Taskforces are specialist teams that undertake intensive bursts of activity in specific high risk trade sectors and locations in the UK. The teams will visit traders to examine their records and carry out other investigations.

David Gauke, the Exchequer Secretary, said:

"HMRC is on target to collect more than £50m as a result of the taskforces launched in 2011/12.

"We have made it clear that we will not tolerate tax evasion – everyone needs to pay the taxes they owe in full. We are determined to crack down on the minority who choose to break the rules. It is not fair that at a time when most hard-working people are paying the right tax, others are trying to get out of paying what they should."

HMRC's Mike Eland, Director General Enforcement and Compliance, said:

“These six new taskforces will bring together specialists from across HMRC to tackle tax dodgers. If you have paid all your taxes you have nothing to worry about. But deliberately evading tax you should be paying can land you with not only a heavy fine but possibly a criminal prosecution as well.

“This is not an empty threat - HMRC can and will track you down if you choose to break the rules.”

HMRC launched 12 taskforces in 2011/12. Thirty will follow in 2012/13.

Taskforces are a result of the Government's £917m spending review investment to tackle tax evasion, avoidance and fraud from 2011/12, which aims to raise an additional £7bn each year by 2014/15.

If you are aware of someone who is evading their taxes you can tell HMRC via the Tax Evasion Hotline by phone, on 0800 788 887, email or by post. Full details can be found at www.hmrc.gov.uk

Decline in fortune

A company had been late paying its monthly PAYE payments during 2010/11 and incurred penalties totalling £6,354.

Although not disputing the late payments, the company director said that for three months payment had been only one day late, for one month it had been two days late and for three months three days late. Payment for December was 19 days late.

The director explained that the reason for lateness was because the company had faced difficult trading conditions in the year, with turnover declining from about £3m to £2m, and customers delaying payment. The bank had refused overdraft facilities and in September the company had to make a quarter of its employees redundant. The directors had injected cash secured on their homes into the company to keep it trading. The accounts for the company showed bad debts of £56,187 for the year ended 31 December 2010.

The director said that as a result of a telephone conversation with HMRC, he believed late payment was being permitted..

Decision:

The First-tier Tribunal noted from the telephone notes that no express assurance (that late payment was being permitted) had been given. With regard to the penalty, the director said that the fine of £6,354 for making payment between one day and two weeks late was 'unjust and excessive'. To this the tribunal responded that it was a statutory tribunal and had no power to interfere with the legislation, in this instance, FA 2009, Sch 56. The question to be decided was whether the decline of the company provided reasonable excuse for the late payments. The tribunal agreed that the fall in the company's fortunes was beyond its control. However, given that once it realised the severity of the penalty regime, measures had been put in place to ensure payments did reach HMRC on the correct day, it seemed likely that the company could have made most of the payments made late in 2010/11 on time.

The tribunal concluded that only for the December payment, which had been 19 days late, did the company have reasonable excuse. This delay suggested that the company could not possibly have paid on time.

The taxpayer's appeal was allowed in respect of the December payment only.

Commentary – This case demonstrates the importance of the payments for PAYE being made absolutely on time. In this case the majority of the payments were made only days late and a scheme which applied more altitude or discretion would have perhaps ended up with a better and different result. That discretion does not exist as amply demonstrated with this case. Advisors need to ensure that their clients are aware of the importance of the deadline and therefore maximum effort is made to ensure that it is met.

Trio Offset Ltd TC1757

Failure to deduct tax from payments to 'shadow director'

A company (IL) paid one of its shareholders (W), who owned 65% of its share capital but was not a director, without deducting PAYE and NIC. IL subsequently went into liquidation, and HMRC issued a direction under Income Tax (PAYE) Regulations, SI 2003/2682, reg 72(5), requiring W to pay the tax and NIC.

Decision:

The First-tier Tribunal dismissed W's appeal, finding that he had been a 'shadow director' and that he had known that IL had 'wilfully failed to deduct the amount of tax which should have been deducted from the payments'.

Comments - SI 2003/2682, reg 72(5) provides that where an employer has failed to deduct tax from payments to an employee, HMRC may direct that the tax should be recovered from the employee rather than the employer, if it considers that the employee has received the payments 'knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted'. The First-tier Tribunal held that HMRC had been entitled to make such a direction here, where the company had failed to deduct tax from payments to its controlling shareholder.

MO Williams v HMRC TC01988

Confused delivery

The taxpayer was made redundant in March 2008. He asked HMRC to check whether his employer had deducted the correct amount of tax from his redundancy pay. In reply, the department sent him a form P800 showing that insufficient tax had been taken and the taxpayer owed HMRC tax of £2,037 for 2006/07 and 2007/08. It was agreed that the taxpayer would repay the amount via his PAYE tax code.

In January 2011, HMRC wrote to the taxpayer demanding full payment of the underpaid tax by 25 February 2011. The taxpayer replied stating that he understood the amount was to be collected through his tax code and said the Revenue's letter caused himself and his family 'worry and upset'.

HMRC treated the letter as a complaint. The complaints handler sent another letter saying the first letter 'should not have been issued'. The letter went to say that the taxpayer had overpaid tax in 2008/09. Taking into account the underpayment from the two earlier years, HMRC owed him £1,836. There was therefore no need to code out any underpaid tax.

The taxpayer was also told to expect a 2009/10 tax return which he should complete and return within three months of receipt.

In April 2011, the taxpayer received a tax return. He had expected to receive the form for 2009/10, but this was for 2010/11. He completed it and submitted it online in May. In June he received a penalty for not submitting the 2009/10 return. He contacted HMRC, explained what had happened, completed a return for that year, i.e. 2009/10, and believed the matter had, as a result, been cleared up.

However, he subsequently received a final reminder for the 2009/10 return. He wrote to HMRC saying he had never received that return and asked them to cancel the penalty. HMRC treated the letter as an appeal.

Decision:

The First-tier Tribunal judge accepted the taxpayer's statement that HMRC had sent him a paper 2010/11 tax return, and not one for the previous year. She concluded that this had been human error on HMRC's part. She said the taxpayer's evidence showed him to be a 'transparently honest person who has consistently tried to pay the right amount of tax' and had he been sent a notice to file a 2009/10 return he would have done so.

The taxpayer's appeal was allowed. The tribunal judge added that the taxpayer had been right to believe that late filing penalty for 2009/10 should not have been imposed and it was 'surprising that HMRC were not able to come to this conclusion themselves'. She reminded the taxpayer that although she was unable to deal with complaints about HMRC, he could request compensation in the first place from HMRC but then to the Adjudicator if he was not satisfied.

Commentary – This case demonstrates the importance of keeping a record of the history of dealings with HMRC particularly when matters go wrong. The Tribunal judge's comments are self explanatory. It is also surprising that the case should have made it to the Tribunal in light of the administration by HMRC.

David Preece TC1887

Penalty for failure to account for PAYE

A company paid its controlling director (M) more than £300,000 in 2006/07 without accounting for PAYE. HMRC issued a determination under Income Tax (PAYE) Regulations, SI 2003/2682, reg 80, and imposed a penalty under TMA 1970 s 98A, at the rate of 10% of the evaded tax.

However M's tax return for 2006/07 showed the following entries:

Pay from all employments (including the bonus)	£ 304,740
Foreign dividends	27
UK dividends	33,357
Total income received	338,124
Losses	(327,112)
Total income after loss relief	11,012
Personal allowance	(5,035)
Taxable income	5,977

The salary and bonus was shown in the tax return and the tax due was nil.

In 2008 the Income Tax (Pay As You Earn) (Amendment) Regulations, SI 2008/782 inserted regulations 72E to 72G into the PAYE regulations with effect from 6 April 2008. The Explanatory Memorandum to SI 2008/782 says:

Where an employer has failed to deduct or account for PAYE, the employee may nevertheless have included the payment in question in a tax return and self-assessed a liability to tax in relation to the payment. Or they may have paid tax in relation to the payment as a self-assessment payment on account, or suffered sub-contractors' deductions. The conditions which must be satisfied in order for HMRC to exercise the power to make a direction to transfer the PAYE liability to the employee will not normally be met, meaning that HMRC are obliged to seek recovery from the employer.

These Regulations introduce a new power to make a direction to transfer a PAYE liability from an employer to an employee which will apply to prevent tax being charged on the same income twice. Typically (but not always) the power is likely to become exercisable in cases where a worker's status has been recategorised from self-employment to employment following a status review by HMRC.

The Demibourne case was decided in 2005, and regulations 72E and 72F introduced in 2008. Between those dates HMRC operated a practice based on the suggestion made in the last paragraph of the Demibourne decision by the Special Commissioner. He indicated to HMRC that it would be appropriate to credit the tax paid by the employee, which would in a timely case be repayable, against the tax due under the determination on the employer. The "Demibourne concession" or "practice" in this period was to obtain a mandate from the employee under which any repayment due to them as part of an error or mistake claim or as a result of an amendment of a return and self-assessment could be set against the employer's liability. Rather oddly this practice would not have helped the employee in Demibourne as he was out of time to make a claim: yet it was only in the context of a claim being out of time that the Special Commissioner suggested the "mandate" procedure. What the mandate procedure avoids is the need for the employer to first pay the tax so as to generate a credit to the employee for PAYE tax which is capable of founding a repayment. (See the third paragraph of the Guidance Note which explains that regulation 185(5) of the PAYE regulations prevents a credit for tax that has not actually been accounted for being used to create a repayment).

