# Contents

# PERSONAL TAX

## Residence rules from 6 April 2013 (Lecture P726 – 12.01 minutes)

**Introduction**

The planned statutory definition was due to take effect from 6 April 2012 but has been delayed until 6 April 2013.

In the meantime a 124 page document has been issued by HMRC entitled *STATUTORY DEFINITION OF TAX RESIDENCE AND REFORM OF ORDINARY RESIDENCE: A SUMMARY OF RESPONSES.* Included in the document is draft legislation. The stated aim is for the residency test to be *transparent, objective and simple to use.*

The original consultation proposed the following approach:

- PART A - Definitely excluding the individual from being resident, based on day counts, in which case that is all that needs to be considered
- PART B - Definitely including the individual as resident, again based on day counts, where PART A does not apply
- PART C - If neither PART A nor PART B applies, balancing day counts against connecting factors in the UK such as family, employment and accessible accommodation

The draft legislation changes this, although it achieves the same result by way of a different route.

**The basic test**

This can be tabulated as under:

| ***UK RESIDENT*** |
|---|
| *1. meets at least 1* ***automatic residence test*** *but not any* ***automatic overseas test,*** *OR* |
| *2. does not meet any of the automatic residence or automatic overseas tests but does meet the* ***sufficient UK ties test*** *by reference to a combination of the number of days spent in the UK and the number of ties that exist* |

| ***NOT UK RESIDENT*** |
|---|
| *1. meets at least 1 automatic overseas test, OR* |
| *2. does not meet any automatic overseas test, automatic residence test, or the sufficient UK ties test* |

**Automatic residence test**

These comprise:

1. **Day count test** by spending at least 183 days in the UK. The whereabouts at midnight test applies here, subject to two exceptions.

 

2. **UK home test** where the only home is in the UK or, if he has more than one home, all of them are in the UK. It must be the individual's home for at least 91 days, all or part of which must fall within the tax year. Whilst there is no definition of a home for this purpose, HMRC say that they do not consider a holiday home, weekend home or temporary retreat is a home.

3. **Full-time work in the UK test** covering work of at least 35 hours per week, over a continuous period of more than 9 months (excluding short breaks such as illness or holidays) and with no more

4. than 25% of the duties being performed outside of the UK. Consideration is being given to increasing the 9 months to 12.

**Automatic overseas test**

- not UK resident in all of the previous 3 tax years and present in UK for less than 45 days in the current tax year; or

- UK resident in one or more of the previous 3 tax years and present in UK for not more than 15 days in the current tax year (originally this was 11 days); or

- leaves the UK to carry out ***full-time work abroad*** (employed or self-employed) for at least 1 tax year provided present in UK in the tax year for less than 91 days and spends no more than 20 working days in the UK (defined as any day on which at least 3 hours of work is undertaken). The 20 day test may increase to 26 and the hours test may increase to 5.

**Sufficient UK ties test**

This is only relevant if none of the automatic UK tests or overseas tests are met. There are 5 possible ties with the UK as under:

- ***Family tie***
- ***Accommodation tie***
- ***Work tie***
- ***90 day tie***
- ***Country tie*** (this tie does not apply unless UK resident in at least 1 of the previous 3 tax years)

**UK ties day count**

Where the ***sufficient UK ties test*** is relevant, how many of the 5 ties must apply to be UK resident depends on the number of days spent in the UK. The fewer the days spent in the UK the greater the number of ties can exist without becoming resident:

| ***days in UK*** | ***impact of UK ties where UK resident in the 3 years preceding the tax year concerned*** |
|---|---|
| *16 to 45* | *resident if at least 4 ties* |
| *46 to 90* | *resident if at least 3 ties* |
| *91 to 120* | *resident if at least 2 ties* |
| *121 +* | *resident if at least 1 tie* |

| *days in UK* | *impact of UK ties where not UK resident in the 3 years preceding the tax year concerned* |
|---|---|
| *16 to 45* | *not resident* |
| *46 to 90* | *resident if all 4 ties (the country tie does not apply in any event)* |
| *91 to 120* | *resident if at least 3 ties* |
| *121 +* | *resident if at least 2 ties* |

**Family tie**

This exists if in the tax year there is a relevant relationship at any time with a UK resident. The other person covers spouse or civil partner where they are not separated; living together as if a spouse or civil partner; child under 18 unless the individual sees the child in the UK for less than 61 days in the tax year, with any part of a day counting as 1 day.

**Accommodation tie**

This exists where an individual has accommodation that is available to be used by them for a continuous period of at least 91 days in the tax year, and the individual spends at least 1 night in that place during the tax year. Where there are less than 16 days between the periods in which a particular place is available, that place is treated as available for that period. Short stays in hotels etc. will therefore not count unless the room is booked for at least 91 days or the 16 day rule applies. If the latter may be an issue the individual should book another hotel etc. to stop the 16 day rule applying.

**Work tie**

This exists if working in the UK for at least 40 days in the tax year. A working day covers over 3 hours' work done in the UK, but this may increase to 5 hours.

**90 day tie**

This exists if spent over 90 days in the UK in the preceding tax year and/or the tax year preceding that.

**Country tie**

This exists if in the tax year more time is spent in the UK than anywhere else.

**Other changes**

- Days spent in the UK for reasons beyond the person's control will be disregarded in exceptional circumstances, up to a limit of 60 days. He must intend to leave as soon as those circumstances permit.
- The whereabouts at midnight rule does not apply to someone arriving in the UK as a passenger on day 1 and leaves the UK on day 2, provided in that time he does not engage in any activities that are to a substantial extent unrelated to his passage through the UK.
- Split-year treatment will be available for leavers, who will be able to spend up to 15 days in the UK in the part of the tax year following departure.
- Split-year treatment will also be available to spouses or civil/common law partners of an individual working full-time abroad.
- Transitional rules will allow the new statutory rules to be used for previous years where the individual needs to know what their residence status was prior to 2013/14.

*Contributed by Gerry Hart*

 

## Company Cars – still a good idea? (Lecture P727 – 8.08 minutes)

The income tax charge on the benefit of having a company car for private use has been announced for all tax years up to and including 2016/17. As such, a robust tax strategy can now be established for a range of companies and their employees so as to fully take into account the tax exposure.

The amount charged as a benefit is based on a % of the list price of the car, graduated according to the level of the car's carbon dioxide emissions. Business mileage levels are ignored, as is the actual private use and the age of the car. The graduation is in 1% steps for every additional 5 grams per kilometre, with a maximum charge of 35%. There was a car price cap of £80,000, but that ceased to apply from 6 April 2011. That means that a car costing £200,000 has an annual tax charge on £28,000 in 2010/11, increasing then to £70,000 in 2011/12.

The level of CO2 emissions qualifying for the basic minimum 15% charge is 125 g/km for 2011/12. There is a lower charge of 10% of list price where CO2 emissions do not exceed 120 g/km.

Finance Act 2010 also introduced a new 5% rate of benefit in kind on cars emitting strictly no more than 75 g/km (this special rate will still be subject to the 3% addition for diesel vehicles). This new rate commenced on 6 April 2010 and runs for five years.

From 6 April 2012 the Table has been restructured. The 10% charge reduces to 99g/km (compared to the previous 120 g/km). From there, 100g/km (up to 104g/km) will be taxed at 11%, 105g/km to 109g/km at 12% and so on. This represents a significant increase for some taxpayers. For example taxpayer with a 118g/km company car will see their benefit increase from 10% in 2011/12 to 14% in 2012/13 – an increase of 40% in tax.

Diesel cars emit less CO2 than petrol cars and so would be taxed on a lower % of list price than an equivalent petrol car. However, diesel cars emit greater quantities of air pollutants, and accordingly a supplement of 3% of the list price applies – e.g. a diesel car, which would give rise to a 20% charge on the basis of its CO2 emissions, is instead charged at 23%. The maximum charge for diesel cars is capped at 35%. The diesel supplement is set to be removed in 2016.

For 2014/15 there will be a 1% increase in benefit charge for cars emitting more than 75g/km up to a maximum of 35%. For 2015/16 and 2016/17 there will be an increase of 2% up to a maximum of 37%.

If we take the example of a BMW 520SE the benefit will increase from 21% in 2011/12, to 23% in 2012/13, 24% in 2013/14, 25% in 2014/15, 27% in 2015/16 and to 29% in 2016/17. An increase of nearly 40% over the next few years.

More than ever a low-emission company car should be the focus of all current purchasing decisions. Low emissions combined with a reasonable list price will not create too onerous a car benefit.

A 40% increase over 5 years on a current benefit of £3,000 will not affect the client as much as a 40% increase on a £10,000 benefit. Ultomately it will be the clients decision as to whether they have a company car or not but we should explain very clearly the tax implications of doing so and the differences in tax liability depending on their choice of company car.

 

*Illustration 1*

Mother runs a small company and decides to provide her 2 children with a company car each – Nissan Pixo 1.0 Vistia. They do not work for the company, and all mileage will be private. She is a 40% taxpayer. The tax position is as follows:

Income tax on mother per car:

List price £6,995 @ 10% = £699 @ 40% = £279 pa

Company's position per car:

100% FYA on £6,995 @ 20% = £1,399

Class 1A NIC on £699 @ 13.8% = £96 pa, reducing to £77 after small company tax relief.

Full VAT reclaim on input tax on car servicing etc (unless registered for the VAT flat rate scheme). Corporation tax relief will be obtained at 20% or more on the running costs.

## Delivering a Cap on Income tax Relief (Lecture P728 – 14.56 minutes)

The Government announced at Budget 2012 the introduction of a limit on currently uncapped income tax reliefs from April 2013. Individuals will be able to claim reliefs worth up to £50,000 or 25 per cent of their income, whichever is greater. The Government stated in the Budget that the cap would not extend to those reliefs that are already limited.

After extensive engagement with the charity sector following the Budget, the Chancellor has also decided to exclude charitable reliefs from the cap, to ensure that there is no impact on charitable donations. The reliefs affected by the cap will include, among others, loss reliefs that can be claimed sideways against general income, and qualifying loan interest relief. The full list of affected reliefs is given below.

*Scope of the consultation*

This sets out the Government's proposed approach to implementing and delivering the cap, including:

- how an individual's income will be defined and calculated for the purposes of the cap;
- when the cap will apply;
- how reliefs will be ordered; and
- the operation of the cap through Income Tax Self Assessment (ITSA).

*Income tax reliefs*

There are currently more than 350 special rules that can apply when calculating income tax, and the term 'relief' is used in connection with many of these. These 'reliefs' can operate in a variety of ways. Some exclude certain items from taxable income, reducing the amount of general income liable to tax; others alter the tax rate applicable; and some allow individuals to deduct amounts from certain income streams, such as expenses. The cap on reliefs will only apply to those reliefs that are used to reduce the amount of general income liable to tax. The cap will only apply to reliefs that are offset against general income and not currently capped.

*Reliefs not subject to the cap*

Reliefs that do not meet both the criteria set out above will not be affected by the cap.

*Computational rules*

Computational rules affect the calculation of individual income streams. As such, they cannot be offset against general income. They include capital allowances, items with tax exempt status (for example statutory redundancy payments) and allowable expenses. These will not be affected by the cap. However, to the extent that computational reliefs, such as capital allowances, create or augment a loss that may be set against general income that loss relief will be capped.

*Reliefs subject to existing limits*

Some income tax reliefs are subject to existing limits as part of the rules governing their operation. Where this is the case, the relief is presumed to have been designed with a specific policy objective in mind and the relevant cap set at the optimal level to achieve this. Therefore reliefs that have their own limits will not be affected by the cap.

*Charitable reliefs*

Charitable reliefs support donations to charity by providing tax relief on those donations. At Budget 2012, the Government was clear that it does not want donations to charity to be affected by the relief cap. Therefore, following extensive engagement with the charity sector, the Government has excluded the following from the cap:

- Gift Aid;
- Relief for gifts of land and shares;
- Payroll Giving; and
- Community Investment Tax Relief.

*Reliefs subject to the cap*

The following income tax reliefs will be capped to the extent that they can be relieved against general income:

1. Trade Loss Relief against general income – available for losses made by an individual carrying on a trade, profession or vocation;
2. Early Trade Losses Relief – available to an individual in the first four years of the trade, profession or vocation;
3. Post-cessation Trade Relief – available for qualifying payments or qualifying events within seven years of the permanent cessation of the trade;
4. Property Loss Relief against general income – available for property business losses arising from capital allowances or agricultural expenses;
5. Post-cessation Property Relief – available for qualifying payments or qualifying events within seven years of the permanent cessation of the UK property business;
6. Employment Loss Relief - available in certain circumstances where losses or liabilities arise from employment;
7. Former Employees Deduction for Liabilities – available for payments made by former employees for which they are entitled to claim a deduction from their general income in the year in which the payment is made;
8. Share Loss Relief – available for what would otherwise be a capital loss on the disposal (or deemed disposal) of certain qualifying shares;
9. Losses on Deeply Discounted Securities – available only for losses on gilt strips and on listed securities held since at least 26 March 2003; and

10. Qualifying Loan Interest – available for interest paid on certain loans. These include loans to buy an interest in certain types of company, or to buy an interest in a partnership, and loans taken out by personal representatives to pay inheritance tax.

*How the cap will be calculated*

The cap will be set at the greater of £50,000 or 25 per cent of an individual's income.

The starting point for this calculation will be the same for all affected individuals: their total income liable to income tax. This figure will then be adjusted based on an individual's net pay arrangements (i.e. the arrangements they make for pension deductions and/or charitable donations) to create a level playing field between those whose deductions are made before they pay income tax, and those whose deductions are made after tax. The result – "adjusted total income" – will be the measure of income for the cap.

The principle is that individuals are treated equally by taking account of:

- the different ways that people make tax-relievable pension and retirement annuity payments and charitable donations;
- the impact the above payments can have on the amount of their income for the purposes of income tax; and
- how they receive tax relief at their highest rate of tax on those payments.

*When the cap will apply*

Claims for income tax relief are made in respect of the year in which the relevant event occurs (e.g. a loss arising or loan interest being paid). The cap will apply to the year of the claim and any other earlier or later year in which the relief claimed is allocated. This means that in instances where for example losses have been carried back, the cap will be calculated to apply in each year that a calculation is made. The following example illustrates how this will work in practice.

*Example – Jenny*

In 2013-14 Jenny's income is £650,000 from employment and £100,000 share of profit from a partnership. She has losses from a property rental business in 2013-14 of £250,000 for which she makes a claim for loss relief against her general income for 2013-14.

Her individual relief cap in 2013-14 is £187,500 (25 per cent of £750,000, as this is greater than £50,000). Jenny can relieve £187,500 of her property losses in 2013-14, leaving £62,500 unrelieved. As the provisions for property loss relief enable claims in the same or next tax year, she is able to offset – subject to how much 2014-15 cap she utilises – the remaining 2013-14 loss relief of £62,500 against her 2014-15 income.

In 2014-15 her income is £675,000 from employment and £75,000 from a partnership. She has losses from her property business in 2014-15 of £100,000 for which she claims loss relief against her 2014-15 income.

Her cap in 2014-15 is £187,500 (25 per cent of £750,000). She can fully claim 2014-15 loss relief of £100,000, plus 2013-14 losses carried forward of £62,500 against her general income, as together these total less than 25 per cent of her income in that year. The existing processes for claiming reliefs will not change – a claim for relief must be for the full amount of a loss made and not already utilised. So, given that her losses are greater than her relief allowance, Jenny would not be able to claim relief for less than her cap in 2013-14. Similarly, she could not claim less than her actual losses of £100,000 arising in 2014-15, and choose to carry some of these forward. This will limit the extent to which reliefs can be spread across years to circumvent the cap.

*How reliefs will be ordered*

Some tax reliefs reduce the amount of the individual’s income where the calculation of their income tax liability starts. Examples are pension net pay arrangements and Payroll Giving where relief is given by reducing the amount of the individual’s gross pay brought into their tax calculation. Other tax reliefs are given effect as a deduction calculating the individual’s total income. Below is the statutory structure for calculating the amount of an individual’s income which is liable to income tax.

