TAX UPDATE

Tolley®CPD

October 2012

Disclaimer

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

All rights reserved. No part of these notes may be reproduced or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of Tolley CPD.

Tolley®
Tax intelligence from LexisNexis®

CONTENTS

PERSONAL TAX		4
Benefits through a partnership – The Cooper case	(Lecture P738 – 9.52 minutes)	4
Pool car when working from home?		5
Tax-free sum on termination of employment?		5
Tax-free sum post termination of employment		6
Payment in lieu of notice or compensation?		7
Bank employee receiving mortgage		7
Repayment of voluntary class 3 contributions?		7
Pensions auto enrolment	(Lecture P736 – 10.03 minutes)	8
French tax issues for holiday home owners	(Lecture P737 – 5.21 minutes)	11
CAPITAL TAXES		**12**
What qualifies for rollover relief?		12
Not so 'bootiful' – Who pays the tax?	(Lecture P737 – 5.21 minutes)	12
Market value of loan notes on conversion		13
Charitable relief not due		13
New SDLT disclosure rules		14
Business property relief and FHLs	(Lecture P739 – 12.55 minutes)	14
ADMINISTRATION		**16**
Finance Bill 2013		16
FATCA		16
Mutual assistance between HMRC & South Africa Revenue Service		16
Special circumstances for penalty reduction		17
More evidence required from HMRC		17
Failure to account for PAYE		17
Surcharge on tax paid late		18
Application for disclosure of documents		18
The GAAR, anti-avoidance and more	(Lecture P740 – 10.37 minutes)	18
Real time in the real world	(Lecture B736 – 8.39 minutes)	21
BUSINESS TAX		**23**
Latest goodwill issues on incorporation	(Lecture B737 – 9.05 minutes)	23
SEIS guidance from HMRC	(Lecture B738 – 12.36 minutes)	24
Whether loans made to participators		27
Freedom of establishment		27
Compensation on post office closure		27
Compensation or trading receipt?		28
Availability of capital allowances?		28
Who is a qualifying person for AIA purposes?		29
Costs of defending ownership of business		29
Contribution to legal costs incurred by parent company		30
Prepayments of interest		30

VAT **32**
UK courts to decide 32
Do not rely on others 32
Public houses: option to tax 33
Misunderstanding the option 33
Penalty mitigated by 100% 34
Partnership introducing clients to fund managers 34
What is the supply - goods or services? (Lecture B739 – 19.24 minutes) 34
Bad debts and credit notes (Lecture B740 – 14.38 minutes) 37

Tolley® Tax intelligence from LexisNexis®

PERSONAL TAX

Benefits through a partnership – The Cooper case (Lecture P738 – 9.52 minutes)

Benefits 'made available'

Can benefits-in-kind (e.g. cars and car fuel) provided by one business be treated as 'made available' by reason of an individual's employment with another, related business?

In the case of company cars, *ITEPA 2003, s 114(1)* provides:

"*(1) This Chapter applies to a car or a van in relation to a particular tax year if in that year the car or van—*

> *(a) is made available (without any transfer of the property in it) to an employee or a member of the employee's family or household,*
>
> *(b) is so made available by reason of the employment (see section 117), and*
>
> *(c) is available for the employee's or member's private use (see section 118).*"

Similarly, the provisions treating car fuel provided for private use as a benefit-in-kind (*ITEPA 2003, s 149*) applies (*inter alia*) where fuel is provided for the car by reason of the employee's employment.

What if (say) the car is provided through a partnership, of which the company's director or employee (or a family member) is a partner?

Car and fuel provided through a partnership

In *Cooper & Ors (Leaside Timber & Builders Merchants Ltd) v Revenue & Customs* [2012] UKFTT 439 (TC), four individuals were partners in CMS (DJC, PDC, SC and NC). Of those partners:

- DJC and PDC were directors of Leaside Timber & Builders Merchants Ltd (L Ltd);
- SC is DJC's wife; and
- NC is DJC's son.