The key question is whether any amount representing tax on the bonus and salary payments has been self-assessed by being included in Mr Marshall's return and is or would be assessed as payable by way of income tax.

Decision:

The First-tier Tribunal upheld the determination and the penalty. Sir Stephen Oliver held that the fact that the director had declared the income in his personal return did not absolve the company of its liability to account for tax.

Comments - The First-tier Tribunal upheld HMRC's view that a penalty under TMA 1970 s 98A was correctly charged in the circumstances here, where a company had failed to account for PAYE on substantial payments to its controlling director. No "amount intended to represent tax on the payments" had been self-assessed. This was because the self-assessed amount of tax on the payments in M's self-assessment return was nil.

David A Marshall Jeweller Ltd v HMRC TC1955

Determination under TMA 1970 s 28C

HMRC issued three determinations under TMA 1970 s 28C. The recipient (B) submitted a notice of appeal. HMRC applied for the appeal to be struck out, contending that the Tribunal had no jurisdiction to hear an appeal against a determination under s 28C.

Decision:

The First-tier Tribunal accepted this contention and struck out the appeals. Judge Hellier held that 'the procedure envisaged by s 28C requires no right to appeal against the amounts in any determination'. He observed that 'a taxpayer has a remedy for incorrect amounts which he may pursue by submitting a return and self-assessment'. The Upper Tribunal upheld this decision. Judge Clark observed that B 'had a choice. If he had wanted to keep open the ability to question within the Tribunal appeals system the amounts of the tax stated by the determinations to be due, he needed to take the path labelled "submit self-assessments".

'By deciding to follow the other path and allow the determinations to stand unchanged, he denied himself the opportunity of challenging on appeal the amounts of tax demanded as a result of those determinations.'

Comments - The Upper Tribunal upheld the First-tier Tribunal decision that there was no right of appeal against a determination under TMA 1970 s 28C.

M Bartram v HMRC (Upper Tribunal)

Surcharge cancelled

The taxpayer received a one-off share dividend in November 2009. A capital gains tax charge, due on 31 January 2011, arose on the payment. When the dividend was paid to the taxpayer she was not registered on the self-assessment system. She told HMRC about the dividend on 10 January 2011 and they issued her a tax return on 3 February. She filed the return and paid the tax one month later. HMRC subsequently imposed a surcharge for late payment of tax.

The taxpayer appealed. She said there had been a delay in HMRC allocating her a unique tax reference (UTR), which was why they had not sent her a tax return to complete in time for the 31 January deadline. She said she did not know it was her responsibility to inform HMRC of her liability, nor that she should have calculated the tax due and ensured it was paid before 28 February.

Decision:

The First-tier Tribunal said that ignorance of the law was 'not generally an excuse for failing to comply with it'. However, the tribunal judge said that HMRC's delay in issuing the UTR was also a factor, as was the fact that the taxpayer had taken steps before the January deadline to meet her obligation. This was a borderline case, but looking at the circumstances as a whole, the taxpayer did have a reasonable excuse for the late payment of tax.

The taxpayer's appeal was allowed.

Comments – Although it is a well tried rationale of ignorance being a defence it is generally not accepted however fair or unfair that may seem. However in this case the importance of record keeping is gain amply demonstrated as although the taxpayer would have been unlikely to have succeeded being able to demonstrate the part played by HMRC helped the taxpayer’s case.

J M Lyons TC1816

Bankruptcy: whether appeal settled by agreement

A chartered accountant (M) entered into a series of transactions in 1997/98, intended to produce a capital loss.

Following an enquiry, HMRC rejected his loss claim and amended his self-assessment to charge additional tax of £951,790. M appealed, and applied for postponement of the tax. The General Commissioners rejected the postponement application, and HMRC took county court proceedings to collect the tax. The Durham County Court gave judgment for HMRC, and in December 2006 M was declared bankrupt. The trustee in bankruptcy decided not to proceed with the appeal against the closure notice, and admitted HMRC's claim. In 2010 M sought to have his appeal heard by the First-tier Tribunal.

The First-tier Tribunal held that he had no 'locus standi' to pursue the appeal, as that right had vested in the trustee, who had agreed to settle the appeal, within TMA 1970 s 54(1).

Decision:

The Upper Tribunal upheld this decision.

Comments - The Upper Tribunal upheld the First-tier Tribunal decision that the effect of the bankruptcy order was that the right of appeal had vested in the trustee in bankruptcy, who had taken the view that the appeal was not worth pursuing, and had settled it by an agreement with HMRC. The decision here is in line with the earlier decision in Ahajot (Count Artsrunik) v Waller (2004 SSCD 151).

D McNulty v HMRC (Upper Tribunal)

Application for costs

HMRC began an enquiry into the return submitted by an individual (C), and subsequently issued an amendment, against which C appealed. On the day of the hearing, HMRC agreed to reduce the amount charged by the amendment. C applied for costs.

Decision:

The First-tier Tribunal rejected his application, holding that HMRC had not acted unreasonably, and the Upper Tribunal dismissed C's appeal against this decision.

Comments - The Upper Tribunal upheld the First-tier Tribunal decision that HMRC had not acted unreasonably, so that the appellant was not entitled to costs. The decision here is in line with the earlier decision in Conlon v Hewitt (2005 SSCD 46).

GC Catana v HMRC (Upper Tribunal)

Assessments following confiscation order

An individual (M) was convicted in 2007 of several offences relating to dealing in counterfeit and contraband cigarettes. In February 2009 the court made a confiscation order of £35,316 under Proceeds of Crime Act 2002 s 6. In August 2009 HMRC issued discovery assessments charging income tax totalling £382,687 on M's income from self-employment. M appealed, contending that the confiscation order should be treated as extinguishing the tax liability on his income.

Decision:

The First-tier Tribunal rejected this contention and dismissed his appeal. Judge Huddleston held that 'in certain circumstances it may be the case that the proceedings under the Proceeds of Crime Act do indeed encompass an assessment of all of the tax liability which may or may not be due in particular circumstances, but that can only be determined after the assessment process has been undertaken'. However that was not the case here. The appropriate course of action was to confirm the assessments, leaving the amount M had paid under the confiscation order to be set against the tax liability.

Comments - The appellant here had been convicted of dealing in counterfeit and contraband cigarettes, and the court had made a confiscation order under the proceeds of Crime Act.

HMRC formed the opinion that the appellant had derived a significant income from his dealings, and that the transactions in respect of which he had been convicted did not represent the full extent of his income. They issued assessments accordingly. The First-tier Tribunal upheld the assessments, while accepting that the amount which the appellant had paid under the confiscation order should be set against his tax liability.

J Martin v HMRC TC1990

Application for judicial review of HMRC settlement

This case follows on from the widely publicised case of Goldman Sachs International v HMRC (No 2) ([2010] SFTD 930), in which HMRC had issued a ruling to a company (GSI) that the exercise of certain options to employees gave rise to a liability to national insurance contributions. GSI appealed, contending that the staff were supplied by an associated company (GSL), and applied for a preliminary hearing to determine whether it could be treated as the employer of the employees who had exercised the options.

The First-tier Tribunal held a preliminary hearing, reviewed the evidence in detail, and determined the preliminary issue in favour of HMRC, finding that GSL 'did not have a place of business in Great Britain at any time relevant to these appeals', and holding that GSL was a 'foreign employer' within Social Security (Categorisation of Earners) Regulations, SI 1978/1689, r 1(2), with the result that GSI was the 'host employer' within SI 1978/1689, Sch 3 para 9, and was the 'secondary contributor' for the purposes of SSCBA 1992 s 7. GSI appealed to the Upper Tribunal, but the appeal was subsequently settled by an agreement which attracted considerable adverse publicity for reportedly waiving the interest which was legally chargeable on the unpaid tax, and was strongly criticised by the House of Commons Public Accounts Committee for being unduly lenient.

Another company (UKU) subsequently applied to the QB for judicial review of the agreement between HMRC and GSI, contending that the settlement breached HMRC's duty of fairness to the general body of taxpayers. HMRC opposed the application but the QB granted it.

Decision:

Simon J held that the evidence showed that UKU had an arguable case, and that it was 'plainly in the public interest' for there to be a full judicial review. He observed that 'maladministration and legality' are separate issues, and that it was arguable that the court could declare the agreement to have been illegal.