- Step 1 determines the individual’s “total income” by bringing together all the amounts of income (components) on which the individual is liable to income tax.
- Step 2 deducts those reliefs (other than personal allowances) that are given effect against the individual’s income. These may be reliefs that reduce total income or a component of total income. The general rule is that the order in which such reliefs are given is that which results in the greatest reduction in the individual’s income tax liability. The result after step 2 is the individual’s net income for the year.
- Step 3 deducts the personal allowance and blind person’s allowance (where applicable) from net income.
- Step 4 applies the rates of tax to the amounts of components remaining after step 3. It is at this step that any extension to an individual’s basic rate limit or higher rate limit is given effect to provide higher rate relief or additional rate relief on Gift Aid donations or personal pension contributions that have had basic rate relief at source.
- Step 5 adds together the amounts of tax calculated on each component.
- Step 6 deducts ‘tax reducers’. These include, for example, relief in respect of subscriptions for shares qualifying under the Enterprise Investment Scheme where, from 6 April 2011, tax relief is available at 30 per cent of the cost of the shares.
- Finally, Step 7 then adds any other amounts of income tax to which the individual is liable. This could be, for example, to recover excess relief for Gift Aid or pension scheme provisions.

The result is the individual’s tax liability for the tax year.

The reliefs that will be limited by the cap all take effect at step 2 of the income tax calculation. Where an individual has more than one step 2 relief, they will still be able decide which reliefs they wish to use in a tax year, and therefore the extent to which those separate reliefs contribute to their relief allowance for the year.

*Delivery through Income Tax Self Assessment (ITSA)*

Income tax reliefs will continue to be claimed in the normal way by individuals on their ITSA tax returns. There will continue to be some exceptions where claims may be made outside a return (for example, claims made before a notice to file a tax return is issued or made after the time limit has passed for amending the tax return for the relevant year). In the main, these arrangements will not be disturbed by the introduction of the cap. However, if an individual wants to claim relief of more than £50,000 before they receive the ITSA notice to file, they will need to calculate their cap in advance of the return.

The amounts currently reported on ITSA returns for total income, relief at source and gross pension contributions will be used to calculate an individual’s adjusted income for the purpose of the cap. The total income figure will not include any amounts donated through Payroll Giving. The Self Assessment (SA) return will be revised to include a box in which individuals may enter sums donated via Payroll Giving, so these can be included in the calculation of adjusted income for the purposes of the cap.

 

Only those affected by the cap and who donate via Payroll Giving – a small number of individuals – will need to provide this information, which they will find on their payslips. HMRC guidance on the relief cap will remind its customers that they will need to retain this information for their SA returns if they might fit into this category.

*Transitional years*
While the cap will apply to reliefs in 2013-14 and later years, some people will elect to carry trading losses arising in 2013-14 and later back to years prior to this. In these instances, the claim for relief will still be made after the introduction of the cap, notwithstanding the calculation of the individual's tax liability by reference to a year prior to the cap's introduction. As such, the cap will be applied in these 'pre-cap year' calculations.

*Contributed by Tony Jenkins*

## Interest on life insurance policy: person liable

J had been employed as a geologist in Angola. In 1996, he had entered into a life assurance policy with an insurance company, E, in respect of his own life. The sum assured was £100,000. In 1998, J went missing in Angola, believed to have been abducted by rebels, and nothing had been heard of him since that time. Before J's death, his mother had been appointed to act on J's behalf under a power of attorney. Following J's disappearance, his mother entered into protracted negotiations with E, following which E agreed to make a payment under the life assurance policy of the principal amount insured (£100,000) plus an additional amount expressed to be interest, approximately £36,500 (the extra payment). Payment was agreed under the terms of a deed of discharge signed by the mother in her capacity as J's attorney and by J's parents as his next of kin. Under the deed of discharge, payment was to be made to the parents in return for them giving up their rights under the life assurance policy. The proceeds of the life assurance policy were transferred into J's bank account. In November 2002, the money was then transferred by the mother, in her capacity as attorney, into an offshore account in J's name. In 2005, the mother entered into a deed to swear to J's death and obtain a grant of representation in respect of his estate. For the tax year 2002/03, the respondent Revenue and Customs Commissioners assessed the extra payment to tax and held the parents liable for the payment thereof as the persons entitled, under the deed of discharge, to the extra payment.

J's parents appealed that assessment to the First-tier Tribunal (Tax and Chancery Chamber) (the FTT). They contended that: (i) the extra payment, if interest, had been exempt under s 329 of the Income and Corporation Taxes Act 1988 (ICTA); (ii) in the alternative, that it had not been interest but a payment of a capital sum and therefore not taxable; and (iii) that if there had been a liability to tax, it had been that of J and/or his estate but not that of the parents.

The FTT determined that the extra payment was not exempt from tax under s 329 of ICTA, that it had been a payment of interest for tax purposes and thus chargeable to income tax under s 18 of ICTA and that the persons liable for the tax under s 59(1) of ICTA were J's parents. The parents appealed to the Upper Tribunal (Tax and Chancery Chamber). They submitted that the FTT had erred in law in holding that: (i) the extra payment, if interest, had not been exempt from tax under s 329 of ICTA as it should have been characterised as damages for distress and the inconvenience of late payment; (ii) the extra payment had been interest; and (iii) the persons liable for tax, if any, were them.

*Decision:*

The appeal would be allowed in part.

(1) In the context of both life and general insurance there was a clear distinction between, on the one hand, a payment of interest made with respect to a payment of "damages ... in respect of a person's death" (s 329(1)(a) ICTA) and a payment made pursuant to the death of a person whose life had been insured under a life insurance policy, which was not a payment of "damages".

In the instant case, the extra payment had not been "damages in respect of the ... death of" J pursuant to s 329 of ICTA.

(2) On the evidence, the FTT had been correct to find that the extra payment had been interest. It was clear from the fact that it was a general principle adopted by E to pay interest at a given rate following the date when the death benefit became due that E's payment of interest to J's parents had not been ex gratia, but simply a part of E's normal practice. Under the terms of the life assurance policy, there had been no need for E to possess anything other than satisfactory proof of J's death for the death benefit to be due. There had been no contractual requirement for J's parents to provide E with either a death certificate or a deed swearing J's death. It was clear that E had accepted that J had died and that interest would run from the date on which he had disappeared as the date on which the death benefit was properly due. Receipt by E of the deed swearing as to J's death had not been necessary for the death benefit to have been due under the life assurance policy. Consequently, there had been a debt due at the time of the extra payment.

Riches v Westminster Bank Ltd [1947] 1 All ER 469 applied; Euro Hotel (Belgravia) Ltd, Re [1975] 3 All ER 1075 applied.

(3) Both the Revenue and the FTT had erred in law in having treated J's parents, as next of kin, as being entitled to the income, namely the interest represented by the extra payment for the purposes of s 59(1) of ICTA and, therefore, liable for the tax on the extra payment. J's estate was, as at 2003, unadministered and no person entitled under his assumed intestacy would have had any sufficient entitlement to the death benefit and the extra payment to have made him entitled to the income in respect of which the tax was directed to be charged.

Stamp Duties Comr (Queensland) v Livingston [1964] 3 All ER 692 applied; Marshall (Inspector of Taxes) v Kerr [1994] 3 All ER 106 applied.

**Comments -** ITTOIA 2005 s 751 provides that certain payments of interest on 'damages for personal injury' qualify for exemption from income tax. The Upper Tribunal upheld the First-tier decision that the payment here failed to qualify for exemption under this provision. ITTOIA 2005 s 371 provides that the person liable to tax on interest 'is the person receiving or entitled to the interest'. The Upper Tribunal reversed the First-tier decision on this issue, and allowed the appeal on the grounds that the parents had not been 'entitled to the interest'. It is understood that HMRC intends to seek leave to the Court of Appeal, on the grounds that the Upper Tribunal has erred in law by concentrating exclusively on the word 'entitled' and ignoring the preceding words 'receiving or'.

*Pope v Revenue and Customs Comrs [2012] UKUT 206 (TCC)*

## Payment on cancellation of service agreement

A Spanish citizen (G) began working for a Spanish company (S), which was a member of an international group, in 1991. In 2000 he was transferred to a UK company (SU) in the same group. In 2003 his employment was terminated. Following negotiations, SU paid G £694,783 as compensation. Following an enquiry, HMRC issued a ruling that part of this payment was taxable under ITEPA 2003 s 62. R appealed, contending that the whole of the payment should be treated as compensation for loss of employment, within ITEPA 2003 s 401, and as qualifying for relief for 'foreign service' under ITEPA 2003 s 413.

*Decision:*

The First-tier Tribunal accepted this contention and allowed R's appeal.

**Comments -** The First-tier Tribunal accepted the appellant's contention that the whole of the payment he had received was compensation for loss of employment within ITEPA 2003 s 401, so that it qualified for relief for foreign service under ITEPA 2003 s 413 (and none of it was taxable under s 62). The size of the payment and its relief are a very good demonstration of the foreign service relief. This case and the following case demonstrate the importance of being not ordinarily resident and the advantages that it can bring. It will be important to not forget these particularly when the new rules (outlined in the Statutory Residence document) relating to ordinary residence and the changes start to operate.

*A Gomez Rubio v HMRC TC2047*

## Non-resident employee: whether income remitted to UK

An individual (P), whose main home was in Germany, worked in the UK from April 2006 to October 2008, during which time he was accepted as resident, but not ordinarily resident, in the UK. His fiancée (L) had lived in the UK since 2003, having arrived as a student. P's earnings for days when he was working in the UK were taxable under ITEPA 2003 s 25, and his earnings for days when he was working outside the UK were chargeable under ITEPA 2003 s 26 (so that they were only taxable if they were remitted to the UK). P's salary was paid into a Guernsey bank account. In his 2007/08 tax return, P stated that he had earned £490,621 relating to duties outside the UK, and that only a small part of these earnings had been remitted to the UK. He therefore claimed a substantial repayment. HMRC began an enquiry, and ascertained that some of P's salary had been transferred from the Guernsey account to an Isle of Man account in the joint names of P and L. A debit card relating to this account had been used to draw cash from cash machines in the UK, and to purchase goods in the UK. HMRC issued an amendment to P's self-assessment, ruling that this money had been remitted to the UK and was therefore taxable under s 26. P appealed, contending that the money which had been transferred to the Isle of Man account was beneficially owned by L, and that he was not chargeable on the sums which L had withdrawn from the account.

*Decision:*

The First-tier Tribunal accepted P's evidence and allowed the appeal. Judge Herrington observed that the circumstances in which the Isle of Man account was opened as a joint account rather than solely in L's name were wholly plausible, since 'it would be difficult for a young student from overseas to be given an account immediately that allowed the use of an unrestricted debit card, as opposed to the account that (L) had with a restricted use debit card before she met (P)'.

**Comments -** ITEPA 2003 s 25 was repealed, and ITEPA 2003 s 26 was significantly amended, by FA 2008 with effect from 2008/09. Nevertheless, this remains an interesting authority on whether income has been remitted to the UK. The appellant had deliberately arranged for his salary to be paid to a non-UK bank account. Some of it had then been transferred to a joint account in the names of the appellant and his fiancée, and the appellant's fiancée had then spent that money in the UK. HMRC considered that the effect of this was that the appellant had remitted this money to the UK, so that it fell within the charge to UK tax. However the First-tier Tribunal accepted the appellant's contention that the money in the joint account should be treated as belonging to the appellant's fiancée, and held that the appellant should not be treated as having remitted it to the UK.

*KO Pflum v HMRC TC2051*

## Changes to National Insurance rules for people going to or coming from Norway, Iceland and Liechtenstein

From 1 June 2012 EC Regulations 883/2004 and 987/2009 will apply to Norway, Iceland and Liechtenstein. The new rules replace very similar Regulations 1408/71 and 574/72. These are the regulations that came into operation in 2010 in respect of the countries in the EU. This represents the extension into the three countries which are in the EEA.

If you go to live or work in Norway, Iceland or Liechtenstein from 1 June 2012 then the new rules will apply to you and your employer. Under both the old rules and the new rules, depending upon the circumstances of your employment, it may be that you continue to pay UK National Insurance contributions whilst you are there or that you have to start paying contributions to the country you are in instead.

An important difference between the old rules and the new rules is that if you are working in the UK for a Norwegian, Icelandic or Liechtenstein employer and you are paying your contributions here then your employer may also have to start paying UK contributions.

The new rules also apply to self-employed people moving between the UK and Norway, Iceland or Liechtenstein.

There are special transitional rules in the new Regulations. If you were subject to the legislation of the UK or Norway/Iceland/Liechtenstein under the old rules in force before 1 June 2012 and the introduction of the new rules would change which country you have to pay contributions to, then you may be able to carry on paying to the first country until there is a change in your circumstances. If you think this may apply to you contact HM Revenue & Customs (HMRC) for advice.

The HMRC website will shortly be updated with detailed guidance about the new rules. In the meantime, advice can be obtained by calling the NIC&EO International Caseworker Helpline on Tel 0845 915 4811, or if you are phoning from outside the UK dial the International Code then 44 191 203 7010.

### Private use is not incidental

The taxpayer company owned various company cars, each of which was provided with company fuel. HMRC said that the cars were provided to Mr and Mrs Jeffries, the owners of the company, for private use and charged the company class 1A National Insurance on the benefit.

The company argued that the cars were pooled cars and were used for business travel only. On that basis, under ITEPA 2003, ss 167 and 168, no taxable benefit arose.

*Decision:*

The First-tier Tribunal agreed that conditions (a) and (c) in s 167(3) were fulfilled. The cars were made available to and used by employees of the company. The problem came with condition (d), private use of the vehicle. While the cars were used for business, Mr and Mrs Jeffries also used them to attend events at their children's schools, as well as other private occasions. The tribunal was not convinced that the private use of the cars was only incidental to the business use. The private purpose of seeing their children in a sports event was a purpose in its own right.

The company taxpayer's appeal was dismissed.

**Comments –** This case is another case demonstrating how important understanding all the rules relating to car benefit is. This is another example where the computation of or lack of computation of the correct fuel benefit is based on a flawed understanding of the rules. In Impact Foiling the directors mistakenly believed that reimbursement could be made a significant time after the year. The cars in this case were used for private use and therefore fuel was provided for that private use. Reimbursement of all private fuel is necessary to avoid the charge.

*Time for Group Ltd TC1909*

# CAPITAL TAXES

## Loss not allowable from CGT avoidance scheme with composite transaction

On 31 December 2002, the taxpayer incurred a liability to capital gains tax (CGT) in respect of the gain in the sum of £10,726,438 accruing to him on the redemption of loan notes issued to him as consideration for his disposal of his shares in PL Schofield Ltd (the company). On 9 January 2003, representatives of PricewaterhouseCoopers advised the taxpayer of a tax avoidance scheme whereby he might defer or avoid such liability by the creation of an allowable capital loss in an amount equivalent to or greater than his chargeable gain. The taxpayer accepted such advice and entered into the transactions with Kleinwort Benson Private Bank Ltd (KBPB), on the assumption that he would cease to be resident in the United Kingdom for tax purposes before 6 April 2003. The taxpayer left for Spain on 29 March 2003. He stayed there for the five or so years needed to establish non-residence. In the event, the FTSE 100 Index went up. On 7 February 2003, the taxpayer and KBPB entered into four European Style options, expiring on 7 April 2003, consisting of two pairs. The overall result of the acquisition and closure/exercise of all four options was, in cash terms, that the taxpayer had paid out £65,589 more than he had received. On the other hand, if the scheme was effective for tax purposes, the taxpayer had avoided a liability to CGT on his gain of £10,726,438. In his self-assessment tax return for the year 2002/03, the taxpayer claimed to be entitled to deduct from that gain the loss of £11,305,017. On 8 December 2004, the inspector initiated an enquiry into the taxpayer's return and subsequently disallowed the deduction of that amount on the ground that "…the avoidance scheme…is ineffective". On dismissal of his appeal by the First-tier Tribunal (Tax Chamber) (the FTT), the taxpayer appealed to the Upper Tribunal (Tax and Chancery Chamber) (the tribunal). The tribunal dismissed his appeal and refused him permission to appeal, taking the view that the composite transaction in the instant case (namely the grant of all four options and their closing out) was not a transaction to which ss 2 and 16 of TCGA 1992 applied so as to generate a loss to the taxpayer. The options code did not fall to be applied to each option separately as if each option existed as a discrete entity on its own apart from the overall scheme to which it owed its existence in the first place. The taxpayer was granted leave to appeal by a single judge.