CMS provided administrative and personnel services to the company. CMS also provided cars and car fuel to the partners. The cars were owned (outright or under hire purchase terms) by CMS and not by L Ltd, and were used for business and private purposes. CMS's management charges to L Ltd for the administrative and personnel services covered CMS's costs, including the cars and car fuel.

HMRC assessed L Ltd to Class 1A NIC, and also charged DJC and PDC income tax in respect of car and car fuel benefit (DJC was also assessed in respect of the cars and car fuel provided to SC and NC, as members of his family or household). The assessments were for a number of years, and the tax at issue was substantial (around £70,000 for L Ltd and £145,000 for the individuals). The individuals and L Ltd appealed, arguing that the cars and fuel were received by reason of their being partners in CMS, and not in DJC's and PDC's capacity as directors of L Ltd.

The tribunal noted, on the authority of *Wicks v Firth* and *Johnson v Firth* ([1983] 56 TC 318), that a benefit in kind can be provided (or made available) by an entity which is not the employer of the person enjoying the benefit. The tribunal also noted that CMS had no business other than providing services to the company, and considered that the partnership's management fees were excessive on the basis of what would be commercially reasonable in dealings between independent parties acting at arm's length. It commented:

> "Taking the arrangements in their entirety, and having regard to the relationships between the parties, the Company was, at the least, complicit in the provision of the cars and the car fuel to the Individual Appellants."

The Tribunal's view was that CMS would not have existed in a commercial sense but for L Ltd, its only customer, and added:

> "The benefit of the cars and the car fuel was provided by CMS, but we are compelled to conclude that it would not have been so provided were Mr D J Cooper and Mr P D Cooper not directors of the Company. The fact of their employment was one of the causes - and we would say the dominant cause - of the benefit being provided by CMS to the Individual Appellants."

It was argued for the appellants (among other things) that there would be an element of double taxation; once because the individuals were taxable on their partnership profit shares, and once under the benefit-in-kind provisions. However, the tribunal commented:

> "if there is an element of double taxation, it arises not by reason of any discretionary powers conferred upon the Commissioners, or by reason of any ambiguity in the terms of the relevant provisions, but because the parties concerned have voluntarily chosen, upon advice, to arrange their affairs in a particular

way. They have to live with the consequence of that."

The appeals were dismissed.

Conclusion

Whilst decisions of the First-tier Tribunal do not carry the force of law, they can be persuasive in similar cases. It is not known whether the *Cooper & Ors* case is being appealed, but it seems likely that HMRC will take the opportunity to challenge structures involving partnerships (including LLPs) providing management services to related companies in circumstances involving cars being provided to partners, unless there is a clear commercial rationale for both the provision of the cars, and for the level of management charges.

Contributed by Mark McLaughlin

Pool car when working from home?

New Image Training was formed in 2002 to run hairdresser training courses. These took place initially mainly in schools, colleges and salons. The company's registered office was also the home of the sole owners, Mr and Mrs E, but no training took place at that address. In 2005, new premises at South Street were bought for the business, and subsequently a lot of training was carried out there.

A car purchased in 2004 was kept at the registered office address and used solely for business purposes; private use of the car was not allowed. HMRC said that the car was available for private use as Mr E used it to drive from his home to the office in South Street. The taxpayer appealed, saying that his home address was his main place of work.

Decision:

The First-tier Tribunal decided that the main issue to consider was whether or not the registered address was where Mr E conducted his business. The judge noted that ITEPA 2003, s 339 allows an employee to have more than one permanent workplace at the same time. In this instance, Mr E undoubtedly worked at the business premises in South Street, but maintained, for example, a desk, computer and a business telephone at his home address. People expected to be able to contact him at both locations, and there was evidence that HMRC had contacted him at his home address.

The tribunal concluded that both addresses were Mr E's places of work and that the car was used for business purposes. Furthermore, the judge accepted Mr E's assertion that the car was a pool car and not used for private journeys.