Comments - This case has attracted significant publicity, and tax professionals may be surprised to learn that the High Court granted UK Uncut permission to bring a judicial review of the tax settlement reached by HMRC with Goldman Sachs. Older readers may remember the 1981 case of R v CIR (ex p. National Federation of Self-Employed and Small Businesses Ltd), 55 TC 133, in which the House of Lords held that an amnesty given to certain casual workers had been 'genuinely in the care and management of the taxes', under the powers entrusted to the Revenue. HMRC consider that the same principle should apply to the settlement reached here. However, the House of Commons Public Accounts Committee has been notably critical of the settlement. Simon J held that UK Uncut had demonstrated an 'arguable case' that the settlement had been illegal, and directed that the application should proceed to a full hearing. (At the time of writing, the full transcript of his decision is not yet available.).

R (oao UK Uncut Legal Action Ltd) v HMRC (QB)

Validity of football league rules

This case follows on from the earlier decision in HMRC v Portsmouth City Football Club Ltd, Ch D [2010] EWHC 2013 (Ch). The case concerned the so called 'football creditor rule' operated by the Football League Ltd. Under this rule, in the event of a member club becoming insolvent certain creditors, such as other clubs in the league, the club's players, managers and other employees and the Football League itself, are paid in full before any other creditors. HMRC said that this rule caused it, and others, loss, and challenged it. They suggested that the rule contravened fundamental principles of insolvency law.

Decision:

The Ch D rejected this contention and dismissed HMRC's application. Sir David Richards held that HMRC had not shown that the League's rules automatically violated either the 'pari passu' principle or the 'anti-deprivation rule'. He held that the 'pari passu' principle only came into play where a company went into liquidation, and did not apply to an administration which did not result in a liquidation. The 'anti-deprivation rule' did apply to companies in administration, but the League rule requiring the transfer of a share where a member club went into administration did not automatically contravene it.

The High Court said that in most circumstances in which the Football League's insolvency policy operated, they would not be rendered void by the anti-deprivation rule or pari passu principle. In any event, this could only be tested in a real case. The court decided not to make the declarations requested by HMRC.

Comments - There is a great deal of money at stake in this case. The Ch D rejected HMRC's contention that the Football League rules, which require priority to be given to 'football creditors' when a member club goes into administration, contravened specific principles of insolvency law.HMRC have expressed disappointment with the judgment and are considering an appeal. They continue to believe 'that the football creditor rule is unfair to all other unsecured creditors who are forced to make do with much smaller returns - if anything - on monies owed to them by football clubs which enter administration'.

CRC v Football League Ltd (Chancery Division)

CIS: contractor failing to deduct tax

A contractor (H) failed to deduct tax from payments made to a subcontractor (F). H subsequently requested HMRC to make a direction under Income Tax (Construction Industry Scheme) Regulations, SI 2005/2045, reg 9. HMRC refused to make such a direction, and H appealed.

Decision:

The First-tier Tribunal dismissed his appeal, finding that he had failed to take 'reasonable care' to comply

Comments – SI 2005/2045, reg 9 provides that, where a contractor has not deducted tax from an amount paid to a subcontractor, HMRC may issue a direction absolving the contractor from having to pay the tax, if specific circumstances apply. Regulation 9(3) provides that such a direction may be made if the contractor satisfies HMRC that he took reasonable care to comply with the regulations, and that his failure to make the required deduction was 'due to an error made in good faith'. The First-tier Tribunal upheld HMRC's view that the contractor had not taken reasonable care, so that HMRC had acted correctly in declining to make a direction absolving him from having to pay the tax.

S Hoskins v HMRC (TC01972

BUSINESS TAX

The Taxation of 'Controlling Persons' and IR35 (Lecture B721 – 8.40 minutes)

Background

The Government's Budget 2012 document stated that a package of measures would be introduced to tackle avoidance through the use of personal service companies and to make legislation easier to understand for those who are genuinely in business. These measures included:

> *"Subject to consultation, requiring office holders/controlling persons who are integral to the running of an organisation to have PAYE and NICs deducted at source by the organisation by which they are engaged. (Finance Bill 2013)"*

What does this measure mean, and why is it being introduced?

Tax arrangements of public sector workers

Danny Alexander MP, Chief Secretary to the Treasury, made a statement to the House of Commons on 23 May 2012, following a review of the tax arrangements of 'public sector appointees'. The aim of the review was to ascertain the extent of arrangements which could allow public sector appointees to minimise their tax payments, and to make appropriate recommendations.

The review found that over 2,400 key people in central Government departments were paid 'off-payroll', in some cases for more than ten years. The HM Treasury document 'Review of the tax arrangements of public sector appointees' (www.hm-treasury.gov.uk/d/tax_pay_appointees_review_230512.pdf) outlines the review's findings, which included that around 10% of cases relate to payments made directly to a personal service company; less than 5% relate to payments made directly to individuals, and over 85% to intermediaries such as employment agencies.

The Government's proposals in respect of those engaged in central Government departments and arm's length bodies broadly include the following:

- Board members and senior officials with significant financial responsibility should be on the organisation's payroll, unless there are 'exceptional' circumstances;
- Any such exceptions should exist for no longer than six months; and
- Engagements lasting more than six months, costing over £220 per day, should include contractual provisions that allow the department to seek an assurance from contractors regarding their income tax and NICS obligations. Departments should consider terminating contracts if that assurance is not provided.

The measures are to be implemented within three months from the above announcement.

Additional measures

The proposed new tax measures announced in Budget 2012 are in addition to the existing intermediaries legislation ('IR35') and the provisions dealing with agency workers (*ITEPA 2003, Pt 2, Chs 7, 8*), and will take precedence over those provisions in respect of 'controlling persons'.

If IR35 and the agency legislation is being retained, why are additional measures necessary? Mr Alexander explained:

> *"When IR35 was introduced 10 years ago, it was comparatively rare for controlling persons of an organisation to work through a personal service company. In the past few years, however, there have been high-profile reports of that happening, so today the Government are also consulting on the Budget proposal that all so-called "controlling persons" must by law be on the payroll of their organisation. This proposed tightening of the rules will apply to any organisation, be it public or private. It is right that when an individual is in a position to control the major activities of an organisation, they should be on the payroll of that organisation."*

The above Treasury document states:

> "*…when an individual is not on the employer's payroll, it will not always be clear and transparent to the employer that the individual is meeting their income tax and NICs obligations.*"

HMRC's and the Treasury's consultation document on controlling persons points out (para 2.21):

> *"The Government believes that, because of their role in an organisation, controlling persons should be required to meet their income tax and National Insurance obligations in a way which is transparent to their engager. This is not currently possible where they work through a PSC."*

It goes on to add (para 2.23):

> *"The Government recognises that, in the public sector, it is particularly important that off-payroll appointments are made to the highest possible standards."*

However, it is important to note that the new measures dealing with 'controlling persons' will apply to both the public and private sectors.

Taxation of Controlling Persons

HMRC and the Treasury published the consultation document 'The Taxation of Controlling Persons' on 23 May 2012. The Government's stated view is that where an individual has the requisite level of control to direct the activities of the organisation and they are engaged at a senior level (through an intermediary) then that individual should be taxed as an employee.

The purpose of the proposed measures is to ensure that where an organisation engages a controlling person, the engaging organisation will be required to deduct the PAYE income tax and National Insurance contributions at source, as they would for their employees.

Thus the whole amount paid by an engager to a personal service company would be treated as remuneration of the 'controlling person', i.e. as if they were an employee, effectively in the same way as other employees of the organisation.

'Controlling persons'

The above provision will take precedence over the intermediaries (IR35) and agency provisions, but only in the case of controlling persons. So what is a 'controlling person'?

The Government has not yet published draft legislation defining a 'controlling person'.

The consultation document defines a controlling person as:

> *"…someone who is able to shape the direction of the organisation having authority or responsibility for directing or controlling the major activities of the engaging organisation during the year. This would be someone who has managerial control over a significant proportion of the organisation's employees and/or control over a significant proportion of the budget of the organisation."*

Exclusion

However, the Government proposes to exclude micro businesses who engage controlling persons through a personal service company from the above provision.

A 'micro business is defined as a business which employs fewer than 10 persons and whose turnover and/or balance sheet does not exceed €2 million (approximately £1.7 million).

The consultation document can be downloaded from HMRC's website. The consultation period ends on 16 August 2012.

Contributed by Mark McLaughlin

Disincorporation relief **(Lecture B722 – 8.46 minutes)**

'Disincorporation' is the broad term given to the process of a business changing its legal form from a limited company to a sole trader or partnership. This is achieved by transferring the business as a going concern, with its assets and liabilities, from the company to one or all of the shareholders. The business is then continued by them in a self-employed capacity.

The UK tax system currently allows for capital gains to be held over on the incorporation of a business (TCGA 1992, ss 162, 165).However, no corresponding reliefs apply to a disincorporation.

The Office of Tax Simplification (OTS) published a discussion paper on disincorporation relief in July 2011.This was followed by a report in February 2012 ('Small business tax review: Disincorporation relief'). The report considered a single question: Should there be a disincorporation relief?

HM Treasury subsequently published its 'Consultation on a disincorporation relief' on 7 June 2012 (see below).

The tax issues

The main tax consequence highlighted by the OTS under current tax law of a disincorporation is a potential double tax charge on gains from the assets transferred, i.e.firstly on the company (which disposes of its assets) and secondly on the shareholders (who dispose of their shares).