The taxpayer contended that both the FTT and the tribunal had been wrong in failing to recognise that each option had been a separate transaction giving rise to four separate assets. His case was that the options, taken for what they were and applied to the unambiguous provisions of the Act, would result in the taxpayer having suffered a loss and an allowable loss notwithstanding that there was an element of a scheme for the avoidance of a liability to CGT arising from the taxpayer's unconnected gain on the disposal of his shares in the company. The Revenue and Customs Commissioners (the Revenue), applying the principle established in Ramsay PVT Ltd v Inland Revenue Commissioners [1981] 1 All ER 865 (the Ramsay principle), accepted the findings of the FTT and the tribunal that the relevant transaction was the aggregate of all four options. That aggregation showed that each constituent had been set up in order to be destroyed by the other, with the consequence that there was no asset, no disposal, and no loss to which ss 1 and 2 of TCGA could apply. Consequently, none of the four options had been capable of giving rise to any chargeable gain or allowable loss. In essence, the Revenue's case was simple. If the Ramsay principle applied, the FTT and the tribunal had been right, if it did not, they had been wrong.

*Decision:*

The Ramsay principle required the court to identify the relevant transaction and consider whether the provisions of TCGA on their proper construction were apt to apply to it. Further, to force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves might have negated, would be a denial rather than an affirmation of the true judicial process. In each case, the facts had be established, and a legal analysis made: legislation could not be required or even be desirable to enable the courts to arrive at a conclusion which corresponded with the parties' own intentions.

Having considered the Ramsay principle and the accepted approach derived therefrom, it was wrong to accept the step by step approach for which the taxpayer had contended for. There was nothing in any of the later cases referred to by either party to cast doubt on either that principle or its application in that case. Accordingly, it was clear that the Ramsay principle applied and displaced the step by step approach for which the taxpayer contended.

Ramsay (W T) Ltd v IRC, Eilbeck (Inspector of Taxes) v Rawling [1981] 1 All ER 865 applied.

Decision of Upper Tribunal (Tax and Chancery Chamber) Warren J (P) and Judge Clark [2011] STC 1920 affirmed. The appeal would be dismissed.

**Comments –** The CA upheld the decisions of the First-tier Tribunal and the Upper Tribunal that the transactions here were a composite transaction within the Ramsay principle, so that the appellant's attempt to create a tax loss was unsuccessful. The Court of Appeal in Schofield decided that Ramsay applied and the taxpayer's step-by-step approach was wrong. HMRC have claimed a great victory as a result of this decision, so it may be helpful to emphasise to clients that avoidance schemes which look appealing will be scrutinised carefully by the department and possibly the courts.

*Schofield v Revenue and Customs Comrs [2012] EWCA Civ 927*

## Payment date counts

The taxpayer company bought five flats and exchanged contracts on 2 October 2009, with the purchase price being paid seven days later. Land transaction returns were submitted on 20 November, 42 days after the completion date.

The First-tier Tribunal concluded that the returns had been submitted late and the taxpayer had not had reasonable excuse, so it confirmed the penalties.

The taxpayer appealed, saying that it had from the date in December 2009, when its title was registered by the Land Registry, to submit the return.

*Decision:*

The Upper Tribunal rejected the appellant's argument. The effective date was 9 October 2009, as this was the date when full consideration was paid. Furthermore, FA 2003, s 44(5)(a) referred to 'possession' rather than 'ownership' and the taxpayer had not been prevented from taking possession of the properties at 9 October. By paying the contractual price, the taxpayer had secured the right to be registered as owner.

The taxpayer's appeal was dismissed.

**Comments –** The due payment of tax unfortunately differs from tax to tax but is no less important. When dealing with any particular tax care must be exercised to identify when is the correct date for payment particularly if it relates to a tax that one is less familiar with. It also demonstrates that the importance of the issue of reasonable excuse must always be borne in mind in case it is necessary to take advantage of that let-out.

*Lancer Scott Ltd v CRC, Upper Tribunal (Tax and Chancery Chamber), 10 January 2012*

## Payment to settle court proceedings deductible in computing gain

A public company (L) acquired the share capital in another public company (N) in 2000. N's chairman (B) had owned a substantial shareholding in N, and following the takeover, he received consideration valued at more than £33,000,000. In July 2002 B transferred much of this consideration (shares and loan notes) into a trust, giving rise to a CGT liability. Meanwhile L had formed the opinion that a profit forecast which B had provided during the takeover negotiations had been misleading. L began court proceedings against B, alleging fraudulent misrepresentation and seeking damages of £132,000,000. In 2006 B and L agreed an out-of-court settlement under which B paid L £12,000,000 plus legal costs of £5,668,648. B claimed that these sums should be deducted from his CGT liability for 2002/03. HMRC rejected the claim and B appealed, contending that the payments related to a 'contingent liability in respect of a warranty or representation made on a disposal', within TCGA 1992 s 49(1)(c), and were deductible under s 49(2).

*Decision:*

The First-tier Tribunal allowed the appeal in part. Judge Scott held that there was insufficient evidence to allow the tribunal to 'make findings as to the quantum of the contingent liability predicated on the profit forecast representation'. The provisions of TCGA 1992 s 49 were satisfied 'in principle', but 'the quantum of any contingent liability cannot be assessed in this forum'. Furthermore, there was 'not a close enough nexus between the legal costs incurred and the contingent liability to allow any costs to form part of a contingent liability within the meaning of section 49'.

**Comments -** There was a lot of money at stake in this case: the judgment has been anonymised. TCGA 1992 s 49 (1)(c) refers to 'any contingent liability in respect of a warranty or representation made on a disposal by way of sale or lease of any property other than land'. TCGA 1992 s 49(2) provides that such sums may be deducted 'if any such contingent liability subsequently becomes enforceable and is being or has been enforced'. The First-tier Tribunal accepted the appellant's contention that he was entitled to a deduction under this provision, subject to agreement as to figures.

*B Nevis v HMRC TC2061*

# ADMINISTRATION

## Penalty for late submission of return

A woman (L) submitted her 2009/10 tax return, on paper, on 17 January 2011. HMRC imposed a penalty and she appealed, contending that the penalty was unreasonable because she had not realised that she was required to submit a return until she received a letter from HMRC on 10 January informing her of this. She had telephoned HMRC on the same day and had received a paper return in response to that telephone call.

*Decision:*

The First-tier Tribunal accepted her evidence and allowed her appeal. Judge Geraint Jones observed that HMRC had 'given no explanation as to why one of its personnel should have offered to send out a paper return when, on its case, the deadline for using a paper return had expired and, thereafter, only online filing would be acceptable. Similarly, it has given no explanation for why a member of its staff desisted from informing the appellant that it was too late for her to file a paper tax return and, instead, must now file online.' It appeared that HMRC had waived the requirement for a return submitted between 31 October and 31 January to be submitted online, rather than on paper. Furthermore, it appeared that, if L had been told that she would have to submit her return online, she would have done so. There was a reasonable excuse for her failure to submit the return online.

**Comments -** The First-tier Tribunal held that, by sending the appellant a paper return on 10 January, HMRC had waived the normal requirement for a return submitted after 31 October to be filed online. PKF's Philip Fisher commented "It does beg the question whether she's the only person to have suffered in this way and the other question is what on earth is this doing going to tribunal? What a mad case to take. It's a £100 penalty on someone who didn't file a tax return in a situation where the Revenue had misled her." Though Judge Geraint Jones has become an unpopular figure at HMRC HQ, Jones is not acting entirely in isolation, as the European Court of Justice has made a number of decisions that put more weight on the burden of proof, fairness and clarity in tax law.

However, the Lomas case should not raise false hopes for the 630,000 taxpayers who were due to file tax returns for the tax year that ended on 5 April 2011. Many failed to do so since the deadline on 31 January passed earlier this year and have been subject to automatic £100 penalties, plus penalties of £10 per day, up to a maximum of £900, since 1 May. Under the new penalties regime, returns which remain outstanding after 31 July will be subject to additional penalties of £300 or 5% of the tax due, whichever is greater. Another £300 fine (or 5%) falls due on 1 February the following year. Since penalties are no longer capped at the amount of tax due, the total levied could be £1,600.

*Ms K Lomas v HMRC (TC02010)*

## PAYE Changes

From 6 April 2013, Form P38(S) will be withdrawn and students will be treated in the same way as all other employees for PAYE tax and NICs purposes regardless of when they work for you.

## Papers, please

HMRC opened an enquiry into the taxpayer's 2005/06 and 2007/08 tax returns; the enquiry window for 2006/07 had closed. They made informal requests for information for all three years asking for certificates of interest for bank and building society accounts and a breakdown of self-employment income and expenses.

In relation to 2006/7, HMRC said they had reason to believe that the taxpayer had received building society interest that had not been included in her self-assessment tax return and asked for certificates of interest received in respect of that only. The taxpayer replied that she had received compensation under a court order that had wrongly been treated as taxable.

As the taxpayer did not send the documents requested, HMRC issued a notice under FA 2008, Sch 36 para 1. The taxpayer appealed, saying that she was due a rebate rather than being liable to further tax.

*Decision:*

The First-tier Tribunal said the effect of Sch 36 paras 29(2) and 62(3) was that documents were statutory records for as long as they were required, under the taxes acts, to be retained. With regard to information needed to enable a taxpayer to complete a tax return, TMA 1970, s 12B(2) states that a self-employed taxpayer must keep the relevant documents until 'the fifth anniversary of the 31st January following the end of the year of assessment or the sixth anniversary of the end of the period if not a tax year'.

In any event, as the enquiries into the 2005/06 and 2007/08 returns were opened within the allotted time, the records had to be preserved until the enquiries were closed. Thus the documents were statutory records and the taxpayer had no right of appeal against the Sch 36 para 1 notices. However, as HMRC had not opened an enquiry into the 2006/07 return within the correct time, the relevant supporting documentation had ceased to be statutory records by the time the notice was issued in August 2011. She could therefore appeal against that notice.

The tribunal judge noted that information could only be required if was 'reasonably required for the purposes of checking the taxpayer's position'.

In this instance, the taxpayer had not disputed that she received interest, rather that she was due to pay tax on it. HMRC said they would look at her claim for a rebate, but needed the relevant document to allow that to happen. This was rational, so the information was reasonably required.

The taxpayer's appeal was dismissed.

**Comments –** This case demonstrates the key understanding of basic principles in relation to dealing with the tax affairs of client. In a year when the Finance Act weighs in at 700 plus pages thus “de-simplifying” tax legislation even further it pays to concentrate on the workings of the tax management aspect of the system. This case demonstrates the understanding required of the changes that have been made in recent years to HMRC powers and rules particularly by reference to what are statutory records. The judgement demonstrated how the lack of an enquiry into a particular year had removed the relevant supporting documentation from being statutory records.

*Priti Lee (TC1998)*

## Honest and genuine beliefs

The taxpayer was required to file a tax return and pay tax of £228,013 by 31 January 2011. She attempted to do so by cheque, but this was not successful. Payment was not actually made until 7 March 2011, and as a result a surcharge notice of £11,400 was issued.

The taxpayer planned to pay the tax from a company account, as she left her own money with the company as a director's loan, but was late paying as a result of a misunderstanding of the operation of her company bank accounts. The manager of her bank branch had recently arranged to transfer a substantial cash balance held in the company current account to an account which paid interest.

The taxpayer did not, however, understand that funds that would earn interest would be placed in a separate account or that she would need to take action for these funds to be available to meet cheques drawn on the current account.

According to the taxpayer, the mechanics of how the funds would pay interest had not been specifically discussed in the informal meeting she had had with the bank manager. The court accepted this explanation, finding that she honestly and genuinely believed the cheque would be honoured.

HMRC attempted to contact the taxpayer about the nonpayment, but she was out of the country for much of February 2011. Upon her return, she contacted HMRC and immediately paid the outstanding tax by debit card.

The appeal hinged on whether an honest and genuine belief that the tax had been paid by the due date was grounds for default on the payment.

*Decision:*

In Intelligent Management UK Ltd (TC1541) the First-tier Tribunal had ruled: '… that there must be some reasonable belief for the honest and genuine belief. The tribunal does not consider that an irrational or unreasonable belief, even if honest and genuine, would suffice.'

In this case, however, the tribunal ruled that whether a person holds an honest and genuine belief is a question of fact. Whether a belief is irrational or apparently unreasonable might be a factor in deciding if somebody claiming to have a stated belief does in fact hold the belief, but it is not a factor affecting whether an honest belief amounts to a reasonable excuse.

The tribunal therefore found that, even if the taxpayer's failure to make precise enquiries about the bank accounts could feed an argument that her belief was unreasonable, that was irrelevant.

The appeal was allowed, and the surcharge amount set aside.

**Comments –** Many of the rules relating to the management of tax affairs assume a basic understanding of the process. In an era when practitioners struggle to keep abreast of technical changes both large and small. Although an explanation of why an action was not taken or was taken at the wrong time might seem incredible the importance of an appeal process that takes into account the knowledge and belief of the taxpayer is crucial to the proper operation of the tax system.

*H Chichester TC2081*

## Postcode confusion

The taxpayer left his employment in April 2009 and received a redundancy payment. Tax at 20% was deducted from the sum and the taxpayer was told HMRC would contact him if he needed to pay any further tax on the amount.

As he had not heard from HMRC, the taxpayer contacted the department in January 2011, first by telephone and then by letter, asking them about his tax liability. The department told him he would have to tax at 40% on part of his 2009/10 income and said it would arrange for a tax return to be sent to him.

In March, HMRC sent the taxpayer a form SA250. This was sent to the taxpayer at the same address as the previous letter but included the wrong postcode. The department said it sent him a notice to file separately, but the taxpayer said he did not receive it. In July, HMRC issued the taxpayer a penalty for failing to submit his tax return.

The taxpayer appealed against this and sent his return online. With regard to the penalty, he explained that a road in the neighbouring village has the same name as the one where he lived, but was distinguished by a different postcode. It did, however, lead to post going to the wrong house, which was probably why he did not receive the notice.

*Decision:*

The First-tier Tribunal agreed that on the balance of probabilities, the notice to file was not delivered to the taxpayer. The judge noted that HMRC had used an incorrect postcode in previous correspondence, and repeating this error on the notice to file could have led to it being misdirected. In addition, the tribunal judge said the taxpayer was a credible witness: he had initiated contact with HMRC despite having been told the department would contact him, and that once he was aware that the filing deadline for his return had passed, he organised its submission online.

HMRC claimed that the notice to file was deemed to have been delivered under Interpretation Act, s 7. The judge decided the deeming provisions in the act did not apply. First, the notice would have to be properly addressed, which she had found was more than likely not to be the case. Second, there was no deemed delivery if 'the contrary is proved' and she had found as a fact that the notice was not delivered.

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

**Comments –** This case demonstrates that although there are statutory provisions which deal with mundane items such as the correct delivery of tax documents when they are important such as with the notice to file it is essential that HMRC correctly deals with their part of the process. In this case the Judge took an appropriate course of action and found as a matter of fact that the notice was not delivered. The importance of credibility and therefore record keeping of actions taken cannot be over emphasised.

*J Hart TC1880*

## Penalty for error in return: 'reasonable care'

An individual (H) disposed of some loan notes in 2008/09, giving rise to a substantial CGT liability. In his return he completed Box 20, indicating that he was making a claim for relief, but without giving details of the relief. HMRC began an enquiry and, after correspondence, H accepted that he was not entitled to relief under TCGA 1992 s 135. HMRC imposed a penalty under FA 2007 Sch 24. H appealed, contending that he had relied upon his accountants who had told him that he was entitled to relief, and had therefore taken 'reasonable care' within FA 2007 Sch 24 para 18.

*Decision:*

The First-tier Tribunal accepted this contention and allowed the appeal. Judge Cannan held that 'the effect of paragraph 18 is to remove the liability of a taxpayer to a penalty where a return is completed and lodged by an agent, and an inaccuracy in the return is the result of something done or omitted by the agent, but the taxpayer took reasonable care to avoid that inaccuracy'. He held that 'a taxpayer cannot simply leave everything to his agent', and 'must satisfy himself that the agent has not made any obvious error'. On the evidence, H's accountants had been careless, but H had 'had no reason to doubt their competence or their advice that relief was available'.

**Comments -** FA 2007 Sch 24 provides for penalties for errors. Sch 24 para 18(3) provides that a taxpayer is not liable to a penalty in respect of anything done or omitted by his agent where the taxpayer satisfies HMRC that he 'took reasonable care to avoid inaccuracy'. The First-tier Tribunal held that the provisions of paragraph 18(3) were satisfied in this case, so that no penalty should be imposed.

*JR Hanson v HMRC TC2000*

## Penalty for alleged failure to submit partnership return

A limited liability partnership appealed against penalties under TMA 1970 s 93A, contending that it had submitted the relevant return within the statutory time limit.

*Decision:*

The First-tier Tribunal initially dismissed the appeal (TC00595), with Judge Petherbridge finding that the representative partner had not provided 'a shred of evidence that that was, in fact, the case. No copy of the partnership return has been produced and no evidence of it having been posted has been produced.'