The taxpayer's appeal was allowed.

Comments – This is an interesting case in that it deals with two different aspects of the employment tax legislation – that of travelling expenses being incurred and the treatment of a company car and the tax consequences flowing from that. In the changing environment many people run businesses or companies from a home address and this case also embodied similar facts. The car was unfortunately only used for business purposes and it would have been better if the use of the vehicle had been further explored.

New Image Training Ltd TC2146

Tax-free sum on termination of employment?

In September 2006 the appellant took up employment at a start-up company ("S") as Chief Operating Officer, on a basic salary, before deductions, of £165,000 per annum. Under cl 21.3 of the employment agreement—dealing with termination payments in lieu of notice for any reason other than performance or conduct related issues—S "agreed to make … within 14 calendar days of the Termination Date equivalent to (a) the basic salary that would have been paid to [the appellant] by the Company; and (b) the cost to the Company of providing [the appellant] within any private medical insurance … during (in each case) a 12 month period of notice". On 26 June 2007 S terminated the appellant's employment without notice. Following negotiations, the parties agreed under a compromise agreement, dated 27 July 2007, that S would pay the appellant £123,175 "by way of payment in lieu of notice, which shall be subject to deductions for income tax and employee's national insurance contributions (as required by law)", payable in three instalments. S made the payments under the compromise agreement but deducted income tax from the whole of the £123,750. In his self-assessment return, the appellant reclaimed the tax deducted on payment of the first £30,000 on the basis it was a payment on termination of employment within ITEPA 2003 s 403(1). HMRC disallowed the claim on the basis that the payment of £123,750 was "earnings" within the general definition of ITEPA 2003 s 62 and thus within the charge to tax on employment income provided by ITEPA 2003 s 9(2). The appellant appealed on the basis that the £123,750 was not paid under cl 21.3 of the agreement which had terminated; the source of the payment was the settlement of his claims against S for wrongful dismissal in breach of contract.

Decision:

The negotiations in the present case were aimed at enforcing, to the maximum extent attainable in the circumstances, the appellant's contractual

entitlement under cl 21.3 of the agreement. The appellant was unable as a practical matter to obtain full enforcement of that contractual entitlement and was obliged to (and did) settle for less. He settled for less rather than entering into litigation to enforce his full contractual entitlement. There was no real force in the contention that he was settling a dispute as to whether or not his employment had been terminated for performance issues; it was simply an aspect of the negotiations about enforcement of that entitlement. If the appellant's argument were correct, it would be open to anyone entitled to a contractual payment in lieu of notice to accept less in settlement of his claim to enforce the contractual entitlement, and thus achieve exemption from tax under ITEPA s 403 in respect of the first £30,000. That would not be a sensible result consistent with a purposive interpretation of the legislation. Accordingly the £123,750 payment made under the compromise agreement was not in any realistic sense damages for S's breach of the agreement. Therefore the payment was “earnings” within ITEPA 2003 s 62. It followed that the appeal would be dismissed.

Appeal dismissed.

Comments – The treatment of a termination payment or its components requires careful analysis as there many provisions that could come into play. One of the most crucial distinctions in determining the provision applicable is the determination of whether the payment are earnings or other sums being received. The application of various exemptions are in Part 6 Chapter 3 of ITEPA 2003 and therefore may not be relevant if the sums are assessed under the “wrong” provisions. This case demonstrates well that distinction.

B Goldman v Revenue and Customs Comrs TC 1999

Tax-free sum post termination of employment

The taxpayer, a UK citizen, was marketing director for a US timeshare company owned by a married couple.

The couple divorced in 1989, and the ex-wife became the sole owner of the company. In 1994, the taxpayer resigned and received no compensation.

Two years later, the ex-wife sold her company and gave the taxpayer $2m by personal cheque. He had no prior knowledge of the payment, which she said was 'in recognition of his contribution and dedication to the company and our friendship'.