Other tax issues were also identified by the OTS as arising on a transfer of a business from a company:

- *Stock and work-in-progress*– these would be deemed to be disposed of at its market value. However, the parties may elect (CTA 2009, s 167(1)-(4)) for the actual transfer value to be used (or the book value if higher) so that no charge is raised on transfer;

- *Capital allowances* - a balancing charge may arise on the disposal of machinery and plant, based on the excess of the market value of the assets transferred over the written down value of the assets (or pool of assets). An election (CAA 2001, ss 265-267) may be made for the transfer to be deemed to be made at written down value, so that no charge is raised;

- *Losses* - trading losses in the company for the final year before disincorporation may be carried back and set against total profits of the final three years (CTA 2009, s 39), but may not be transferred into the unincorporated business;

- *General* - capital losses, excess management expenses and non-trading loan relationship deficits of the company may not be transferred across into the unincorporated business nor, except in the case of loan relationship deficits, carried back;

- *Stamp duty land tax* - the transfer of land will give rise to a potential stamp duty land tax charge, although a transfer of the property in specie during the course of winding up the company will not give rise to the charge provided that there are no loans charged on the property; and

- *VAT* - where the company is VAT registered, the transfer of the business to existing shareholders would normally satisfy the "transfer as a going concern" criteria, with the result that no VAT is chargeable on the assets transferred (SI 1995/1268, reg 5). It should also be possible to elect for the VAT registration to pass to the successor business.

OTS Proposals

The OTS proposals in its report included:

- The relief should target 'micro'(i.e. very small) companies, which no longer wish to operate through a corporate entity and have no commercial need to do so.

- It would only be available to trading companies.

- The 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.

- Disincorporation relief would not be extended to the other areas mentioned above, or include transfers of trades to LLPs.

- The relief would not be extended to losses.

The OTS 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 OTS report can be accessed via the HM Treasury website: http://www.hm-treasury.gov.uk/d/ots_small_business_tax_review_disincorporation_280212.pdf.

Treasury Consultation

HM Treasury published its 'Consultation on a disincorporation relief' on 7 June 2012. The Government proposes to use certain criteria when considering what (if any) measures to take following the consultation. These are broadly as follows:

- *Commercial need* – any change in policy, additional legislation or reforms to tax administration should be justified by a clear commercial need.

- *Targeted*– any policy change should be focused on those businesses and circumstances where it is most justified.

- *Simple to understand and straightforward to administer* – tax relief or other policy measures to make disincorporation easier should not add significant complexity to the tax system.

- *Not open to abuse* – any new policy should not provide opportunities to artificially reduce tax or to avoid liabilities to a business' other creditors.

The government appears to be concentrating on "the very smallest business" for disincorporation relief purpose. It is keen to understand the reasons why such businesses may wish to disincorporate.The consultation assumes that, following disincorporation, the company will either be formally wound up or voluntarily dissolved. Aside from any tax issues, the government wishes to ensure that the company's creditors will not be adversely affected if disincorporation is made easier.

The consultation splits the tax charges that can occur on disincorporation into two broad categories:

- *Charges on the company*– Corporation tax charges can arise on the disposal of the assets including goodwill, plant and machinery, stock and land.

- *Charges on the shareholders* –tax charges may arise in relation to the shares, such as on distribution of the company's assets. (including cash). The distribution may be liable to income tax, or capital gains tax (e.g. on a formal winding up of the company).

The consultation document illustrates these potential tax charges as follows:

Example: Window Cleaners Ltd

Window Cleaners Ltd a one man company that incorporated on 1 April 2004 and the shareholder, Mr Smith, had previously carried on the business as a self employed individual before 1 April 2002. Turnover is below the VAT threshold. The business has an established repeat customer base. The only significant business assets are a van, equipment and goodwill. The van and equipment are worth around £3,000 and the goodwill is valued at £15,000, together worth £18,000. The goodwill was acquired from Mr Smith for £5,000 on 1 April 2004. The Capital Gains rules apply and Corporation Tax is payable @ 20 per cent.

Tax chargeable on goodwill:

If the assets are distributed back to the shareholder (Mr Smith) on 1 February 2012 the following charge would arise on the goodwill:

- Corporation Tax on goodwill gain £8,540 (£15,000 - £5,000 less indexation £1,460 (£5,000 x 0.292)) @ 20 per cent = £1,708

There is no Corporation Tax to pay on any gains made on the transfer of the van and equipment because these are chattels worth no more than £6,000.

<u>Shareholder charges</u>

Mr Smith will also have to consider what tax he will have to pay on the value of the distributed assets of £18,000. The amount of charge will depend on whether the assets are treated as income or capital.

If distributed as capital, the actual amount of Capital Gains Tax that Mr Smith will have to pay will depend on a number of factors, including how much was paid for the shares, whether incorporation relief was claimed, whether Entrepreneurs' Relief conditions are satisfied and availability of capital loss relief.

Assuming £100 was paid for the shares, that Mr Smith has no other gains in the tax year (and so the annual exempt amount of £10,600 can be used against the gain) and that he is entitled to Entrepreneurs' Relief, then the amount of Capital Gains Tax to pay would be:

- (£18,000 - £100 - £10,600) x 10 per cent = £730

If the assets are distributed as income (i.e. a dividend) Mr Smith will only have to pay Income Tax if any part of the dividend is liable to Higher Rate Tax.

The government's key decisions concerning disincorporation relief will be:

1. *Scope of tax charges covered*

   The consultation indicates (among other things) that any relief for the company's shareholders in respect of distributions might include a targeted anti-avoidance rule to deal with any abuse.

2. *Size of business eligible for relief; and*

   The OTS report refers to the smallest businesses in terms of turnover in the range £20,000-£30,000. However, the consultation indicates the threshold for eligibility in respect of disincorporation relief as potentially being the VAT registration threshold (currently £77,000).

3. *Lifetime of the relief*

   The government is considering the length of availability before the relief is reviewed or ended, and whether the OTS recommendation of 5 years should be adopted, lengthened or shortened.

The consultation document can be downloaded from the HM Treasury website: (http://www.hm-treasury.gov.uk/consult_disincorporation_relief.htm).

The consultation period ends on 30 August 2012.

Contributed by Mark McLaughlin

Whether private bank statements formed part of taxpayer's statutory records

The appellant, a carpenter, worked as a sole trader and sometimes used sub-contractors. He was registered for VAT, and as such was required to keep records by VATA 1994 Sch 11, para 6. HMRC opened an enquiry into the appellant's 2007–08 self-assessment return. The appellant supplied business bank statements for one of his accounts ("A") but refused to supply his private bank statements from bank ("B") on the basis that payments by sole traders to their personal accounts took the form of capital introduced into the business and personal bank documentation was outside HMRC's remit. HMRC issued a notice under FA 2008 Sch 36, para 1(1) ("the notice") requiring him to provide various information and documents, including the B accounts on the basis that use of a private bank account to make business payments made it part of the business records. Thereafter HMRC imposed a fixed penalty notice of £300 and a penalty notice charging a daily penalty of £15 from 14 September 2010 to 21 October 2010, a total of £570. The appellant appealed against the notice, in so far as it related to the B bank statements, and the penalty notices. The issue arose as to whether the private bank statements formed part of the appellant's statutory records, as defined in FA 2008 Sch 36, para 62(1).

Decision:

The definition of statutory records in FA 2008 Sch 36, para 62(1) meant that if a taxpayer was required by any statutory provision relating to tax to keep a document, then that document was a “statutory record”. There was no necessary link between the tax which was under enquiry and the source of the obligation to keep the records for tax purposes. Business bank statements constituted business records and statutory records, having regard to reg 31(1)(a) of the Value Added Tax Regulations 1995, SI 1995/2518—which specified that records included “business and accounting records”—VATA 1994 Sch 11, para 6(2)—which allowed that regulation “to be framed by reference to such records as may be specified in any notice published by the Commissioners”—Notice 700/21—which stated that bank statements were among those business records which “must” be kept—and the fact that HMRC had set out “in writing”, as allowed by VATA Sch 11, para 6(3), that business records had to be kept for a minimum of six years. On the facts, the B account was an operational part of the business, used for making regular payments of business expenses; the fact that it also contained personal expenditure did not prevent it from being “business records” and thus “statutory records” within the meaning of Sch 36. Accordingly the appellant had no right of appeal against the notice under Sch 36, para 1(1). It followed that the appeal would be dismissed.

Appeal dismissed.

Comments – Business records are fundamental to running a business. Naturally these are likely to be examined by HMRC. Last year HMRC had a major initiative in Business Records Checks which will restart this year. This case demonstrates the importance of ensuring that business records are just that and they are maintained separately from private records if the taxpayer does not wish them to be examined by HMRC. The fact that the records also contained personal expenditure did not prevent them from being “business records”.

Beckwith v Revenue and Customs Comrs TC 1876

Company Tax Returns—update on XBRL Tagging Requirement

HMRC has confirmed it will not be extending in April 2013 the list of specified information in company accounts and computations which must be tagged using XBRL when filing company tax returns online.