The partnership appealed to the Upper Tribunal, which remitted the case for rehearing by a different First-tier Tribunal judge. At the rehearing Judge Gammie accepted the partnership's evidence and allowed the appeal.

**Comments -** This is an interesting case because it demonstrates the differing attitudes which different Tribunal judges have taken to the burden of proof. Both the First-tier Tribunal decisions have now been published, although unfortunately the Upper Tribunal decision, which remitted the case for rehearing, has not yet been published. At the initial appeal hearing, Judge Petherbridge took the view that the partnership had not produced enough evidence to show that it had submitted the return: his decision implied that he would have expected the partnership to obtain a certificate of posting, to use special delivery, or to photocopy the return before submitting it. The Upper Tribunal apparently felt that Judge Petherbridge had imposed too high a standard, and at the rehearing, Judge Gammie accepted the partnership's evidence that it had posted the return.

*Eamas Consulting Llp v HMRC (No 2) TC2009*

## Application for recusal of Tribunal judge

A company (T) reclaimed input tax of £1,847, 976 relating to transactions in mobile telephones. HMRC rejected the claim on the grounds that it appeared that the transactions were connected to MTIC fraud. T appealed. The First-tier Tribunal began hearing the appeal, chaired by Judge Tildesley. Several days after the beginning of the hearing, T applied for Judge Tildesley to be recused from the appeal, contending that decisions which he had reached in similar cases indicated that he was biased in favour of HMRC.

*Decision:*

Judge Berner heard T's application and dismissed it, holding that 'there is nothing in the conduct of the proceedings to suggest otherwise than that the Judge has acted with scrupulous fairness throughout'.

**Comments -** This case concerns an application to recuse a judge from an appeal on the basis of a real danger of apparent and/or perceived bias. Any suggestion of judicial bias must be considered with utmost seriousness. The test is whether, from the point of view of a fair-minded and informed observer, there is a real possibility that the Tribunal or one of its members are biased in the sense of approaching the relevant decision with a closed mind and without impartial consideration of the relevant issues. Judge Berner found that that there was nothing in the judge's earlier decisions which amounted to pre-determination of the issue, and refused the application.

*Tricor plc v HMRC TC02022*

## Confused banking instructions

The taxpayer company appealed against a number of default surcharges imposed by HMRC.

For the period to September 2009, the company's VAT return was submitted on time, and all but £39.50 of the £17,013.39 tax due was paid. The outstanding amount was paid late as a result of a misposting on a journal entry on the company's accounting system. The First-tier Tribunal decided that a genuine mistake had been made by the company, but the legislation did 'not provide shelter for mistakes, only for reasonable excuses'. Confusion did not constitute a reasonable excuse, so the default could not be avoided.

The return for the next period, i.e. the three months to December 2009, was also sent on time, but the VAT was paid one day late.

The company director said he had reasonable excuse on the basis that his partner's father had died in December 2009 and the funeral was on 6 January. Furthermore, they had expected that by paying electronically on the due date, the money would be received by HMRC on the same day.

*Decision:*

The tribunal judge noted that the funeral had taken place some four weeks before the day the instructions to pay the VAT were given to the bank, so the bereavement on its own could not constitute reasonable excuse. As to when the money would leave the company's bank account and reach HMRC, the tribunal decided that a 'reasonable person would have checked with the bank' as to how long this would take. So again there was no reasonable excuse for late payment.

For the period to March 2010, the VAT was paid on time, but the return was late. The taxpayer's claim that the return had been posted on time was rejected by the tribunal.

With regard to the periods to December 2010 and March 2011, the returns were on time, but payments were late, because the company missed the bank's deadline for next day payment. Again, the tribunal felt that the taxpayer should have checked to ensure that the method of payment would allow for the VAT to be paid on time.

The tribunal concluded that there were defaults for each period. However, the judge accepted the taxpayer's contention that the surcharge notice for the March 2010 period had not been received, thus reducing the penalty due.

The taxpayer company's appeal was dismissed.

**Comments -** The timing confusion in relation to the payments for various periods would not have happened if the business had paid its online VAT returns by direct debit, said Neil Warren, independent VAT consultant. He noted that some 'business owners are reluctant to commit to a direct debit arrangement, but it is certainly the safest option to ensure there are no default surcharge problems'.

*Garnmoss Ltd trading as Parham Builders TC2001*

## Negligence - whether defendant owing duty of care to claimant

An English company (the company) carried on trade in branded mobile telephones outside of the distribution channels authorised by the brand owners. It would pay VAT on the purchase price, which it would reclaim from the Customs and Excise Commissioners (the Commissioners). In August 2003, the Commissioners introduced measures to combat fraud in the wholesale market by denying recovery of VAT unless the trader concerned was able to satisfy the Commissioners that it had made appropriate checks. In September 2003, the company engaged the defendant accountancy firm (KPMG) to ensure that it would be able to recover VAT. The general terms of business referred to in KPMG's engagement letter provided that the contract between the company and KPMG would not create or give rise to any third party rights and excluded the application of any legislation giving to or conferring on third parties any contractual or other rights. The company entered negotiations for a loan facility with the claimant company during which it provided documents showing what due diligence it and KPMG conducted. In January 2004, the loan was provided to a Delaware company (the subsidiary), which made a loan to the company through another company. In February and April 2004, the Commissioners advised the company that it was investigating its transactions. Subsequently, the company ceased trading. Between July and November 2004, the Commissioners formally rejected all of the company's VAT claims for purchases covered by its returns for December 2003 and February to April 2004. In February 2007, the subsidiary defaulted on its loan. In March 2009, the company was ordered to be wound up and it was subsequently dissolved.

The claimant commenced negligence proceedings against KPMG on the basis that KPMG owed a duty of care to the subsidiary and the claimant as investors in the company. KPMG sought summary judgment.

It fell to be determined whether KPMG owed a duty of care to the claimant.

*Decision:*

The application would be allowed.

It was settled law that there were three broad approaches on which the courts decided whether a duty of care existed, involving consideration: (i) whether there had been an assumption of responsibility; (ii) whether a threefold test of foreseeability, proximity and “fairness, justice and reasonableness” had been satisfied; or (iii) whether the alleged duty would be “incremental” to previous cases.

In the instant case, it had been inconceivable that any reasonable businessman would have considered that KPMG had voluntarily assumed an unlimited responsibility towards potential investors in the company. Alternatively, it would not be fair, just and reasonable to impose a duty of care on KPMG which could result in unlimited liability (or at any rate, liability up to the full amount of the loans to be advanced by the claimant, together with a high rate of interest on such loans) when it would have been obvious to all concerned that: (i) KPMG's relationship with its client had been governed by an engagement letter which had been likely to contain limitations on the extent of KPMG's liability and very possibly an exclusion of liability to third parties; (ii) the business in which the company had proposed to engage had been a high risk business; and (iii) KPMG would not have been prepared to accept such a responsibility to the claimant if it had been asked to do so.

Summary judgment would be entered dismissing the claimant's action as KPMG had owed the claimant no duty of care.

**Comments –** The successful outcome in this case demonstrates the importance of clearly setting out responsibilities. The letter of engagement is crucially important as it forms the basis of the contractual arrangement. The letter spelled this out clearly. It is worth looking at this judgement carefully. Many tax professionals have little experience of negligence cases and how they are dealt with. They become a battleground for the parties involved with very unpleasant experiences for the parties directly involved. The most important lesson is that it is very easy to make mistakes and those mistakes will continue for a very long time. It highlights the importance of review procedures, limitation of liabilities in engagement letters and professional indemnity insurance.

*Arrowhead Capital Finance Ltd (in liquidation) v KPMG LLP [2012] EWHC 1801 (Comm)*

## Tax Return Initiative offers chance to settle tax bills

Higher rate taxpayers who have failed to submit tax returns are being offered the opportunity to come forward and pay up under a time-limited HM Revenue & Customs (HMRC) campaign.

The Tax Return Initiative, launched on 3 July, is aimed specifically at people liable to pay tax at rates of 40% and above who have been told to submit a Self-Assessment tax return for 2009/10 or earlier, but have not done so. However the campaign is also available to any individual who has tax returns to submit to HMRC for these years.

People have until 2 October 2012 to tell HMRC they want to take part, submit completed returns, and pay the tax and National Insurance Contributions (NICs) that they owe. By coming forward voluntarily through the campaign customers will receive better terms, and any penalty they pay will be lower than if HMRC comes to them first.

After 2 October, if they have not submitted their tax returns and paid what they owe, HMRC will use its powers to pursue outstanding returns and any unpaid tax and NIC. Penalties of up to 100 per cent of the tax due or even criminal investigation could follow.

Marian Wilson, head of HMRC Campaigns, said:

“This campaign is part of a wider HMRC initiative to provide support and guidance to the public on tax obligations and is aimed at people who fail to submit their tax returns on time and pay what they owe.

"The campaign provides a three-month opportunity for those who want to get their tax affairs up to date to come forward. Our aim is to make it easy for them to contact us and send in completed tax returns, putting their affairs in order. “Penalties will be higher if we come and find people after the opportunity and some could face a criminal investigation. I urge people to come forward and disclose unpaid tax voluntarily”.

How do people take part in the campaign?

- Going online and registering to take part in the campaign - guidance and the online registration form is at http://www.hmrc.gov.uk/campaigns/tri.htm

- Completing all outstanding tax returns and paying any tax and NICs owed by 2 October.

Help is available from HMRC by calling a dedicated helpline on 0845 601 8818.

By coming forward voluntarily through the campaign customers will receive better terms, and any penalty they pay will be lower, than if HMRC comes to them first.

Campaigns launched so far have yielded nearly £510 million from voluntary disclosures and over £120 million from non-compliance follow-up from a large number of civil interventions, including over 18,000 completed investigations. There are also 23 criminal cases underway, and one man, a plumber, was recently sentenced to jail.

## HMRC Open Data Strategy

In line with requirements from Cabinet Office, HM Revenue & Customs (HMRC) has developed an Open Data Strategy, a detailed document laying out plans to publish information in a linkable and re-usable format with the aim to drive reform and improvement through transparency and citizen participation.

*Transparency Implementation Plan and Data Catalogue*

HMRC's Business Plan 2011-15 commits to the development and publication of an implementation plan as a means of considering the types of information HMRC hold and how they can release new data into the public domain.

This is an ambitious and valuable exercise given the size of HMRC and the very wide range of data they hold. The Transparency Implementation Plan will be a key part of HMRC's efforts to communicate and drive the delivery of transparency commitments.

This is the initial version of the Transparency Implementation Plan. As HMRC continue work to make transparency a part of everyday activities, HMRC will be able to update and expand it.

## A modern man

The taxpayer, Dr Gordon, received no tax return from HMRC for either 2008/09 or 2009/10, but realised he had income to declare. He contacted a tax adviser who prepared tax returns for him for these years.

The taxpayer telephoned HMRC in January 2010 to ask how he should pay tax relating to 2008/09, and was advised he could pay by debit card, which he did there and then.

After preparing and submitting his 2009/10 return, the adviser wrote to Dr Gordon and informed him that tax for that year, together with a payment on account for 2010/11, would be due on 31 January 2011. The letter stated that HMRC would send a demand for the tax to Dr Gordon.

As in previous years, Dr Gordon received no demand for payment, statement of account or payment slip from HMRC following receipt of his 2009/10 return. He attempted to contact his adviser after January 2011, but was not able to speak to him until May 2011, at which point he telephoned HMRC and paid the outstanding tax.

As the tax was due on 31 January 2011, a surcharge of £488.55 for late payment was issued to the taxpayer, against which he appealed.

*Decision:*

The First-tier Tribunal noted that under TMA 1970, s 59C the surcharge could be appealed if the taxpayer had a reasonable excuse for late payment. The tribunal found 'unhappily' that he did not have a reasonable excuse for the delay. While HMRC's failure to provide payslips or statements had not helped Dr Gordon, he knew when the tax was due and knew that he could pay on the phone with a debit card. Therefore the adviser's comment that HMRC would issue a demand for payment was not in itself reasonable grounds for surcharge to be dropped.

The tribunal noted that Dr Gordon was 'a modern man and knew that he did not need a payslip', and drew the distinction with someone who was 80 and had always used payslips.

The taxpayer's appeal was dismissed.

**Comments –** The last few lines above demonstrate how the Tribunals operate fairly – what might be a reasonable excuse for one person does not necessarily work as well for another.

*C Gordon TC1987*

## New HMRC campaigns and taskforces (Lecture P729 – 8.59 minutes)

**Tax Return Initiative**

This campaign is aimed at 40% and 50% taxpayers who are required to complete a Self Assessment tax return for tax years 2009/10 and/or earlier and have not yet done so. The campaign started on 3 July and will run until 2 October 2012.

It is billed as an opportunity for people to bring their tax affairs up to date quickly and simply.

Any person who has been sent returns or been told to complete tax returns for years 2009/10 and/or earlier and has not yet done so is encouraged to take part in this opportunity and can do so by submitting the returns and paying what they owe before 2 October.

By coming forward in this campaign, the taxpayer is promised better terms and any penalty will be lower than if HMRC contacts the taxpayer. In particular there will be no tax-related late filing penalty, although the fixed penalty for a late return plus interest and surcharges on tax paid late may still apply.

**Direct Selling campaign**

This is aimed at those who sell products to customers away from a retail shop, often in the customers own homes. Sellers are sometimes referred to as 'Agents' for the companies whose products they sell. Selling could involve a party, sales door to door or simply selling to friends or relatives. For this campaign however, it will not involve those selling financial products. Sellers or Agents take commission on those sales which they should report to HMRC if they earn enough to pay tax.

This Campaign will focus on helping the increasing numbers of customers involved in direct selling - including those wanting to top up their income from another job or work after redundancy/retirement and those people doing it around caring commitments - to understand their tax obligations and set them on the right track for the future.

**Trades Campaigns - Home Improvement Sweep Up**

This is the third campaign focusing on the home repair, maintenance and improvement (Home Maintenance) sector following the Plumbers' Tax Safe Plan and Electricians' Tax Safe Plan campaigns. This 'sweep up' will focus on trades people working in a variety of skilled trades such as roofing, window fitting, carpentry, bricklaying, and joinery.

This campaign will encourage all those trades people working in the home improvement sector with unpaid tax, who have yet to come forward, to bring their tax affairs up to date in a straightforward way using a time limited opportunity.

**More HMRC taskforces**

HMRC has announced several new taskforces to investigate tax evasion in specific commercial and geographical sectors. The taskforces bring together various compliance and enforcement teams for intensive bursts of targeted activity, typically focusing on 300 of the highest risk cases.

If you have clients within any of the categories you may wish to warn them of the possibility of an approach from HMRC. It is an opportunity for you to check the business records and identify any possible problem areas in the event of HMRC scrutiny.

The new taskforces are:

- **Property rentals** in East Anglia, London, Leeds, York, Leicester, Nottingham, Lincoln, Durham and Sunderland. Expected yield £17million.
- **Restaurants** in the Midlands, South West England and South Wales - extension of work already underway in Scotland, North West and London Expected yield £7.5million.
- **Taxi firms** in Nottingham, Yorkshire, Leicestershire and Derbyshire. Expected yield £2million.
- **Market traders** in London. Expected yield £1.85million.
- **Motor traders** in South Wales, South West England, Yorkshire, Nottinghamshire and North East England. Expected yield £22million.
- **Pubs & nightclubs** in Scotland. Expected yield £5million.
- **Hair and beauty businesses** in Northern Ireland. Expected yield £2.5million.

As stated, the taskforce focusing on restaurants will be an extension of the similar campaigns that have already targeted establishments in London, the North West and Scotland. Nearly 30 companies have been prosecuted under the initial exercise, and HMRC is projecting a yield of more than £13million plus a further £7.5million under the extension. Restaurants are clearly now regarded by HMRC as a prime source of tax revenue.

Overall, about 30 taskforce campaigns have been undertaken since the beginning of 2011, with more due to start during 2012/13.

According to Exchequer Secretary David Gauke, the 12 taskforces launched in 2011/12 are on target to collect more than £50million.

*Contributed by Gerry Hart*

## Penalties for Errors (Lecture P730 – 12.29 minutes)

### Background

The penalty regime for errors (FA 2007, Sch 24) provides for reductions for disclosure (i.e. prompted or unprompted). These reductions have probably become familiar to most advisers dealing with HMRC enquiries into clients' tax returns, where penalties are potentially due.