Filing Company Tax Returns Online—the XBRL Tagging Requirement

In his “Review of HMRC Online Services” (March 2006), Lord Carter of Coles recommended that companies should be required to file their Company Tax Returns online using XBRL tagging in accounts and computations. The recommendation has been implemented with effect from 1 April 2011.

The vast majority of companies have successfully delivered their first online return using XBRL. HMRC received 1·6 million such returns in the first year. HMRC acknowledges that this has been a major change. The department's approach during the transitional period in the first two years is to advise and support people to comply with filing requirements, not to reject returns or penalise people for getting things wrong. For example, HMRC does not reject returns where a reasonable attempt has been made with XBRL tagging and does not open Corporation Tax enquiries solely or mainly to check the quality of XBRL tagging.

HMRC undertook that there would be no extension before 31 March 2013 of the list of specified information which, where present in accounts or computations, must have an XBRL tag. The “list of specified information' means items within the “minimum tagging requirements” documents on the HMRC website.

Find the documents on minimum tagging requirements (www.hmrc.gov.uk/softwaredevelopers/ct/min-tag-req.htm)

The present Government is committed to an expansion of public services provided digitally. As set out in the "Digital by default" consultation document published on 8 August 2011, HMRC will be playing its part in this initiative. On 29 February 2012, HMRC published its summary of responses to this consultation. HMRC had asked for views on increasing the amount of XBRL tagging when the transitional period expires at the end of March 2013. All responses agreed that there should be no major extension of the list of specified information from April 2013. HMRC has accepted this view and the tagging requirement will not change in April 2013.

Read the summary of responses to the "Digital by default" consultation (customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document& columns=1&id=HMCE_PROD1_031947)

HMRC is working with software suppliers and other representatives to make limited changes to the list from autumn 2013. There will be a single requirement for detailed profit and loss account tags, whether appearing in the accounts or the tax computations, and an improvement to the structure of the computations tags. Beyond that, there will be no major change without full consultation.

HMRC is continuing to expand the effective exploitation of XBRL, by quality assurance of XBRL tagging in a selection of returns already received and by development of the effective use of XBRL tags in risk assessment and other compliance work.

Some software products already support fuller tagging of accounts than is required by the list of specified information and others are coming to market. This is welcome, even though HMRC is not yet making full tagging compulsory. More information with XBRL tags helps HMRC's risk assessment, reducing the demands it needs to make on the majority of companies in assuring compliance with tax obligations. It also helps HMRC to analyse accounts information across all or part of the population for policy research and monitoring.

As XBRL-tagged accounts become available on the public record, HMRC will work with Companies House, software developers and other interested parties to encourage the development of accounts preparation products and online services which best support the wider Government digital agenda.

What now for Fixtures? (Lecture B725 – 14.58 minutes)

In the past, when it came to commercial property transactions, members of the tax department were often the last to know what their clients had been doing over the previous year. It was only when the time came to prepare the tax return that they discovered what had taken place.

With the recent changes to the fixtures rules this will have to change, as timing will be everything and the only way that the right decisions can be made will be for property advisers and tax professionals to work much more closely together.

The new legislation took effect in April 2012, but it is important to understand that not all of the rules apply immediately. However, now is the best time to get up to speed on what the changes mean and determine what information is needed to act in the best interests of the client.

Position before April 2012

A fixture is defined at s 173(1) as 'plant or machinery that is so installed or otherwise fixed in or to, a building … to become, in law, part of that building or land'.

Section 185 states that the purchaser's entitlement to capital allowances is restricted to the disposal value that the past owner of the property brought into account, even if this was not the immediate past owner. Furthermore, it is the purchaser's responsibility to obtain and provide details of prior claims and disposal values.

If it can be established that no restriction applies under s 185, the purchaser's entitlement is governed by s 562 which deals with property purchased together with any other property. It states at subsection (2) that:

'… all property sold as a result of one bargain is to be treated as sold together even though —
(a) separate prices are, or purport to be, agreed for separate items of that property, or
(b) there are, or purport to be, separate sales of separate items of that property.

In layman's terms this means that, irrespective of what a purchase contract may say, the purchase price of a building can be apportioned between the plant and machinery within that property and the building structure (or setting) and the land.

It sounds simple but in practice this is quite complicated to determine.

Under the normal self-assessment rules, taxpayers broadly have a two-year window to submit and amend a claim for capital allowances. However, nothing requires the qualifying expenditure to be added to a capital allowances pool for the chargeable period in which the capital expenditure was actually incurred.

This means that the taxpayer can still make claims many years after the purchase of their property by adding the expenditure to a capital allowances pool in that later period. This is provided that they still own the plant and machinery in accordance with s 58(4). Enquiries about the tax history of the property should be made as part of a solicitor's normal enquiries at the time of purchase or disposal of a property.Accountants should be raising capital allowances with their clients as soon as they become aware that they have bought or plan to purchase a property. Failing that, they should also make standard enquiries on an annual basis when completing the tax return of that client.

What happens now

If an individual or a company is selling a commercial property purchased before April 2012 then little will change immediately, but we will look at this and the effect of the transitional period later.

Fundamentally, the new rules will require that for a purchaser of a property to claim capital allowances on the fixtures within a property, the following must now happen.

For purchases from April 2012, where any seller has claimed capital allowances and is required to bring a disposal value into account in accordance with CAA 2001, s 196 there must be a joint election under s 198 or s 199.

Alternatively, either one or both of the parties to the transaction must have made an application to the First-tier Tribunal, to fix the disposal value of the fixtures, within two years of the sale.

Together, these requirements are termed 'the fixed value requirement' which must be satisfied.

There is one exception to the fixed value requirement, which could apply in a minority of cases.

Where the purchaser acquires the property from a non-taxpayer who has acquired the property from a capital allowances claimant, the two-year time limit will not apply, instead the purchaser must provide other documentation to support a claim. This should be in the form of a written statement about the disposal value that was brought into account at an earlier time.

Where any seller has claimed capital allowances but a joint election is not possible, i.e. where the disposal event is covered by s 61 or by items 2 or 3 of the table at s 196, the seller must have confirmed the disposal value of the fixtures in a written statement within two years of the date of the sale.

This is termed 'the disposal value statement requirement'. There are no exceptions to the disposal value statement requirement and no application to the First-tier Tribunal is possible.

For purchases from April 2014, after the transitional period, in addition to the requirements set out above, any seller who could claim capital allowances must have pooled the expenditure on the fixtures or have claimed a 100% first year allowance.

This is referred to in the new legislation as ‘the pooling requirement’. There are no exceptions to this requirement.

Transitional period

As stated before, not all of these new rules will apply immediately. There is a two-year transitional period between April 2012 and April 2014 when there are not so many obstacles to overcome.

One point that must be made is that it is the purchaser of a property who is likely to be affected the most by these new rules and possibly have the most to lose.

It is therefore important that property agents are aware of the impact of the new rules and that clients keep their other advisers apprised of the action they may take before any transaction is completed.

The purchaser’s solicitors will need to ensure they receive a properly completed section 19 of the standard form of commercial property standard enquiries (known as a CPSE form) to determine the capital allowances history for the property being sold. This is something that has been ignored or incorrectly completed in the majority of cases in the past.

A seller has the right to make a capital allowances claim within, broadly, two years of the sale. When a buyer wishes to make a claim he must ensure that he has fulfilled the burden of proof required by HMRC and met the requirements of CAA 2001, s 185 if they are relevant.

HMRC are taking a much firmer stance on this point, as the First-tier Tribunal decision in *Mr and Mrs Tapsell and Mr Lester as partnership The Granleys* (TC1231) shows.

In that case, the partners purchased a care home as going concern for £650,001, of which £40,000 was allocated to ‘fixtures and fittings’. In the tax year ended April 2003 the buyers made a claim for capital allowances for plant and machinery of £146,014.

This was based on an apportionment of £106,014 relating to the purchase of the plant and machinery fixtures in the property plus the £40,000 shown in the contract.

Shortly after this, the sellers submitted a capital allowances claim for £68,811 for the same tax year. They provided no supporting details to HMRC. They then emigrated to the USA and could not be traced by the buyers or HMRC.

HMRC disallowed the buyer’s capital allowances claim on the grounds that they failed to show that the same expenditure on plant and machinery had not been claimed by the sellers.

On appeal the First-tier Tribunal found in favour of HMRC and held that the burden of proof fell on the buyers to prove that the sellers had not claimed on the same plant and machinery.

This decision highlights the importance of any such claim being properly investigated and having the legislation applied as intended in a timely way.

Where a capital allowances claim has been made previously, a s 198 election may be entered into between both parties agreeing how the capital allowances should be distributed.

Should agreement not be reached, either party has two years from the date of completion to refer the matter to a First-tier Tribunal for determination. The seller should be advised to come to an agreement if possible as, apart from providing certainty, it is probably less costly.

Where a s 198 election agreement is not entered into or a decision not sought from the tribunal in time, any future rights to claim these allowances on the original plant and machinery will be lost to the buyer and any future owner of the property as well.