### Special reduction

However, in addition to reductions for disclosure, the penalty regime also provides for 'special' reductions in appropriate circumstances. The legislation (FA 2007, Sch 24, para 11) ('Special reduction') provides:

> "(1) If they think it right because of special circumstances, HMRC may reduce a penalty under paragraph 1, 1A or 2.
>
> (2) In sub-paragraph (1) "special circumstances" does not include—
>
> (*a*) ability to pay, or
>
> (*b*) the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.

> (3) In sub-paragraph (1) the reference to reducing a penalty includes a reference to—
>
> (*a*) staying a penalty, and
>
> (*b*) agreeing a compromise in relation to proceedings for a penalty."

The tribunal can apply a special reduction in penalties due to special circumstances only if HMRC's decision in respect of Sch 24, para 11 is considered to be flawed (Sch 24, para 17(3)(b)).

**Suspended penalties**

In addition, HMRC has discretion to suspend penalties in suitable cases involving careless error. The legislation (FA 2007, Sch 24, para 14) ('Suspension') provides:

> "(1) HMRC may suspend all or part of a penalty for a careless inaccuracy under paragraph 1 by notice in writing to P.
>
> (2) A notice must specify—
>
> (*a*) what part of the penalty is to be suspended,
>
> (*b*) a period of suspension not exceeding two years, and
>
> (*c*) conditions of suspension to be complied with by P.
>
> (3) HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy.
>
> (4) A condition of suspension may specify—
>
> (*a*) action to be taken, and
>
> (*b*) a period within which it must be taken.
>
> (5) On the expiry of the period of suspension—
>
> (*a*) if P satisfies HMRC that the conditions of suspension have been complied with, the suspended penalty or part is cancelled, and
>
> (*b*) otherwise, the suspended penalty or part becomes payable.
>
> (6) If, during the period of suspension of all or part of a penalty under paragraph 1, P becomes liable for another penalty under that paragraph, the suspended penalty or part becomes payable.

**Penalty appeals**

There is a right of appeal against HMRC's decision that a penalty is payable. The tribunal may either affirm or cancel HMRC's decision. There is also a right of appeal against the amount of penalty charged; the tribunal may either affirm HMRC's decision, or substitute it for another decision that HMRC had the power to make.

In the case of penalty suspensions, the taxpayer may appeal against HMRC's decision not to suspend a penalty. In those cases, the tribunal has the power to order HMRC to suspend the penalty, but only if HMRC's decision not to suspend was flawed.

There is also a right of appeal against HMRC's conditions of suspension. The tribunal may affirm HMRC's conditions of suspension, or alternatively may vary them but only if HMRC's conditions are considered to be flawed (FA 2007, Sch 24, paras 15, 17).

Some recent cases in which the special reduction and/or suspended penalties have been considered are outlined below.

*Roche v HMRC* [2012] UKFTT 333 (TC)

The taxpayer omitted a redundancy payment and certain other items of income (e.g. bank interest) on her tax 2008/09 tax return. Following an enquiry into the return, HMRC amended the taxpayer's return, and assessed penalties amounting to 15% of the potential lost revenue on the basis of careless behaviour (i.e. the minimum penalty on the basis of prompted disclosure). HMRC offered to suspend the penalty for the omitted bank interest, but not on the redundancy payment or other income. The taxpayer appealed.

The tribunal noted that no penalty reduction had been applied for special circumstances, and held that HMRC's decision not to apply a reduction was flawed, as proper consideration had not been given to the potential special circumstances in the case.

The tribunal reduced the penalty by 50%, to take account of special circumstances which resulted in the taxpayer's failure to include the redundancy payment on her tax return.

However, the tribunal found that HMRC's decision not to suspend the penalty attributable to the redundancy payment (and also on an omitted pension) was not flawed. The tribunal followed the reasoning of the decision in *Fane v HMRC* [2011] UKFTT 210 (TC), in which the tribunal accepted HMRC's approach that a 'one-off' error was not normally suitable for a suspended penalty.

*White v HMRC* [2012] UKFTT 364 (TC)

The taxpayer was made redundant, and her employer made a termination payment. Following an enquiry into the taxpayer's self-assessment return for the relevant tax year, HMRC charged a penalty of 15% (ie 30% penalty reduced for a prompted disclosure) for a careless error in respect of the taxable element of the termination payment, which had been omitted from the taxpayer's return (nb she had been confused by the fact that two forms P60 were issued, the second of which related to the omitted taxable element of the redundancy payment).

HMRC refused to suspend the penalty, and considered that there were no special circumstances to allow a 'special reduction' to be applied to the penalty. The taxpayer appealed against the penalties assessed.

The tribunal had some sympathy for the taxpayer, but considered that the failure to report the redundancy payment accurately on her tax return was careless. The tribunal held that it was not a suitable case for suspension, as the provisions in Sch 24, para 14 were not suitable for dealing with 'one-off' events such as redundancy. HMRC's decision not to suspend the penalty was therefore not 'flawed'.

However, the tribunal held that HMRC's decision regarding the special reduction was flawed. There was no evidence that HMRC had considered a special reduction before the penalty determination was issued, and HMRC gave no reasons for concluding that there were no special circumstances justifying a reduction in the penalty. The tribunal considered that there were "unusual circumstances" which took this case out of the ordinary, and decided that the penalty be reduced by 60%.

*Boughey v HMRC* [2012] UKFTT 398 (TC)

The taxpayer's 2008/09 self-assessment return included a claim for exemption on the first £30,000 of a redundancy payment. However, relief had already been given through the PAYE system. HMRC levied a 15% penalty on the basis of a careless error. HMRC refused to suspend the penalty, indicating that a claim for the £30,000 relief for a redundancy payment was not a careless inaccuracy in respect of which suspension conditions could be set.

HMRC stated that, to enable a penalty to be suspended (inter alia), a suspension condition needed to be set "that is specific to the careless inaccuracy". However, the tribunal pointed out that this was not a statutory requirement. The tribunal decided that HMRC's decision not to suspend the penalty was flawed.

The taxpayer had proposed a suspension condition that his tax returns should be prepared by a qualified accountant during any suspension period. The tribunal, whilst pointing out that this was a "borderline" case, concluded that this was a suitable case for suspending the penalty. The tribunal ordered HMRC to suspend the penalty for two years, on condition that the taxpayer's self-assessment returns during that period must be completed on his behalf (and also certified as being accurate) by a Chartered or Certified accountant.

**HMRC guidance**

HMRC's Compliance Handbook Manual includes guidance on both the special reduction (at CH170100 and following) and the suspension of penalties (at CH83110). However, it should be remembered that this guidance represents HMRC's views on the application of the legislation, and does not carry the force of law.

*Contributed by Mark McLaughlin*

## RTI Update (Lecture B728 – 11.20 minutes)

The key aspects of this session bring out the latest news from HMRC, and an idea of the progress from here on. The notes, therefore, provide links to all of the resources on the Internet that you can use.

*Pilot running*
The reports from the pilot emerging from HMRC are very positive, and HMRC has a number of employers / pension providers with very large numbers of individuals now submitting monthly successfully. On the other hand, informal reports via BASDA (the Accounting and tax software trade body) indicate that one medium sized employer took 6 months to make their first successful submission. This is likely to include preparation time, and is likely to be down to data issues (see below) but it does raise a warning. HMRC can afford to be pleased with the pilot so far, having got it successfully running for the entire Prudential pension population; tens of thousands of additional employers will start joining the pilot from October, so listen for further announcements.

Latest news on the pilot and more about early joining is here http://www.hmrc.gov.uk/news/rti-expands.htm

*Implementation date*
It is widely known that the planned implementation date is April to October 2013, but it is not so widely known that HMRC is hoping to bring ALL small employers on board from April, as this is much simpler for them in terms of the switch from one regime to the other. You may need to warn your clients to start planning for this, in advance of any announcement.

*Data quality issues*
HMRC have made no bones about data quality, and this issue has been publicised for a year now, but employers and payroll agents are very slow taking the hint. If the employee data quality is poor, then RTI CANNOT work. If you are switching in April, then tie is now getting short to get the data looked at for integrity. What is required is not very complex, but it can be a time consuming task.

HMRC's new Video on YouTube is excellent and sets out the needs of RTI in data quality in detail. This is covered in the slides and the audio lecture. Find the video and a link to a webinar here http://hmrc.presscentre.com/Press-Releases/RTI-video-offers-employers-vision-of-new-PAYE-system-67d19.aspx

*Terminology*
You'll need to get used to the new terminology:

**EAS – Employee Alignment Submission** – (also called payroll alignment) a submission of employee data with no payment information to check that the employer and HMRC have all of the same details in respect of each employee. Larger employers will be required to make a separate submission before being allowed to commence RTI filing. The professional bodies have asked HMRC to provide the option for smaller employers to do this in the last two months of 2011/12 so that they have a smooth start to RTI live. Until now, HMRC has expected the EAS to be done just before the first RTI submission in April. However, if there are problems with data, this would mean that the April payroll could be held up.

**FPS – Full Payment Submission** – this is RTI for real, with the data regarding payment on it.

*Unresolved problems*
There are a number of issues directly relevant to smaller employers which HMRC are still looking at. These include:

*The on or before requirement*
The requirement to make a FPS on or before payment is a practical issue for many small employers who pay staff and have their wages written up later on a gross up basis – such as bar staff and harvest workers. HMRC are receptive to the problem and looking at how this might be solved

*Below LEL employees*
There is no doubt about these employees where there is a payroll scheme – they must be included on the payroll from the start of RTI, even where there is no need to make a deduction or even a record of earnings for NI purposes. This needs to be resolved in the data quality stage.

However, there are very many employers (including domestic employers) who pay employees less than LEL and do not have a payroll schemes; for example the self-employed who pay their spouse for admin work. HMRC are not keen to have new payroll schemes registered and are therefore considering what the solution might be for these employers.

*Other news*
There are now FAQ's on ex-patriate employees published as a PDF : http://www.hmrc.gov.uk/rti/expats-RTI.pdf

All of the current guidance for those employers operating in the pilot scheme is at http://www.hmrc.gov.uk/payerti/index.htm

General FAQ's – updated regularly – are at
http://www.hmrc.gov.uk/rti/employerfaqs.htm

HMRC will be publishing a pack for agents in the Autumn, which will comprise slides and notes for a presentation on RTI. This will be suitable for personalising by adding your firm's logo, and then for use for presentations to clients. Make sure that you are enrolled with the Agent Account Manager (AAM) service to hear about this, and for talks on RTI presented by HMRC. http://www.hmrc.gov.uk/agents/aam.htm

*Contributed by Rebecca Benneyworth*

# BUSINESS TAX

## Business cars – buy or lease? (Lecture B726 – 16.09 minutes)

Clients may often wonder whether they should buy or lease their next car. They may feel more comfortable buying the car as they then own it outright but is that the best option?

When you lease a vehicle over a 12, 24 or 36 month period the vehicle is simply handed back to the leasing company at the end of the lease term. The rentals paid during the lease term are effectively lost but will these be significantly different to the money lost in depreciation and finance charges when buying a car?

So is the cost to the client effectively the same?

If the cost is broadly the same, the decision whether to buy or lease then depends on other factors such as tax relief, cash flow etc.

*Tax relief when purchasing a car*

The rules for WDAs are as follows:
- 20% for the general pool (including cars with ≤ 160g/km $CO_2$), reducing to 18% from April 2012
- 10% for integral features, long life assets and cars with > 160g/km, reducing to 8% from April 2012

The changes to 18% and 8% will take effect from 1 April 2012 for companies and 6 April 2012 for income tax businesses. Businesses with accounting periods spanning the date of change will have to calculate a hybrid rate, under which the two applicable rates will be apportioned on a daily basis.

Budget 2012 outlined plans to reduce the 160 g/km limit to 130g/km from April 2013.

The concept of "pooling" does delay the timing of tax relief when buying a car. If a car is in the 18% pool there will be no balancing allowance on sale of the car – the proceeds are simply deducted from the pool and the WDA continues on the balance. This is the case even if the car is the only asset in the 18% pool. There will only be a balancing allowance on the 18% and 8% pools on cessation of trade.

100% first year allowances are available on cars with emissions of no more than 110g/km ("QUALECs" – qualifying low emission cars). Budget 2012 provides that this limit is being reduced to 95 g/km from April 2013.

QUALECs could be very tax-efficient cars to buy through the OMB company for staff or for family members. Currently there are many cars which are just under the 110 g/km limit and hence qualify for a 100% FYA. There are not many that would meet the 95 g/km limit (due to take effect from April 2013) so if a client is considering purchasing a QUALEC they should do so before the limits reduce.

Road fund tax is also very low for these cars.

Examples of QUALECS

| Model | List Price | Likely Discount | Co2 Emissions (g/km) | 0- 60 Secs |
|---|---|---|---|---|
| Audi A3 Sportback 1.6TDi 105 SE | £20,115 | £1,620 | 109 | 11.7 |
| BMW 320d Efficient Dynamics | £28,080 | £0 | 109 | 8.0 |
| Ford Focus 1.6 TDCi 115 Zetec | £18,595 | £1,770 | 109 | 11.9 |
| Honda Civic 1.4i VTEC Hybrid ES | £17,970 | £1,000 | 109 | 12.1 |
| Mini Cooper 1.6D | £16,120 | £726 | 99 | 9.7 |
| Nissan Pixo 1.0 Visia | £6,995 | nil | 103 | 11.0 |
| Peugeot 107 Urban Lite | £8,095 | £1,200 | 106 | 14.2 |
| Polo 1.4 TDi 80 BlueMotion 1 | £13,105 | £900 | 99 | 12.8 |
| Seat Ibiza 1.4 TDi Ecomotive | £11,805 | £1,000 | 98 | 12.9 |
| Smart ForTwo Coupe 60 mhd Pure | £6,912 | £150 | 103 | 16.7 |
| Toyota Aygo VVT-i | £7,505 | £450 | 106 | 14.2 |
| Toyota IQ 1.0 | £9,615 | £450 | 99 | 14.7 |
| VW Golf 1.6TDi 105 Bluemotion | £20,305 | £1,495 | 107 | 11.3 |
| Volvo C30 1.6D Drive Start/Stop | £16,245 | £1,000 | 104 | 10.7 |

**Example – Piers**

Piers prepares annual accounts to 5 April 2013 and incurs the following capital expenditure:

| | £ |
|---|---|
| BMW 320d Efficient Dynamics 109 g/km | 28,080 |
| Fiat Panda 1.1 Active ECO 119 g/km | 5,995 |
| Lexus RX450h SE-L Hybrid 148 g/km | 41,600 |
| Porsche Boxster 2.9 221 g/km | 33,704 |
| Peugeot 407 2.2 Coupe 219g/km (40% private use) | 21,995 |
| 18% pool b/f | 55,590 |
| 8% pool pool b/f | 22,350 |

| | ***QUALEC 100%*** | ***Main 18%*** | ***Private Use Car 8%*** | ***SR 8%*** | ***Private Use adjustment*** | ***Total*** |
|---|---|---|---|---|---|---|
| WDV b/f | | 55,590 | | 22,350 | | |
| BMW | 28,080 | | | | | |
| Fiat | | 5,995 | | | | |
| Lexus | | 41,600 | | | | |
| Peugeot | | | 21,995 | | | |
| Porsche | | | | 33,704 | | |
| FYA | (28,080) | | | | | 28,080 |
| WDA | | (18,573) | | (4,484) | | 23,057 |
| WDA | | | (1,760) | | 704 | 1,056 |
| WDV c/f | 0 | 84,612 | 20,235 | 51,570 | | **52,193** |

It should be noted that if the BMW was bought in April 2013 it would only qualify for an 18% WDA. Similarly if the Lexus was bought in April 2013 it would only qualify for an 8% WDA.

It should also be noted that the QUALEC is transferred to the 18% pool at the end of the year – albeit at a nil balance. Consequently when the QUALEC is sold the sale proceeds are set against the 18% pool.

*What if a QUALEC had private use?*

If a QUALEC has private use it stay in its own column. The 100% FYA is adjusted for private use. The balancing charge on eventual sale would also be adjusted for private use.

*Leasing vehicles?*

When leasing a car the 110 g/km is of no relevance to the company. As long as the emissions are 160 g/km or less the company will receive a full lease deduction. When they go above 160 g/km there is a 15% add back. The 160g/km limit is reducing to 130g/km from April 2013.

So when leasing a vehicle the range of “right cars” is actually wider although the benefit in kind rules must still be considered for corporates.

It should also be noted that the leasing of vehicles will give the corporate a deduction for what they spend in the year – when buying a car the allowances are spread over a number of years without the ability to receive a balancing allowance on sale (proceeds are deducted from the 18% or 8% pools).