Hurdles

The government has introduced two significant hurdles to claiming capital allowances. If these are not dealt with properly the result could be a complete loss of capital allowances for taxpayers and potentially have an impact on a property's market value in the future.

As before, if the seller has not claimed capital allowances, a s 198 election is not applicable. This remains unchanged under the new rules.

However, just because the seller has not entered into an election with the purchaser does not prevent the seller from making a late claim after completion of the contract, subject to the terms that are signed.

Unless the purchaser decides to make an application to the First-tier Tribunal, there will be no way for the purchaser to challenge the disposal value relating to a late claim by the seller.

In addition, when the sale of the property is to a non-taxpayer, it seems the new legislation (s 187B(2)(b)) says that after two years from the date of sale, the seller's disposal value cannot be challenged by HMRC, in spite of the fact that an enquiry could still be possible under the self-assessment rules.

While there is a two-year amnesty from the pooling requirement, we strongly recommend that accountants prepare themselves for the added due diligence that will become necessary from April 2014.

In summary

The new legislation requires that where it is established that the seller was entitled to claim capital allowances but has not done so, the seller must pool (called mandatory pooling) the value of the qualifying fixtures before the sale of the relevant property by notifying HMRC in a tax return.

All relevant property owners must first identify and then pool their qualifying expenditure. This does not mean that the capital allowances claim has to be made as this would depend on the taxpayer's circumstances, but it is vital to keep the allowances alive.

In addition, the seller and buyer must agree on a value for the fixtures within the two years of the transaction and make a mandatory s 198 election. This should be agreed at the time as part of the sale negotiations on the property.

The s 198 (or s 199) election must be submitted to HMRC and completed correctly to be valid, or the whole exercise may become void. Once submitted and accepted as being complete by HMRC, the election becomes irrevocable.

Overlooking the s 198 election agreement as part of the sale process could have far-reaching consequences for all subsequent owners of that property. As important new requirements will not have been met, no capital allowances will ever be available to the buyer, or any future owner, of the property.

The mandatory pooling and obligatory s 198 and s 199 elections will have a huge impact on all parties involved in commercial property transactions.

As can be seen above, if the claim is not made correctly there could be considerable adverse financial consequences.

Accountants, tax advisers, property agents and solicitors must become fully conversant with these changes and work together to meet the requirements. Any client for whom they act, who has not made a claim for capital allowances, should be aware of the potential to do so and the due diligence required to make sure a claim is properly submitted.

They should also explain the need for addressing this matter well in advance of any potential sale of a property due to the increasing pressure from HMRC which will not make any concessions regarding full disclosure of previous owners and claims that may have been made.

Extracted from an article in Taxation by Jeanette Edmiston and Ross McNaughton of Portal Tax Claims.

Changes to ESC C16 –CTA 2010, ss 1030A and 1030B **(Lecture B723 – 7.24 minutes)**

The changes brought about by moving former ESC C16 on to a statutory footing commenced on 1 March 2012, so any company that becomes inactive and seeks striking off after that date will be subject to the new rules.

Prior to 1 March 2012

It is worth touching on situations which have been recently resolved, in case the old provisions of ESC C16 still apply to them. The effect of ESC C16 is well understood. Where the company is no longer required, and given that certain undertakings (See Box 2) are given to HMRC, the distribution prior to striking off the company will be treated as a capital distribution in the hands of the recipients, and thus will be liable to capital gains tax rather than income tax.

Undertakings required under ESC C16

The company

- does not intend to trade or carry on business in future; and
- intends to collect its debts, pay off its creditors and distribute any balance of its assets to its shareholders (or has already done so); and
- intends to seek or accept striking off and dissolution.

The company and its shareholders agree that

- they will supply such information as is necessary to determine, and will pay, any Corporation Tax liability on income or capital gains; and
- the shareholders will pay any Capital Gains Tax liability (or Corporation Tax in the case of a corporate shareholder) in respect of any amount distributed to them in cash or otherwise as if the distributions had been made during a winding-up.

Although ESC C16 is replaced by the new statutory treatment from 1 March 2012, where a distribution was made before that date on the basis of undertakings made at the time, HMRC has agreed that the ESC C16 treatment can apply, even if the company or its advisers have not received a reply from HMRC regarding accepting the undertakings. This is based on the proviso that the undertakings are, in fact met. So those who rushed through undertakings and distributions (even if they were made in specie) will benefit from the old treatment provided all was complete (but the company was not necessarily dissolved) before 1 March 2012.

From 1 March 2012

The new rules restrict capital treatment to distributions which total no more than £25,000; otherwise the distribution is treated as an income distribution.

Where a distribution has been made on the basis of the undertakings under ESC C16 (before 1 March), and a subsequent distribution is made on or after 1 March, the new rules will apply. However, there is some dispute as to how exactly the two distributions will be regarded.

HMRC's view is that the interim (pre 1 March) distribution should be aggregated with the post 29 February distribution and the total tested against the £25,000 limit. If the total of the interim and final distributions is more than the limit, then all of the distributions are regarded as income under the new rules (set out in more detail below).

The alternative view expressed is that the distribution following the change is itself compared in isolation to the £25,000 limit and if it is below the limit (that is, ignoring the distribution prior to 1 March) then it qualifies as a capital distribution. Regulation 18 of the Statutory Instrument (SI 2012, No 266) states that it applies to distributions made on or after the commencement date.

This issue has been raised with HMRC, and the position remains deadlocked. Those who make more than one distribution either side of the date of change should therefore be aware that there is significant disagreement to be resolved on this issue.

Treatment in the hands of the recipients

Where the distribution is made under the new rules, where the total amount to be distributed either as a single distribution or in tranches (but all on or after 1 March 2012) is more than £25,000 then the distribution is treated as an income distribution in the hands of the recipients. It is not absolutely clear what the treatment of share capital is, but it may be excluded on the grounds that it does not meet the definition of "distribution". The effect of this is ignored in the examples below when the share capital is a small amount. HMRC later confirmed the treatment and this is dealt with below at 1.1.6.

If recipients wish to secure capital treatment for the amounts distributed, then that option remains available at a cost. The company would have to be liquidated rather than struck off. Current cost quoted for a small solvent company with a single asset – the bank account – are of the order of £4,000 to £5,000. A distribution following the liquidation would be regarded as a capital distribution, against which the cost of the shares could be set. The gain, of course, may well qualify for Entrepreneurs' relief, although that aspect is not considered here.

Effect on smaller company winding up

Clearly, the loss of capital treatment (and access to Entrepreneurs' relief) is a significant additional cost to the shareholder(s), who will need to balance the tax cost against the potential costs of liquidation. Examples 1 to 4 illustrate the issues.

Example 1 – very small company with single shareholder

Ben has retired from his business, which he ran through a limited company for many years. He subscribed £100 for the share capital in 1985, and is now seeking to wind up the company. His income in 2011/12 is £30,000, but in 2012/13 will comprise only his state pension of £5,200. The funds available in the company for distribution total £30,000.

(a) Treatment as an income distribution

In 2011/12, if the amount is treated as an income distribution, Ben will be liable to higher rate tax on some of the funds. His total income would be £63,333, and the taxable income therefore £55,858. Higher rate tax due on the (gross) distribution of £20,858 is £4,693.

If the distribution is made in 2012/13, Ben's income is such that there is no higher rate liability on the income. Although his age allowance would be abated because his total income exceeds the threshold for age allowance, this will still not push any of the dividend into the higher rate band so the tax charge is NIL.

(b) Treatment as capital distribution

The net capital gain of £29,900 is subject to the annual exempt amount of £10,600 (in 2011/12, and at least this sum in 2012/13). The net taxable amount is assumed to qualify for Entrepreneurs' relief, so the tax charge is at 10% : £19,300 x 10% = £1,930.

This is a useful example that capital treatment is not always the best solution! Provided the distribution is timed appropriately, no tax charge will arise on winding up the company.

Example 2 – Larger distribution

Caroline's company has ceased trading as she is moving into full time employment. Her income in 2011/12 is £50,000, and in 2012/13 is expected to be £75,000. She contributed £100 for the shares in 1994, and has a bank balance in the company of £60,000 to distribute.

(a) Treatment as an income distribution

> In 2011/12, adding the gross distribution of £66,666 pushed Caroline over the £100,000 income limit, and will thus cause loss of personal allowance. Her total income is sufficient to displace the full personal allowance (£16,666 / 2 > £7,475). So the tax on the distribution is £15,000, but additional tax is also due on her other income, through the loss of personal allowance. If this is employment income the tax increase is 40% x £7,475 = £2,990, so the total tax charge as a result of the distribution would be £17,990.
>
> In 2012/13 the position is the same – all of the dividend is liable to higher rate tax, and the similar effect of the loss of personal allowance is seen, with the additional tax as a result of this being 40% x £8,105 = £3,242.

(b) Treatment as a capital distribution

> The net capital gain of £59,900, less the annual exempt amount of £10,600 is taxed at 10% assuming entrepreneurs' relief is available. The tax charge would therefore be £4,930. As this represents a saving of at least £13,060 against an income distribution, the cost of engaging a liquidator would be worthwhile. Assuming that the liquidation costs £5,000 including VAT then Caroline would be £8,060 better off taking this option.

Pre dissolution dividend

Caroline in ***Example 2*** may be able to secure a better treatment by distributing a dividend prior to striking off the company. However, it is by no means certain that this will successfully circumvent the rules in the new legislation. The new treatment in CTA 2010, s 1030A applies to "distributions in respect of share capital" in circumstances where the company has made **or intends to make** (my emphasis) an application for striking off under Companies Act 2006, s1003. It is possible that payment of a dividend after cessation of trade and just prior to a striking off application would be regarded as a distribution caught by these rules.

However, if dividends had been drawn down while the company was still operational, Caroline might have drawn sufficient in 2011/12 to top her income up to £100,000, but with no loss of personal allowances. The optimum distribution is therefore £50,000 gross income, £45,000 in cash. This leaves the sum of £15,000 to be distributed on dissolution which could attract capital treatment, with a tax charge of £440 on the capital gain and £11,250 on the dividends. This is not as good as the capital treatment following a liquidation, but it is clear that in some circumstances that this might be preferable. If the figures were skewed further in the taxpayer's favour to leave exactly £25,000 in the company to attract capital treatment under the new rules the tax charge (without the cost of liquidation) would be £8,750 in income tax and £1,430 in CGT, a total of £10,180, which is very close to the cost of liquidating and the resulting capital gain. If the cost of liquidation were a little higher, this would become a preferable option, but is not without risk.

Treatment of share capital

HMRC has now provided confirmation about the treatment of share capital distributed as part of a dissolution. Share capital falls outside the definition of "distribution" for tax purposes, and HMRC has confirmed that a repayment of share capital will not be treated as part of the distribution in respect of share capital under the new rules.

Example 3 – treatment of share capital

Frank's company has ceased trading and has a bank balance of £32,000 after all of the debts have been collected and the liabilities settled. In dissolving the company, the whole £32,000 is repaid to Frank, representing £8,000 in share capital and £24,000 in distributable reserves. As the amount paid out in respect of distributable reserves is less than £25,000, the whole amount is treated as a capital payment.

Example 4 – share capital alongside income distribution.

John' company also has £32,000 to distribute, of which £4,000 represents subscribed share capital and £28,000 the distributable reserves. In this case, the distribution exceeds £25,000, so is subject to income tax treatment, and the balance of £4,000 is still treated as a capital payment.

Bona vacantia

The Treasury Solicitor entered the fray some time ago, in withdrawing the concession regarding the distribution of share capital on a winding up. Previously a concessionary £4,000 could be distributed without the Treasury Solicitor invoking the strict rules and pursuing the shareholders for the crown debt – equal to the share capital and any undistributable reserves.

There was quite significant alarm within the profession at the removal of the concession, but the Treasury Solicitor's office subsequently explained that the implication was that consideration would no longer be given to the amount of share capital, and that they would no longer seek repayment of share capital of any amount following a striking off. This means that there is no requirement for a reduction in share capital to be done before striking the company off.

Contributed by Rebecca Benneyworth

Normal commercial loans **(Lecture B724 – 4.06 minutes)**

Membership of a group is determined by reference to both ownership of ordinary share capital and beneficial entitlement to profits and assets available for distribution to equity holders. For these purposes, an equity holder is any person who:

(i) holds ordinary shares in the company; or

(ii) is a loan creditor for a non-commercial loan which is not a normal commercial loan.

Prior to the amendment introduced by Cl 32, loan notes which carried a right to convert into the shares or securities of a wholly unconnected listed company would not have fallen within the definition of a normal commercial loan in S162 CTA 2010. Holders of such loan notes would therefore have been treated as equity holders. This could sometimes have an unfortunate effect on group relationships.

Cl 32 therefore ensures that, in relation to loans made on or after 21 March 2012, the group status of a company will be unaffected where it issues loan notes with a right of conversion into the shares or securities of unconnected listed companies.

One well-known corporate tax expert has recently commented:

> 'With interest rates at their current level, it has been attractive for an investor to hold a convertible note which can either be repaid in full or converted into the underlying shares if the shares have overperformed. The present rules, which treat such loans as equity instruments, can give rise to uncertainty and risk breaking grouping relationships. This measure will ensure that convertible loan notes issued by a company do not need to be tracked to prevent accidental degrouping and will allow a group more flexibility in deciding from where to issue such loan notes.'

Contributed by Robert Jamieson

VAT

Misled by HMRC

The taxpayer made a time-to-pay arrangement with HMRC in respect of his November 2008 VAT return and assumed that the arrangement would apply to future returns. HMRC, however, imposed default surcharges in respect of the four 2009 returns.

The taxpayer appealed on the ground that HMRC had not brought it to his attention that the arrangement applied only to the November 2008 period, and that new agreements would be necessary for other periods. He said he had been misled by the department.

HMRC said that a time-to-pay arrangement was a concession applicable only to a specific period and was not a 'rolling agreement'. The taxpayer should have made new arrangements for each default period.

Decision:

The First-tier Tribunal found that the taxpayer had been misled: at no point had he been told that the time-to-pay arrangement was no longer in place. Rather, he had been advised that as long as he followed the arrangement, he could ignore the default notices.

The judge decided that the time-to-pay arrangement remained in place throughout the relevant periods of default and that the taxpayer had reasonable excuse.

The taxpayer's appeal was allowed.

Comments - FA 2009 s 108 provides that where an HMRC officer has agreed to a request that payment of tax should be deferred, any penalties (including surcharges) should be deferred during the currency of the agreement. HMRC took the view that the agreement here had been a temporary one which had expired after November 2008. However the First-tier Tribunal allowed the partnership's appeal, finding that HMRC had failed to inform the partnership that the agreement no longer applied.

A time-to-pay deal needs to be agreed with HMRC's Business Payment Support Service before the VAT due on a return is legally due for payment, said independent VAT consultant Neil Warren. 'In this case, the staff employed by HMRC's telephone helpline service appear to have confused the taxpayer, so the appeal was rightly allowed. The court accepted that the taxpayer was a credible witness who believed an ongoing time-to-pay agreement was in place'.

The Copperfields Restaurant TC1974

Persistent underdeclaration

A company (E) dismissed its managing director and its company secretary after its accountants discovered significant financial irregularities. HMRC subsequently formed the opinion that E had underdeclared VAT by more than £13m. It issued assessments under VATA 1994 s 77(4), and imposed a penalty of £2,700,000 under VATA 1994 s 60 (mitigated by 80%). E appealed, contending inter alia that the penalty should be mitigated by more than 80%.

Decision:

The First-tier Tribunal reviewed the evidence in detail, rejected this contention and upheld the penalty in principle, reducing it by £36,000 and holding that there were no grounds for any further mitigation. The Upper Tribunal unanimously upheld this decision, holding that the First-tier Tribunal 'exercised its discretion in a manner which was open to it and did not err in its approach'.

Comments - The underdeclarations of VAT in this case were unusually large, so that significant sums of money were at stake in this case. The Upper Tribunal upheld the First-tier Tribunal decision that the assessments were authorised by VATA 1994 s 77(4), and rejected the company's claims that the penalty should be mitigated by more than the 80% which the First-tier Tribunal had allowed.

ERF Ltd v HMRC (Upper Tribunal)

Medals purchased by football league

In 1996 the Scottish Football League (SFL) had reached an agreement with Customs that it would not reclaim input tax on the cost of medals which it purchased for presentation to the winners of its divisional championships, and would not be required to account for output tax on the onward supply of the medals. However in 2010 the SFL submitted a repayment claim, backdated to 2007, on the basis that it should be allowed to reclaim the input tax without being required to account for output tax. HMRC rejected the claim and the League appealed.

Decision:

The Tribunal dismissed the League's appeal, holding that the award of the medals was 'a supply by way of a business gift in terms of VATA 1994' and that 'since output tax has not been paid on the medals by the deemed consumer, input tax recovery is not available to the SFL'.

Comments - The Tribunal upheld HMRC's view that, as a matter of law, the League was entitled to reclaim input tax on the medals provided that it accounted for output tax in accordance with the normal provisions regarding business gifts. Since the League had failed to account for output tax, it could not 'have its cake and eat it' by reclaiming input tax.

Scottish Football League v HMRC TC1983

Retail scheme confusion

The taxpayer started his service station business and registered for VAT in 1991. At first, he used an accountant to deal with the accounts, PAYE and VAT, but after a few years took over the responsibility himself.

During a VAT inspection in 2008, the inspector noted that no zero-rated mark-up had been calculated for the purpose of VAT accounting. The taxpayer said that the business had adopted VAT retail scheme B (direct calculation scheme 1) and used this at least until 1997. His method of calculation appeared to change at some time between 1997 and 2001, although he asserted that he had been using one of HMRC's authorised schemes.

HMRC said that the taxpayer could not have been using retail scheme B or a variant of it, because there was no calculation of the zero-rated mark-up. They assessed tax of £10,417 for the period between July 2005 and January 2008 using apportionment scheme 1 (retail scheme D).