*Illustration 2*

George runs a small company and decides to provide his wife Mildred with a company car. The car is a VW Golf 2.0 TDi Bluemotion GT which has a list price of £22k and CO2 of 114g/km. The company will lease the vehicle at a monthly lease cost of £270 plus VAT.

Mildred does not work for the company and all mileage will be private. George is a 40% taxpayer. The tax position is as follows:

<u>Income tax on George:</u>

2012/13: List price £22,000 @ 16% = £3,520 @ 40% = £1,408

<u>Company’s position per car:</u>

50% of VAT on lease recovered

CT relief on lease cost (including irrecoverable VAT)  £3,523 @ 20% = £705 pa

Class 1A NIC on £2,860 @ 13.8% = £395 pa

Full VAT reclaim on input tax on car servicing etc.

Corporation tax relief on running costs and on £395 above

*Conclusion*

The tax system certainly favours leasing vehicles as opposed to buying vehicles – unless you purchase a QUALEC.

When the tax advantages are combined with the cash flow advantages of leasing then the leasing of a vehicle is preferable.

## Remuneration through share based scheme fails (Lecture B727 – 9.25 minutes)

The recent case of Sloane Robinson Investment Holdings Limited concerns an award of shares made to four individuals, HS, RC-T, GR and MH ("the Employees") who were also the directors and the principal shareholders of the Appellant. The shares were in two companies, SRIM Performance ("S1") and SRIM Performance 2 ("S2"), controlled as to 999 shares by the trustee of an employee benefit trust and as to the remaining one share by the appellant through a nominee shareholder. The two companies were subsequently liquidated and the Employees received the proceeds of the liquidation in cash.

The Employees were traders in a hedge fund and were in principle entitled to be remunerated by a basic salary, supplemented by a bonus representing a share of the overall profits remaining after all other claims on the business had been met. They effectively negotiated among themselves the distribution of the profits by way of the bonuses, and allocations to each of them were agreed upon. These negotiations took place each year based on the results for the previous year..

Dividing up the amount available for bonuses proceeded on the basis of a specific number of points being agreed for each person; once the individual's number of points had been settled, they were then translated to what was called the "bottom line", i.e. its monetary value. Each person could then use his points as he wished: he could take their value in cash, he could allocate their value to a charity or he could put their value into a tax scheme or a trust. The bonus of any individual could be split between these options, or taken in the form of one of them alone

On 3 November 2003, an interim bonus payment was made to the Employees according to percentages of the profits available for distribution. The Board minute of 29 October preceding these payments were simply recorded under the heading "interim bonus".

By mid-December 2003, the Chancellor's autumn statement had been made and digested and the Appellant's Board had met to give initial approval to exploring some tax-saving schemes being proffered by Robson Rhodes, and a meeting between them and the Appellant was envisaged for January in the New Year. At that time, a scheme had already been worked out by Robson Rhodes for dealing with at least part of the remuneration for the Employees for the financial year ending 28 February 2004 and, if possible, subsequent years. It involved delivering shares to the Employees, subject to forfeiture in certain circumstances with a fixed dividend amounting to over 90% of the subscription price. Another scheme involved an EBT.

On 16 February, the Appellant notified Robson Rhodes that they had decided not to go ahead with the employment benefit trust scheme that year, but wished instead to set up a second dividend scheme for the benefit of the directors, adding that "the amount to go into this scheme will be £9.5m"; this scheme was to become S2. On the same day, the Appellant wrote to the directors of S1 with a request to subscribe for the 'B' shares and undertaking to make payment of £14,500,202 on issue, and asking them to "consider our request that these be applied in making investments which are low risk, but nevertheless give the company the chance to realise a capital gain on the amount invested". The cash amounts to go into the S1 and S2 schemes had thus been ascertained and, as we have seen, the proportions in which the Employees were to share the amounts in S1 had already been fixed on 19 January.

The formation of S2 then followed the same pattern as S1, and S2 was formally incorporated on 19 February with the same corporate director and corporate secretary and a share capital of £1,000 initially divided into 1,000 shares of £1 each. The share awards by the Appellant for shares in S1 were formally recorded on 25 February: to RC-T 6,000 shares; to HS 3,500 shares; to GR 2,500 shares, and to MH 2,500 shares. The forfeiture provisions of the articles were repeated, that exercisable on the Appellant's absolute discretion being effective between 1 and 25 March 2005. The implementation of the dividend scheme was thus complete, save for the payment of the dividends in May and July 2004, and the investment of the funds subscribed.

The Notes to the Appellant's Report and Accounts for the year ended 29 February 2004, dated 29 June 2004, contain the following sentence under the heading 'Directors' Emoluments': Included in directors' emoluments are awards of shares in [S1 and S2] to the value of £24,000,000, [i.e. £14,500,000 + £9,500,000] of which £9,500,000 was unallocated and included within accruals at 29 February 2004.

Before the fixed dividends had been paid, alarm and despondency followed the issue by the Inland Revenue on 7 May of a press release stating that the Finance Bill would contain provisions under which "schemes designed to avoid income tax and NI contributions using employment-related securities have been stopped" as of that date. Robson Rhodes advised on 10 May that "we are reviewing what to do to fix the proposed changes". By mid-May, action was proposed in the form of changes to the articles of S1 and S2 to avoid a tax charge falling on the 'B' shareholders if the fixed dividend was paid. Tax counsel was again consulted and by 24 May the Appellant's in-house lawyer was writing to Robson Rhodes:

The solution adopted by general agreement and after advice from Robson Rhodes was to liquidate S1 and S2. All the Employees chose to receive cash rather than a share of the investments held by the companies. The fixed dividend dates were amended to 11 February 2005, so that they would fall due after the liquidation had been completed. The process was commenced in June and was largely completed in August when payments out were made by the liquidator to the four Employees, the final payments being made in November 2004. Although they did not hold legal title to the shares which remained vested in the Appellant the Employees were, at the request of Robson Rhodes to the liquidator, paid direct and not through the Appellant. The totals paid out were: from S1 £14,413,755 and from S2 £9,454,852 or, respectively, 99.4% and 99.5% of the amounts subscribed by the Appellant.

*The arguments*

The Appellant's case in essence is that the Employees were remunerated in shares, not cash, and the regime that taxes shares in such circumstances (that is, Part 7 of the 2003 Act) is applicable to these shares. Thus, under Part 7, the acquisition of shares, and the disposal or variation of rights in or relating to the shares, are events which of themselves trigger a specific legislative response: whether a calculation of a charge to tax, or an exemption from tax. Where tax avoidance or commerciality is relevant to a calculation or to an exemption, the regime will say so, sections 446A, 446E, 446K, and Chapter 4, being cited as examples.

The Appellant submits that in this case the shares awarded to the Employees were "employment-related securities" within the meaning of section 421B, and "restricted securities" within the meaning of section 423(2). As such, the Employees' acquisition and disposal of the shares is chargeable to income tax as prescribed by Part 7, section 417. And in this case, section 425 prescribes that the acquisition of the shares by the Employees is exempt from tax. The exemption applies because the shares are "restricted securities" on acquisition. In principle, a charge to income tax could be imposed at a later stage, but only if a "chargeable event" occurs within section 427.

The issue between the parties is whether the bonuses are taxable as earnings, or whether they escape income tax altogether. The argument that the Appellant and the Employees achieved tax-free status for the bonuses is that money was put into S1 and S2, the individuals were awarded shares in those companies and then got the money out again when the companies were put into liquidation. Taking a step-by-step approach to this composite transaction, the bonuses are said to have been awarded by way of shares, and not by way of money.

The awards of the shares are said to escape tax because of the effect of section 425 (tax exemption on acquisition, award of restricted securities) and because there was no later chargeable event on the liquidation. Section 425 forms part of Part 7 (employment related securities) which makes provision for taxation (and exemption) of awards of securities, options, and incentives of various kinds.

The Crown submitted that the clear purpose of Part 7 is to provide tax advantages for awards of shares (generally, if not necessarily, in the employer's enterprise or a part of it) as a means of retaining and incentivising employees. It is no purpose of Part 7 to provide a tax-advantaged wrapper for bonuses decided, denominated, paid, received and enjoyed in money. The Appellant claims that its case is simple, and that the employees were remunerated in shares, which engages Part 7 only. This is to ignore why the rewards were paid to the employees, and to invest Part 7 with a function which it does not have.

The Crown's argument was that at the core of the Appellant's case lies the fundamental error of confusing an award of earnings with the mechanism or process for its delivery. The whole purpose of the exercise which the Appellant undertook was to reward the employee with money. Money went into the scheme at the beginning and came out at the end. Construing the statutory provisions purposively and applying them to the transactions viewed realistically, what the individual received was an award of money. The facts show that the bonuses were awarded in accordance with a previously agreed distribution of surplus profits and were ascertainable in money terms. Following that stage, the Employees chose how the money to which they were entitled should reach them; they were therefore entitled to the monetary sums involved before the shares derived from those sums were awarded to them.

This approach has now received the very recent endorsement of the Court of Appeal in HMRC v PA Holdings Ltd [2011] EWCA Civ 1414. In that case employees, who would otherwise have been awarded bonuses in money, received shares instead and were then paid dividends in money. The issue was whether the money was taxable under Schedule E (emoluments) or under Schedule F (distributions). The award of the money was distinguished from the mechanism for its delivery.

*Decision:*

There were a number of other sections quoted in the case (SS18 and 686 of ITEPA) and the Ramsay doctrine which were disposed of in the judgment but the key issue was that of the application of Part 7 of the 2003 Act.

The case for the application of part 7 of the 2003 Act was pressed by Mr Ghosh, on the basis principally that the facts would admit of no other course. The case, he said, was inevitably one in which the Tribunal must recognise that the Employees had a distinct legal character as such and, until awarded the shareholdings they received in S1 and S2 by the Appellant, they had nothing. They therefore had received shares, or a beneficial interests in shares, and must be taxed under the provisions of Part 7 designed explicitly for such a case.

Although we have found that the Employees were entitled to monetary amounts, and that those amounts had been credited to them in the books of the Appellant before an interest in the shares of S1 and S2 arose, we must address this alternative argument on the basis that those findings are unable to be sustained. We look principally for guidance to the very recent decision of the Court of Appeal in PA Holdings. There, in a scheme a good deal more complex than that in this case, the taxpayer employer had wished to pay its employees discretionary annual bonuses. The company's employees had no contractual right to the bonuses, though a clear expectation that they would be paid in accordance with criteria which had been published to them.

The taxpayer company had devised a scheme under which the bonus pool available for all the employees was transferred to a company, in whose shares a trustee was authorised to grant a beneficial interest to employees and to pay dividends from the shares to them; the shares were to be transferred to the employee at the end of a defined period. Employees who had left the employer's service before payment of the dividend forfeited their beneficial interest in the shares and thus the dividend that went with it. It was found as a fact that the dividend payments received by the employees were received by them as emoluments in their hands, representing earnings for work done as employees. The finding however was overlaid by a further finding that the receipts were also dividends in the employees' hands and should be taxed as such.

Moses LJ, giving the unanimous judgment of the Court, recognised the following principles:

- In every case, the question must be asked whether the payment is in return for acting as or being an employee
- The court is not restricted to the legal form of the source of the payment but must focus on the character of the receipt in the hands of the recipient.
- The paramount question is always one of interpretation of the statutory provision in point.
- The appraisal of the facts must be realistic and the construction of the statute purposive.
- Once it is concluded that the payments in the hands of the recipients are earnings from employment, there is no room for the application of statutory provisions which characterise objectively different payments differently.
- The award of the shares and the declaration of the dividend were, in that case, in reality not separate steps but the process for delivery of the bonuses.

It is difficult to see how this case could be distinguished from PA Holdings. The sums eventually paid in the liquidation to the Employees were, to all intents and purposes, the same sums as had been paid into the two companies by the Appellant at the outset. The Employees received what they expected to receive, and from the Appellant's viewpoint the bonuses had been distributed in accordance with the agreed amounts drawn down from accumulated profit in order to capitalise the companies. It is unnecessary for us to express any view on the purposes for which the provisions of Part 7 of the 2003 Act were enacted, because it suffices to say that in these circumstances they cannot apply to a situation which is already covered by sections 18 and 686 of the Act.

A word should be added about the fact of the investment activity undertaken in the companies. We have recorded what actually took place and it remains to evaluate it. Our assessment of the investment activity that took place was that it was essentially cosmetic, and that no significant risk was ever contemplated in regard to it.

That is because: (i) the capital invested was to be there for two or three months at the most, and there could be no real prospect in that time frame of increasing the sums invested without the risk of significant loss, which would have defeated the object of the whole exercise to pay fixed dividends; (ii) Mr Haworth was very anxious about how it was to be done and felt under greater pressure in doing it than he did in regard to his other responsibilities with the Appellant, where he was responsible of course for very much greater amounts being invested; (iii) the three others were said to be broadly comfortable with the investments, but they debated them regularly, evidently keeping a close eye on what were in effect their bonuses; (iv) all the Employees took cash in the liquidation, suggesting that they had never had any real interest in investment as such, and no further use was made of the companies. The fact of the money being invested by S1 and S2 does not therefore change the fundamental analysis of what took place, and it does not alter the conclusion that S1 and S2 were merely money-box companies serving an essentially mechanical purpose.

For these reasons, the appeals do not succeed.

**Comments –** This case is the most recent one to deal with remuneration planning using sophisticated methods to turn what would otherwise be taxed as earnings into something else. The decision in PA Holdings where the Court looked at the root of what was trying to be achieved is likely to mean the demise of such schemes. The principles spelled out particularly: in every case, the question must be asked whether the payment is in return for acting as or being an employee and the court is not restricted to the legal form of the source of the payment but must focus on the character of the receipt in the hands of the recipient mean that the nature of why the payment arose in the first place is likely to result in the payment however varied is likely to be treated as earnings. The timing of this planning around the introduction of Schedule 22 FA 2003 and the subsequent tax year was particularly unfortunate.

## Loan relationship: avoidance scheme

A company (GP) lent £300m to a subsidiary company (GB) in 2000. GB issued GP with unsecured loan stock valued at £300m, redeemable in 2004. In 2003 GP assigned its right to receive interest on the loan stock to another subsidiary company (GK) in return for preference shares which carried the right to a special dividend. GB paid loan interest to GK, which paid the special dividend to GP, which also retained the right to receive the repayment of the £300m loan. HMRC formed the opinion that the purpose of these arrangements, which had been devised by a large accountancy firm, was to take advantage of a perceived loophole in the 'loan relationship' provisions and to achieve a tax saving by allowing GB to claim a deduction for the interest payable without GP being taxed on the interest. HMRC issued amendments to GP's corporation tax returns, on the basis that generally accepted accounting principles (and particularly FRS 5) required GP to derecognise the loan principal to the extent needed to reflect its current value at the date of assignment, and to bring a sum equivalent to the difference between that amount and its face value into account as a loan relationship credit. (HMRC's amendment assessed the required credit as £20,453,476.) GP appealed.

*Decision:*

The First-tier Tribunal dismissed the appeal (subject to agreement as to figures), holding that GP's accounts had failed to recognise that, although its overall position was unchanged, the value of the loan had been diminished in exchange for an augmentation elsewhere. Accordingly the accounts in which GP continued to recognise the loan in full did not accurately reflect GP's own position. The effect of the assignment had been that GP 'no longer had the right to receive the interest; it had instead a more valuable subsidiary'. The transaction should have been 'properly reflected by partial derecognition of the loan, and an addition to the value of (GP's) investment in its subsidiaries'. GP had not been justified in departing from FRS 5. The tribunal noted that there was a possibility that this might eventually lead to double taxation, but observed that 'the transactions were a device for ensuring that relief for payment was not matched by taxation of the receipt; and the appellants have no evident difficulty with that outcome. It does not seem to us that they can legitimately complain if the scheme fails in its purpose and instead results in their paying tax twice.'

**Comments -** There is a great deal of money at stake in this case, which was treated as a test case. Possibly the most interesting part of the Tribunal's decision is its statement that 'the transactions were a device for ensuring that relief for payment was not matched by taxation of the receipt; and the appellants have no evident difficulty with that outcome. It does not seem to us that they can legitimately complain if the scheme fails in its purpose and instead results in their paying tax twice.'

*Greene King plc v HMRC (and related appeal) TC2069*

## Service engineer not 'employed earner'

A company (SP), which manufactured and distributed soft drinks, took over the business of another company (C). C's employees continued to work for SP, and were treated as employees, with the exception of a senior service engineer (RS), whom SP treated as self-employed. RS subsequently claimed that he should also have been treated as an employee, and following an enquiry, HMRC issued a notice ruling that RS had been an employed earner, and that SP was required to account for Class 1 national insurance contributions.

*Decision:*

The First-tier Tribunal allowed SP's appeal, holding that RS 'was not an employed earner and was self-employed'.

**Comments -** The First-tier Tribunal rejected HMRC's contention that the engineer had been an 'employed earner' and accepted the company's contention that he was self-employed.

*Slush Puppie Ltd v HMRC TC2042*

## Construction worker: travelling expenses

The appellant was a miner (W), whose home was in Colwyn Bay, but was employed at Heathrow Airport from September 2002 to June 2005, working on the construction of a new terminal. He claimed deductions for his travelling expenses. HMRC rejected the claims and he appealed.

*Decision:*

The First-tier Tribunal reviewed the evidence in detail and allowed his appeal in part. Judge Berner held that from September 2002 to January 2004 Heathrow had not been W's 'permanent workplace', within ITEPA 2003 s 338(3), so that his expenses were allowable. However, from January 2004 Heathrow had become W's 'permanent workplace', so that his expenses from January 2004 to June 2005 were not allowable.

**Comments -** ITEPA 2003 s 338 provides that an employee may claim a deduction for travel expenses, but not for 'ordinary commuting', which includes travel to and from a 'permanent workplace'. The First-tier Tribunal reviewed the evidence in detail and held that for the first part of the period in question, Heathrow Airport had not been the appellant's 'permanent workplace', so that he was entitled to a deduction. However from January 2004 it had become his 'permanent workplace', so that he was no longer entitled to such a deduction.

*M Williams v HMRC TC2062*

## Conditions to be satisfied for issue of certificate - whether “reason to expect” test met

The appellant company carried on a roofing and cladding business. It applied for gross payment status under the construction industry scheme (“CIS”), pursuant to FA 2004 s 63. HMRC rejected the application on the basis that (i) corporation tax of £333·27 owed by the appellant and due on 1 January 2011 was not paid in full until 1 July 2011; and (ii) the “reason to expect” test in FA 2004 Sch 11, para 12(7) had been failed as the appellant also failed to pay corporation tax of £39,834·69 for the accounting period ended 31 March 2011, which was due on 1 January 2012, on time.

The appellant appealed contending it had a “reasonable excuse” for the purposes of FA 2004 Sch 11, para 12(3) for the failure to pay the £333·27 corporation tax based on the advice of its accountant who believed that CIS taxes had been paid to cover it; and its failure to pay the £39,834·69 on time was due to cash flow difficulties caused by the fact that it was not registered for gross payment.

*Decision*

Although reliance on a third party might be a “reasonable excuse” for the purposes of FA 2004, Sch 11, para 12(3), it was not necessarily a reasonable excuse. Much depended on the nature of the task entrusted to the third party. Thus, specialist tax advice might well give a taxpayer a reasonable excuse if the advice proved to be wrong or misleading. On the other hand, relatively straightforward tasks which were delegated to an agent would not absolve the taxpayer if the agent failed to perform those tasks correctly.

In the present case, the appellant was entitled to rely on the accountant's erroneous advice. Roofing contractors, who retained accountants to deal with the company's tax affairs, could reasonably assume that an overpayment of tax under the CIS might well absolve them from the obligation to pay corporation tax (particularly if the effect of paying an amount of corporation tax determined without the correct credit for income tax accounted for under the CIS would simply be to increase the eventual overpayment of tax for that accounting period). However, it was unlikely that the appellant's accountant could have laboured for seven months under its mistaken misapprehension. The appellant accordingly had not discharged the onus of proof in respect of its "reasonable excuse".

The cash flow problem was an inevitable consequence of a failure to be registered for gross payment. It could not constitute a reasonable excuse for the failure to pay the £39,834·69 corporation tax on time. Thus the "reason to expect" test in FA 2004 Sch 11, para 12(7) had been failed. It followed that the appeal would be dismissed.

**Comments –** This case is interesting as it raises the question on when the taxpayer can rely on their accountant. In Rowland v HMRC in June 2006 (dealing with becoming a partner in a film partnership) it was reasonable for the taxpayer, who did not have the necessary knowledge to appreciate that there was a default, to rely on her accountants. Although the CIS can be perceived as being specialist the Judge's comments regarding the mistaken misapprehension had unfortunate consequences.

*Dale Services Contracts Ltd v Revenue and Customs Comrs TC 1985*

# VAT

## Too late to join

The taxpayer applied to join the VAT flat rate scheme in February 2011. She requested that it be retrospective from March the previous year. HMRC informed her the start date would be December 2010, explaining it could not apply before that date because she had already calculated her VAT using the normal accounting rules for the earlier periods.

The taxpayer claimed there were exceptional circumstances as to why the flat rate scheme application should be backdated: her husband worked with her in the business, and she had to take over his duties when he became seriously ill. In addition, she had to help care for her and her husband's elderly parents.

She had relied on an accountant to apply for the flat rate scheme, but he had not done so, so she had changed to an adviser who made the application.

HMRC sympathised with the taxpayer but said reliance on a third party did not constitute exceptional circumstances.

The taxpayer appealed.

*Decision:*

The First-tier Tribunal found the late application was due to the first accountant's inefficiency, and agreed with HMRC that there were no exceptional circumstances. According to the evidence, the benefit to the taxpayer of being in the flat rate scheme would have been minimal, largely as a result of exempt supplies made by the taxpayer.

Her appeal was dismissed.

**Comments -** HMRC view the flat rate scheme as tax-neutral with timesaving, rather than tax-saving, benefits; if a VAT return has already been submitted by a business on the basis of normal VAT accounting, it is impossible to save time with the retrospective adoption of the scheme. Independent VAT consultant Neil Warren said, 'HMRC policy is clear that belated tax savings are not an “exceptional” factor to allow a business to join retrospectively. The message is plain: accountants need to monitor the benefits of a client joining the scheme on an ongoing basis, to ensure potential windfalls are not lost.'

*JMB Wilmington (TC1975)*

## Education: definition of 'eligible body'

A company (L) provided computer tuition. Initially it accounted for VAT on its supplies, but it subsequently submitted a repayment claim on the basis that it should have treated them as exempt supplies of education. HMRC rejected the claim on the basis that L was not an eligible body. L appealed, contending that it had an 'articulation agreement' with Middlesex University and should therefore be treated as a college of that university.

*Decision:*

The First-tier Tribunal dismissed the appeal. Judge Walters held that the agreement would have been capable of constituting L as a college of the university, provided that the arrangements 'were as a matter of fact rendered a reality by the student careers of (L's) students, taken as a whole'. On the evidence, it appeared that only a minority of L's students actually progressed to study at the university, so that it could not be said that L's 'fundamental purpose' was to provide education services leading to the award of a degree at the university. Accordingly L had not in fact qualified as an 'eligible body'.

**Comments -** VATA 1994 Sch 9 Group 6 Item 1 provides that supplies of education qualify for exemption, where the supplier is an 'eligible body'. An eligible body is defined, at some length, by Sch 9 Group 6 Note 1. Note 1(b) provides that an 'eligible body' includes 'a United Kingdom university, and any college, institution, school or hall of such a university'. The First-tier Tribunal upheld HMRC's view that the company here did not qualify as a college of Middlesex University. Judge Walters held that the agreement between the company and the university could have established the company as a college, provided that a majority of its students had proceeded to study for a degree at the university. However, on the evidence, that was not the case, and only a minority of the company's students actually went on to study at the university.

*London College of Computing Ltd v HMRC TC2028*

## Application for late appeal

Section 83G(1) of the Value Added Tax Act 1994 provides, so far as material: "[(1) An appeal under section 83 is to be made to the tribunal before — (a) the end of the period of 30 days beginning with— (i) in a case where P is the appellant, the date of the document notifying the decision to which the appeal relates ...(6) An appeal may be made after the end of the period specified in subsection (1), (3)(b), (4)(b) or (5) if the tribunal gives permission to do so....]".

In May 2006, the taxpayer submitted a VAT return for the period covering February to April 2006, declaring input tax of approximately £9·8m. In March 2008, the respondent Revenue and Customs Commissioners (the Revenue) notified the taxpayer of its decision to deny it the right to deduct input tax in relation to certain transactions on that return. The taxpayer appealed that decision to the VAT and Duties Tribunal. On 28 April 2009, the Revenue prepared a letter headed "Notification of Decision to Deny Input tax". There was an issue as to whether the letter of 28 April was received by the taxpayer at that time. In February 2010, the Revenue wrote to the taxpayer's tax adviser in relation to the appeal against the decision notified by the letter of the March 2008, referring to the letter of 28 April 2009. On 1 March 2010, the taxpayer's tax adviser emailed the Revenue stating that the taxpayer had not received the letter of 28 April 2009 (28 April), and asking for a copy. A copy of the letter was received by the taxpayer on 8 March 2010. The Revenue then advised that if the taxpayer was to appeal the decision notified by the letter of 28 April, the taxpayer would have to apply for an extension of time to appeal and the Revenue would expect such an application to be accompanied by a full explanation of the reasons for the appeal being brought out of time.

On 25 March 2010, the taxpayer sent to the First-tier Tribunal (FTT), a notice of appeal in relation to the decision of 28 April. That notice was defective and was returned to the taxpayer. On 9 April 2010, the taxpayer issued a revised notice of appeal. The revised notice of appeal was issued by the FTT shortly thereafter. The revised notice referred to the letter of 28 April. On 12 May 2010, the Revenue served a detailed notice of objection to the application for an extension of time to appeal. The taxpayer's application for extension of time was listed for hearing on 16 July 2010, (the hearing). The Revenue wrote to the taxpayer's tax adviser to ask whether the taxpayer intended to rely on any witness evidence or documents. The taxpayer's adviser stated that he would provide a brief statement from V which would state that the taxpayer did not receive the letter of 28 April. V was expected to be available to give oral evidence at the hearing. On the date of the hearing the taxpayer's tax adviser emailed HMRC with a copy of a statement by V and stated that V was not available to attend the hearing by reason of a pre-arranged holiday. Both the taxpayer and the Revenue were represented by counsel and no application for an adjournment was made. The taxpayer accepted that it had the burden of showing that the letter of 28 April had not been received. The FTT considered CPR 3.9 and the overriding objective. It did not accept that the taxpayer had not received the letter of 28 April at around the time it was sent.

Further it was not satisfied that the taxpayer had advanced persuasive reasons as to why time to appeal should be extended; and it was not satisfied that the taxpayer had acted with due diligence in and after March 2010.

The issues were, inter alia, whether there was a good explanation for the delay in making the application for the extension of time and; what would be the consequences for the parties of a refusal to extend time.

*Decision:*

The approach of considering the overriding objective and all the circumstances of the case, including the matters listed in CPR 3.9 was the correct approach to adopt in relation to an application to extend time pursuant to s 83G(6) of VATA 1994.

In the instant case, the FTT had adopted the approach of considering all the circumstances including the matters specifically mentioned in CPR 3.9. That was the correct approach. The FTT had not refused an extension just because there was no good explanation for the delay. It had considered all the circumstances. More specifically, it had considered the overriding objective and the matters listed in CPR 3.9. The decision made by the FTT had been a decision which had been eminently open to it and should not be characterised as perverse.

The appeal would be dismissed.

**Comments –** The Upper Tribunal upheld the principles laid down by the CA in Smith v Brough and held that the First-tier Tribunal had been entitled to decline to admit an application for a late appeal.

*Data Select Ltd v Revenue and Customs Comrs [2012] UKUT 187 (TCC)*

## Second-hand goods: margin scheme

In Bawaria Motors v Minister Finansow (CJEU Case C-160/11), Advocate-General Mazák expressed the Opinion that Article 314 of Directive 2006/112/EC 'must be interpreted as precluding application of the special margin scheme for taxable dealers in relation to the resale of second-hand passenger vehicles and other motor vehicles purchased from taxable persons who, upon the acquisition of those vehicles, exercised a right to deduct part of the input tax on the purchase'.

**Comments -** Chapter 4 (Articles 311—343) of Directive 2006/112/EC provides special arrangements for second-hand goods, works of art, collectors' items and antiques. Article 313 provides that where such goods are supplied by 'taxable dealers', Member States shall apply 'a special scheme for taxing the profit margin'. Article 314 provides that this scheme shall apply where such goods have been supplied to the taxable dealer by a non-taxable person, or by a taxable person in certain specified circumstances. The Advocate-General expressed the Opinion that the margin scheme did not apply to the resale of second-hand vehicles which had been purchased from taxable persons who deducted input tax on the purchase. It seems likely that the CJEU will uphold his Opinion.

*Bawaria Motors v Minister Finansow (CJEU Case C-160/11)*

## Planning permission granted retrospectively

An individual (F) obtained planning permission from Barnet Council for the construction of a single-storey extension to an existing building. While the work was in progress, he discovered that the walls of the existing building were not strong enough to support the proposed extension, so he demolished the existing building and rebuilt it in accordance with the plans. He subsequently obtained retrospective planning permission from Barnet Council. He claimed a refund of VAT under VATA 1994 s 35. HMRC rejected the claim on the basis that the effect of the tribunal decision in MJ Watson v HMRC [2010] UKFTT 526 (TC), TC00780, was that for the purpose of VATA 1994 s 35, planning permission could not be retrospective.

*Decision:*

The First-tier Tribunal allowed F's appeal. Judge Kempster specifically distinguished Watson v HMRC because in that case the council had not made the planning permission retrospective to the start of the work, whereas in this case Barnet Council had done so.

**Comments -** The First-tier Tribunal specifically rejected HMRC's contention that, for the purposes of VATA 1994 s 35, planning permission could not be retrospective. The decision here limits the scope of the 2010 decision in MJ Watson v HMRC, which HMRC has cited as an authority.

*M Francis v HMRC (TC02045)*

## Charity providing welfare services for sick animals

A charity provided free medical or surgical treatment to animals whose owners could not afford to pay for a veterinary surgeon. In 2009 it claimed a repayment of input tax, backdated to 1993, on the payments it had made for veterinary services. HMRC rejected the claim, considering firstly that the relevant supplies were not an 'economic activity', and additionally that the vets had supplied their services to the owners of the animals, rather than to the charity.

*Decision:*

The First-tier Tribunal dismissed the charity's appeal against this decision, specifically distinguishing the earlier decision in Royal Society for Prevention of Cruelty to Animals [1991] VATTR 407 (VTD 6218), on the grounds that in that case the owners of the pets had been 'given a bill for the cost of the treatment and expected to pay for it or at least make a contribution'. Judge Tildesley held that the arrangements here 'did not involve the appellant in the making of taxable supplies'. He observed that the conclusion 'that the pet owner is the recipient and the consumer of the veterinary supplies results in a position which conforms to the common system of VAT. The pet owner as final consumer is not entitled to recover the VAT incurred on the supplies, and the economic relationship between cost and price in the transaction chain is upheld.'

**Comments -** The First-tier Tribunal upheld HMRC's view that the charity was not entitled to reclaim the input tax relating to the fees which it paid to the vets, on behalf of the owners of the animals. Judge Tildesley specifically distinguished the 1991 decision in Royal Society for Prevention of Cruelty to Animals, where the owners of the pets had contributed to the cost of the treatment.

*People's Dispensary for Sick Animals v HMRC (TC02048)*

## Supplies of disposable barbecues

A company (W) sold disposable barbecues. It accounted for VAT at the standard rate. It subsequently submitted a repayment claim on the basis that it should have treated part of the consideration as attributable to supplies of charcoal and as taxable at the reduced rate. HMRC rejected the claim and W appealed.

*Decision:*

The First-tier Tribunal dismissed the appeal, applying the principles laid down in Card Protection Plan Ltd [1999] STC 270. Judge Cannan held that 'it is not open to a taxpayer to carve out an element of what would otherwise be treated as a single supply in order to apply a reduced rate to that element of the supply'.

**Comments -** The First-tier Tribunal upheld HMRC's view that sales of disposable barbecues were chargeable to VAT at the standard rate, and rejected the company's view that it should be treated as making separate supplies of charcoal.

*WM Morrison Supermarkets Ltd v HMRC (TC02052)*

## Medical services supplied to potential emigrants

The Australian Department of Immigration established a panel of doctors, and required applicants for Australian visas to undergo a medical examination by one of these doctors. Two UK doctors were appointed to this panel, and provided such medical examinations in the UK. HMRC issued assessments on the basis that the doctors were required to account for UK VAT on the payments they received for these services. The doctors appealed, contending that their supplies fell within VATA 1994 Sch 5 para 3 and that they were supplying their services to the Australian Department of Immigration, rather than to the individual applicants.