The taxpayer disputed the assessment, claiming that he had intended to use direct calculation scheme 1, where output tax declarations are based on the expected selling prices of zero and standard-rated goods. He submitted new figures on this basis, which were correctly calculated. This resulted in an overpayment of VAT.

Decision:

The First-tier Tribunal found that the taxpayer had intended to use apportionment scheme 1 since April 2001, but had entered the wrong figures in the calculation. The standard-rated and total purchases figures were based on figures net of VAT rather than gross figures.

It emerged during the appeal that the turnover of the business was above the £1m threshold relevant to both apportionment scheme 1 and direct calculation scheme 1, so the tribunal judge had to consider what was the fairest way of dealing with the output tax calculations. The judge concluded that HMRC's calculation based on apportionment scheme 1 was excessive and allowed the appeal in principle. The taxpayer and HMRC were then instructed to consider what calculation gave the best estimate of output tax.

Comments - Neil Warren, independent VAT consultant, noted that the case 'illustrates that a retailer making a higher mark-up percentage on zero-rated goods compared with standard-rated goods pays more tax with apportionment scheme 1 than other retail schemes because the figures are based on purchases rather than selling prices'.

Munaf Patel trading as Cleggs Lane Service Station TC1865

Limited company: whether a charity

A limited company (W) was incorporated in 2004 and registered for VAT in 2006. It collected donated furniture, selling some of it from a shop and giving some of it to people who were in need. In 2007 it wrote to HMRC applying to be treated as exempt from VAT. HMRC rejected this application on the grounds that W was not a registered charity. W appealed. In June 2010, while the appeal was pending, W amended its Articles of Association, and was registered as a charity on 26 June 2010. HMRC accepted that W's supplies qualified for exemption from that date, but rejected W's claim for the exemption to be backdated.

Decision:

The First-tier Tribunal dismissed W's appeal, finding that until it amended its Articles of Association, its objectives had not been exclusively charitable. Since it 'did not have exclusively charitable purposes at the relevant time', it was required to account for VAT on its supplies before 26 June 2010.

Comments - The First-tier Tribunal upheld HMRC's view that the appellant company failed to qualify as a charity at the relevant time. The decision here is in line with the recent Court of Appeal decision in the direct tax case of Helena Partnerships Ltd (aka Helena Housing Ltd) v HMRC.

Wirral Independent Recycling Enterprise Ltd v HMRC TC1960

Management and consultancy services

A UK company (S) supplied management and consultancy services to a company (T) which was resident in the Republic of Ireland. HMRC issued an assessment charging tax on the supplies. S appealed, contending that the supplies were within VATA 1994 Sch 5 para 3, so that the place of supply was in the Republic of Ireland.

Decision:

The First-tier Tribunal accepted this contention and allowed the appeal, finding that the supplies comprised 'sophisticated accounting analyses and cash-flow forecasts for large-scale projects'.

Comments - VATA 1994 Sch 5 para 3 (which was repealed from January 2010) provided that 'services of consultants, engineers, consultancy bureaux, lawyers, accountants and other similar services' were supplied where they were received. The First-tier Tribunal accepted the company's contention that the services here were within this provision, so that the place of supply was the Republic of Ireland, where the recipient was resident.

Matrix Securities Ltd v HMRC TC2006

Imports from outside EU

A clergyman (G) imported a large quantity of wooden crosses from Israel. The UK Border Agency charged import VAT of £60. G appealed, contending inter alia that the crosses should be treated as 'basic necessities' which qualified for relief from import VAT under VAT (Imported Goods) Relief Order, SI 1984/746, Sch 2 Group 6 Item 1.

Decision:

The Tribunal rejected this contention and dismissed his appeal. Judge Mosedale held that 'neither Parliament nor the European Council intended to include in the exemption articles to meet spiritual needs. The crosses are not “basic necessities” under either UK or EU law.'

Comments - SI 1984/746, Sch 2 Group 6 Item 1, provides relief from VAT on the import of 'basic necessities' from outside the EU. The First-tier Tribunal upheld HMRC's view that wooden crosses did not qualify as 'basic necessities' for the purposes of this provision.

The Venerable H Glaisyer v Director of Border Revenue (TC01964)

Supplies of aircraft

A Finnish company purchased two aircraft from a French manufacturer and leased them to an associated company. It failed to declare its purchase of the aircraft as an intra-Community acquisition, although the vendor of the aircraft had declared both transactions as intra-Community sales. The Finnish tax authority issued assessments charging VAT on the acquisitions, and also ruled that the onward supplies were exempt under Article 15(6) of the EC Sixth Directive. The company appealed, and the case was referred to the ECJ for a ruling on the interpretation of Article 15(6).

Decision:

Advocate-General Cruz Villalón expressed the Opinion that Article 15(6) 'must be interpreted as meaning that the exemption provided for therein applies not only to that supply of aircraft which takes place directly to airlines operating for reward chiefly on international routes, but also to the supply of aircraft to an operator which does not itself operate for reward chiefly on international routes, but which in turn supplies the aircraft for the use of an airline which carries on that activity'. He also held that an 'airline operating for reward chiefly on international routes' included 'a commercial airline operating for reward chiefly on international charter routes for the requirements of companies and private persons'.

Comments - Article 15(6) of the EC Sixth Directive provides exemption for 'the supply, modification, repair, maintenance, chartering and hiring of aircraft used by airlines operating for reward chiefly on international routes, and the supply, hiring, repair and maintenance of equipment incorporated or used therein'. The Advocate-General's Opinion includes a useful discussion of the scope of this provision. For a discussion of the implications of this Opinion, see David Thompson's article in Tax Journal, 25 May, page 9.

Re A Oy (ECJ Case C-33/11)

Fees charged to passengers at airport

The company (N) which operated Norwich Airport. decided to charge a fee, which it described as an 'airport development fee', to passengers using the airport. It accounted for VAT on these fees, but subsequently submitted a repayment claim on the basis that they were not consideration for any supply. HMRC rejected the claim and the tribunal dismissed N's appeal.

Decision:

Judge Mosedale observed that passengers were required to pay the fee to obtain a ticket to pass in order through automatic gates prior to the departure lounges, and that 'if they did not buy the ticket, effectively they would be unable to board their flight'. The fees were consideration for permission to access land, which was a supply of services within the charge to VAT.

Comments - The First-tier Tribunal upheld HMRC's view that the 'airport development fee' which the company charged to passengers was consideration for a supply of services, on which VAT was chargeable.

Norwich Airport Ltd v HMRC TC1965

Construction of house comprising two linked buildings

An individual (C) lived with a partner (P) who had two children from a previous relationship. C decided to build a house comprising two separate buildings, one metre apart and linked by timber decking. Each of the buildings comprised two bedrooms, and the larger building also contained a bathroom, living-room and kitchen. The bedrooms in the smaller building were occupied by P's children. C claimed a refund of tax under VATA 1994 s 35. HMRC rejected the claim but the First-tier Tribunal allowed C's appeal.

Decision:

Judge Nowlan held that the fact that the dwelling-house contained two separate buildings did not prevent it from qualifying for relief under s 35.

Comments - VATA 1994 s 35 provides for a refund of VAT to a person constructing 'a building designed as a dwelling or number of dwellings'. HMRC rejected the claim here on the grounds that the dwelling consisted of two separate buildings, linked only by timber decking. However the First-tier Tribunal allowed the claimant's appeal, holding that the singular noun 'building' should be construed as including the plural, so that the fact that the dwelling consisted of two separate buildings did not prevent it from qualifying for relief.

M Catchpole v HMRC TC1995

MTIC fraud: dealing in mobile telephones

A company (M) reclaimed input tax of more than £800,000 in relation to seven transactions in mobile telephones. HMRC rejected the claim on the grounds that it appeared that the transactions were connected to MTIC fraud.

Decision:

The First-tier Tribunal reviewed the evidence in detail and allowed M's appeal with regard to three transactions but dismissed it with regard to the other four transactions. M appealed to the Upper Tribunal, which upheld the First-tier decision as one of fact.

Comments - The Upper Tribunal upheld the First-tier Tribunal decision that the company should have known that some of its transactions were connected to MTIC fraud.

My Secrets Ltd v HMRC (Upper Tribunal)

Little chance of success

The defendant's company was incorporated in 2002 and registered for VAT. HMRC found the business had unpaid VAT and had wrongly deducted input tax. A pre-judgment freezing order was served on the defendant and, in May 2010, the company was wound up.

The defendant's solicitors were served with claims that alleged the defendant had acted in breach of his duties as a director, traded while insolvent, destroyed records and failed to account for VAT. In April 2011, default judgment was entered and the freezing order continued as a post-judgment order.

The defendant applied to have the default judgment set aside on the basis computer records had been withheld and he was entitled to deny the allegations of fraud on oath during a trial.

Decision:

The High Court judge said no useful purpose could be served by setting aside the default judgment; the defendant would be unlikely to succeed even if he were given access to the computer records.

The application was dismissed.

Comments – The verdict is self explanatory

Defty and another v Hirani, Chancery Division, 25 May 2012