*Decision:*

The tribunal rejected these contentions and dismissed the appeals. Judge Brooks held that the supplies did not fall within Sch 5 para 3, so that they were supplied where the doctors belonged, which was in the UK. Furthermore, the supplies were made to the individual applicants rather than to the Australian Department of Immigration.

**Comments -** The First-tier Tribunal upheld HMRC's view that the doctors were required to account for UK VAT on the fees which they charged for providing medical examinations to people wishing to emigrate to Australia.

*Dr N Stanley v HMRC (and related appeal) (TC02059)*

## Administrative advantage

The taxpayer company registered for VAT and joined the flat-rate scheme (FRS) from 1 June 2007. An HMRC inspection in 2011 found errors in the company's VAT returns, including the calculation of the liability based on net as opposed to gross turnover. As a result, they raised an assessment for additional VAT of £4,958.

The taxpayer company sought to withdraw from the FRS retrospectively. Mr Yeabsley, appearing for the company, explained that he had not understood the workings of the scheme and should not have entered into it. The request for retrospective withdrawal was refused, with this confirmed by an internal HMRC review.

Under the VAT Regulations 1995, reg 55, traders may opt to withdraw from the scheme and withdrawal can be retrospective with HMRC agreement. The First-tier Tribunal heard that withdrawals are only backdated 'exceptionally', and that in HMRC's view no exceptional reasons applied in this case.

*Decision:*

The tribunal expressed 'a measure of sympathy' for Mr Yeabsley, but stated that it was his responsibility to assess the full implications of joining the FRS. Additionally, had his VAT returns been completed accurately, he may have realised that the scheme was not advantageous to the company.

The tribunal noted that the taxpayer company had benefited from simplified administration, and this, rather than a reduction in tax liability, was the purpose of the scheme. There was also no suggestion that the taxpayer company had been treated unfairly. On these grounds, the appeal was refused.

**Comments -** Independent VAT consultant Neil Warren said: 'It is still a common error for clients to think that the scheme calculations are based on net rather than gross turnover. In some cases, a business knows the correct rule but makes calculation errors because of a spreadsheet mistake. It is important that advisers check the calculation method when producing year-end accounts for a client, especially as HMRC have a four-year power of assessment if errors have been made over a long period of time.'

*Yeabsley Financial Solutions Ltd TC2044*

## Entertainment v subsistence – input tax issues (Lecture B729 – 12.51 minutes)

There is often confusion about the input tax rules on food, drink or other items involving hospitality supplied to either staff members or non-staff members. The basic principle is that there is no problem with an input tax claim relating to food and drink provided for staff but hospitality provided for non-staff tends to be blocked under the rules of business entertainment. I will clarify the rules with a practical example.

*Example*

John is the audit partner in a two-partner firm of accountants. When working at clients' premises, he often visits restaurants for lunch, usually accompanied by whichever member of the audit team is working with him on the day, and usually one or two directors of the company that he is auditing at the time. Can input tax be claimed on the lunch costs? Would the situation be any different if the clients were from outside the UK?

*Solution*

In effect, there are three different categories of people involved in this arrangement:

- Business owner
- Employee
- Customer

*Customer*

The first key point is that no input tax deduction can be made for the 'customer' meals. The expense here is classed as 'hospitality of any kind' and therefore treated as business entertainment within the VAT regulations. The only exception would be if the customer was an 'overseas customer' and the expense related to a 'business meeting' in which case input tax could be claimed on the meal cost, without any output tax liability against the partnership – see below for further analysis on this point.

*Employee*

It needs to be considered whether the employee expense is being incurred because he is 'acting as host' to the customer, in which case input tax is also blocked on the cost of the employee lunches i.e. through the business entertaining rules. However, if (as seems likely) the meal cost for the employee is being incurred because he is away from the office on a business related job (the audit), then input tax can be claimed because the expense is classed as 'subsistence' rather than 'entertainment'. Input tax would also be claimable if the employer paid for hotel accommodation for the employee as well.

There is also no problem (for input tax purposes) in an employer paying for employee meals generally e.g. the cost of the office Christmas party, a meal out at a local restaurant following a good trading month. In such cases, the expense is seen as a reward for hard work/motivational expense and is for a clear business purpose. It is only input tax on entertaining non-employees that is blocked (or employee costs where they are clearly acting as hosts).

As a practical example of how the rules can get tricky, what is the situation when a company hires e.g. a 12-seater box at a top football match, which will be enjoyed by 6 employees and 6 non-employees. In this situation, at least 50% of the input tax on the cost of the box will be blocked by the business entertaining rules for the non-employees, and it then needs to be considered what role the employees are expected to carry out on the day of the match. If their function is to make sure the guests have an enjoyable time, and place lots of future orders with the company, then input tax on the employee expenses will also be blocked because they are acting as host to the non-staff. But if they are able to enjoy the game without any entertaining function, then input tax can be claimed on their part of the cost.

*Business owner*

Input tax can be claimed on the lunches for the business owner, as long as they are classed as 'subsistence' – usually indicating a business purpose that is away from the main trading premises of the business (HMRC Notice 700, para 12.1.2). As a guideline, a claim should not be a problem if the business meeting/audit work is at least five miles away from the main trading base.

There is also no problem in claiming input tax on the costs of meals for business owners where entertainment is available to staff generally within the firm e.g. the office Christmas party. But there would be a problem if the proprietor or partner entered his own local restaurant meals into his records and claimed input tax.

In the case of the meal in the example being considered, the same situation would apply to the owner's meal as with the employee i.e. as long as it is a subsistence cost rather than a meal to entertain the client, then an input tax claim is not a problem.

*Entertaining overseas customers*

An ECJ case verdict in 2010 led to HMRC reviewing its policy on whether a UK business can claim input tax on entertaining overseas customers. The legislation to implement the change took effect on 1 May 2011 (Value Added Tax (Input Tax) (Amendment) Order 2011 (SI2011/1071) but a business can go back four years and make a backdated claim if it is eligible to do so after taking the points below into account.

A block in claiming input tax on entertaining overseas customers has applied in the UK since 1985 – but this block was incorrect, so input tax can now be claimed on such expenses. However, it is not all good news:

- Although input tax can be claimed on any entertaining of overseas customers, a 'private use' output tax charge will apply if the entertaining is <u>not business related</u> and is <u>not classed as being necessary to the making of taxable supplies</u> (defined as a 'necessity test' and a 'strict business purpose test').

It means that limited hospitality provided at a business meeting to discuss business related matters with overseas customers is not a problem – but an output tax charge will apply if the gathering is not specifically linked to business e.g. a day at the races or trip to a show. HMRC also expect a business to only recover input tax (with no output tax charge for private use) if the entertaining 'is clearly used for the making of taxable supplies as well as being **reasonable in scale and character**.'

Note – 'reasonable in scale and character' seems to indicate that even if entertainment is provided at a qualifying business meeting, it cannot be excessively lavish e.g. tea and biscuits rather than champagne and caviar.

- Be aware that the potential input tax claims only relate to overseas 'customers' – there is no scope to make a claim in relation to overseas suppliers or other business contacts based outside the UK.

- HMRC list 'corporate hospitality events' such as golf days, trips to sporting events and night clubs, track days and evening meals as events where an output tax charge will be needed because the entertaining is not essential to the making of taxable supplies.

**Further information**: HMRC Business Brief 44/10 (November 2010)
**Relevant ECJ Case** – *Danfoss/Astra Zeneca* (Case ref: C371/07)

Message - the opportunity to make substantial input tax claims on entertaining overseas customers is very limited.

*Planning tip – make a charge for guests and spouses*

Imagine that a firm has booked a venue for the office Christmas party – it has been agreed that the firm will pay for both the employees and their spouse/partner to attend free of charge. In such cases, input tax is blocked on the meals/costs relevant to the spouses. However, if a small charge was made for their meal e.g. £5 per head, the input tax would now be claimable on the guest meals as well. This is because there is no 'free hospitality' being provided if a charge is made i.e. the business entertainment rules do not apply. However, output tax must be declared on all of the £5 payments received from the guests.

*Contributed by Neil Warren*

## Flat rate scheme – input tax opportunities (Lecture B730 – 17.05 minutes)

The flat rate scheme (FRS) was introduced in 2002, with the aim of simplifying the record-keeping requirements of a small business in relation to VAT.

The basic principles of the FRS are as follows:

- it is only available to a small business with VAT exclusive annual taxable turnover < £150,000.

- instead of paying VAT based on output tax less input tax, a business will apply a given flat rate percentage to its gross (VAT inclusive) business income – the percentage is based on the category of business to which it belongs. The business still charges VAT to its customers in the normal way. It does not reclaim input tax – apart from in the case of capital goods in some cases.

***Example***

James has taxable sales of £149,000 per year (all standard rated) and very little input tax to claim (£500 per year). If he adopted the FRS, he would qualify for the 12% rate (other business services). Should he use the scheme?

With the FRS, James' annual VAT bill will be calculated as follows:

Gross turnover (£149,000 x 1.2) x 12% flat rate = £21,456

Under normal VAT accounting, his VAT bill would be:

Output tax (£149,000 x 20%) = £29,800

Deducting the input tax suffered of £500 gives VAT payable of £29,300.

The net VAT saving to James is £7,844 (£29,300 less £21,456).

Note - the two reasons why the FRS produces such a good deal in the above example is because the nature of the business means that James has very little input tax to claim and also his activity does not have its own FRS category and benefits from the generous rate of 12%.

*Input tax issues and 1% discount for new business*

A scheme user does not generally claim input tax, the main exception being in relation to capital goods costing more than £2,000 including VAT. The reason for the principle of input tax not being claimed by a scheme user is because the flat rate percentages are adjusted by HMRC to reflect the 'average' input tax incurred by a typical business for the trade category in question. So the reason why the flat rate percentage for a publican is 6.5% compared to 14.5% for accountants is because pubs have higher input tax (goods for resale) compared to a service type business such as an accountant.

Be aware that a scheme user can also reclaim input tax on pre-registration expenditure on its first VAT return (if it uses the scheme from when it first registers for VAT) in the same way as a non-scheme user.

Final planning point – a scheme user gets a 1% discount on his relevant flat rate category in his first year of VAT registration i.e. 13.5% for an accountant. If a business joins the scheme part way through its first year of VAT registration, it gets the 1% discount for the balance of the first year (HMRC Notice 733, para 4.5).

Note – the pitfall in relation to the 1% discount is to think that a scheme user gets the discount for the first year he uses the scheme. This is not correct – it is only in his first year of VAT registration. So if a business joins the scheme more than twelve months after its date of VAT registration, there is no scope to take advantage of the 1% discount.

*Input tax on capital goods (£2,000 limit)*

There is good news in relation to the £2,000 limit. HMRC has confirmed that the limit is met if two (or more) different assets are purchased on the same purchase invoice as long as the total invoice value in relation to capital goods exceeds £2,000.

HMRC Notice 733, para. 15.3 – gives a useful example in relation to kitchen equipment:

**"Items of kitchen equipment** (a pizza oven, a fridge and a dishwasher) bought for a restaurant. If all the items are from one supplier at one time, then they count as one purchase of capital expenditure goods. If they are from three different suppliers or at three different times then they will be three purchases and each must be £2,000 or more (including VAT) to qualify for a reclaim of VAT."

*Example*

John purchases three laptops on the same invoice, each costing £900 plus VAT. One of the laptops will be immediately sold for a profit and the other two will be used in his business as assets. He is VAT registered and uses the FRS. Can input tax be claimed on the computers?

The first laptop is not an asset. However, the other two computers will qualify for input tax deduction because the total amount on the invoice (£2,160 including VAT) exceeds £2,000.

Don't forget that input tax cannot be claimed on capital expenditure if it relates to services, e.g. building work. This was confirmed in the tribunal case (*Sally March v HMRC* [2009] UKFTT 94 (TC)) where VAT paid by a business that was building a new riding arena for a riding school did not qualify for an input tax claim within the scheme. This is because the supplies in question were of ‘building services’ rather than ‘capital goods’. The bricks and materials bought in relation to the project were also excluded from any input tax claim.

*HMRC Notice 733, para 15.4: What counts as goods and services?*

- **A van leased/hired to your business**, counts as one continuous supply of services, as ownership will never transfer to your business.
- **A van bought on hire purchase** is a supply of capital expenditure goods because ownership will eventually transfer to your business. If this cost £2,000 or more (including VAT) then input tax can be claimed.
- **A builder builds an extension** to his business premises supplying all materials himself and including their cost in his final bill. No VAT is claimable, as this construction is a supply of services, not of capital expenditure goods.

Where capital goods are bought with the intention of generating income from them either directly (e.g. boats for hire on a boating lake) or indirectly (e.g. a company van used for deliveries during the week and hired out at weekends), then they are not capital expenditure goods no matter how much they cost.

(HMRC Notice 733, para. 15.7).

*Input tax on pre-registration expenditure*

A business can claim input tax on its first VAT return on pre-registration expenditure if it uses the scheme, in exactly the same way as a non-scheme user. This statement is confirmed in the legislation at VAT Regulations 1995, SI1995/2518, Reg 55F (Exceptional claims for VAT relief), which confirms the same pre-registration input tax claims are available to a scheme user as a non-scheme user in Regulation 111 of the same regulations.

The scope of a claim is as follows:

- Input tax can be claimed on goods (stock) and assets bought by a business within the four year period before the date of VAT registration, which are still owned by the business at the date of VAT registration and used in the business. The four year limit took effect in April 2009, the previous cap being three years

- The time period for services is limited to six months before the date of VAT registration

Note – HMRC Notice 733, para 7.6 makes a partial recognition of the above opportunity in relation to ‘stock and assets’ but is silent (for some reason) on the scope to claim input tax on services in the six-month period before the date of registration. But HMRC’s FRS Policy Team has confirmed to me that they approve a claim on services as well (correctly).

*“7.6 Can I recover VAT on stock and assets I have on hand at registration?*

Yes. Record the claim for eligible VAT in your VAT account for your first VAT return. For details of the rules for claims, see Notice 700/1 Should I be registered for VAT? If you do claim VAT on capital assets on hand at registration and dispose of them later, you must account for VAT at the standard rate of VAT under the normal VAT rules.”

*Input tax apportionment not needed for private use*

To help simplify the flat rate scheme, where VAT on capital expenditure goods is reclaimable (costing over £2,000 etc), the intended use of those items is treated as wholly for taxable supplies i.e. even if there is partial use of the asset for private, non-business or exempt use that would normally lead to a partial input tax block.

*Example at HMRC Notice 733, para 15.8:*

If employees are allowed free use of the company van at weekends to move goods or a business video camera is used free by a friend of the proprietor to video a family wedding, then there is no restriction of input tax or payment of output tax under the flat rate scheme.

*Selling an asset when input tax has been claimed*

If input tax has been claimed on an asset, either because it was bought before the business joined the scheme (or through a pre-registration input tax claim), or because it qualified with the £2,000 limit, then the sale proceeds are excluded from the scheme calculations and the full amount of output tax charged on the asset sale is included in Box 1 of the VAT return in the normal way. This is reasonable because it ensures a business cannot gain a tax advantage by buying and selling an asset with different VAT rules.

*Example at HMRC Notice 733, para 15.9:*

- **A business on the scheme buys a delivery** van for £6,000 inc VAT of £1,000 and it is not used for anything else. As the van is capital expenditure goods, VAT can be reclaimed. When the business later sells or part exchanges the van, say for £2000, it must account for the VAT on this amount at 20%, not at the flat rate.

**Note**: If you have not claimed input tax on capital items, either by choice or because it was not allowed, you must include the sale of those items in your flat rate turnover.

*Final example – selling a business car*

The sale of goods on which input tax was blocked when purchased by a business represents an ‘exempt’ sale (VATA1994, Sch. 9, Group 14) – the main example being a new motor car that is available for private use. Exempt sources of income are included in the flat rate scheme calculations:

*Example*

John is VAT registered as a sole trader (accountant) and uses the flat rate scheme. On 30 June, 2009, he purchased a motor car for £10,000 plus VAT – he could not claim input tax on the purchase of the vehicle (even though it cost more than £2,000) because it was available for John’s private use.

John sold the car in July 2011 for £3,000 – VAT of £435 is payable by John on the VAT return relevant to July (included within Box 1 figure), even though he has not charged the buyer VAT. The selling price of £3,000 is subject to 14.5% VAT with the flat rate scheme i.e. based on the flat rate percentage relevant to an accountant.

*Contributed by Neil Warren*