The taxpayer believed the money was a gift and not subject to tax. He put it in an Isle of Man bank account, believing the interest payments would not attract tax, and did not report the cheque or interest on his UK tax returns.

In 2006, HMRC obtained information from banks concerning offshore deposit accounts and the taxpayer's Isle of Man account came to the department's notice.

Subsequently, the taxpayer reached a settlement under the Revenue's offshore disclosure facility and paid the outstanding tax, interest and a 10% penalty – all relating to the undeclared interest. He described the initial $2m deposit as a gift.

HMRC decided the sum had been emoluments of his employment. They said the taxpayer had been negligent in not including the payment in his tax return because he had not taken advice as to whether or not he should declare the money.

The department assessed him to tax, interest and a penalty on the amount. The taxpayer appealed.

Decision:

The First-tier Tribunal said there was plenty of case law that supported the fact a payment from an employer or former employer would not always be emoluments from employment.

The tribunal judge said: 'If a son works in the family firm, and the father gives the son shares in the company, or if the lord of the manor is particularly fond of one of the household servants, and makes some gift for that reason, the receipts of this nature may very well not be emoluments.'

He noted that, in this instance, the payment had been totally unexpected. It bore no relation to the taxpayer's past salary with the timeshare company; it had not been made in connection with the termination of his employment with that company, and it had been made personally, rather than by the employer.

The judge thought it 'entirely understandable' that the taxpayer might not count a payment received from the former owner of a company, for which he had worked for several years, as taxable salary. It was natural for him to assume the money was purely a gift. The taxpayer's appeal was allowed.

Comments - The First-tier Tribunal rejected HMRC's contention that the payment should be treated as an emolument of the appellant's employment. The facts of this case are unusual, but Judge Nowlan's comments may be worth noting and quoting in subsequent cases.

C Collins TC2088

Payment in lieu of notice or compensation?

The taxpayer worked for ICAP under a service agreement which was initially for three years and renewable annually after that period.

In June 2003, the taxpayer's employment with ICAP came to an end, and a compromise agreement was reached. According to the terms of that agreement, the company was to pay the taxpayer £37,500 as compensation for loss of employment. On payment of that sum the company deducted income tax of £8,250. It did not apply the £30,000 exemption under ITEPA 2003, s 403(1).

The taxpayer obtained a repayment of £4,666 for 2003/04. HMRC subsequently decided that this was incorrect and amended his tax return to recover the repaid tax and a further £3,733, which they said was due. ICAP told HMRC that the payment had been a contracted payment in lieu of notice and represented six months pay on the basis that his salary was £75,000 a year.

The taxpayer appealed, claiming the payment was not a contractual payment in lieu of notice but was a redundancy payment made in compensation for loss of employment.

Decision:

The First-tier Tribunal said that had ICAP made the payment to the taxpayer under the service agreement, it would have counted as an emolument of employment and fallen within ITEPA 2003, s 62. However, it was paid under the compromise agreement where it was described as compensation for loss of employment. The tribunal judge could find no other evidence, apart from the wording of the compromise agreement, that the payment was compensation for loss of employment. He decided it was consideration for loss of notice, as stated by the employer to HMRC. The payment was therefore earnings and taxable under s 62.

The taxpayer's appeal was dismissed.

Comments – As mentioned before the treatment of a termination payment or its components requires careful analysis as there many provisions that could come into play. One of the most crucial distinctions in determining the provision applicable is the determination of whether the payment are earnings or other sums being received. This case demonstrates that although many would treat a termination payment as compensation for loss of office the payment may be in line with the contract as in this case and therefore the payment is fully taxable as falling under s62 of ITEPA.

G Hayward TC2113

Bank employee receiving mortgage

An employee of a major bank purchased a house with the aid of a mortgage from his employer, at a rate not available to the general public. HMRC issued a ruling that tax was due under ITEPA 2003 ss 174 and 175. The employee appealed, contending that the 'official rate' applied by s 175 was too high.

Decision:

The First-tier Tribunal dismissed his appeal. Judge Geraint Jones held that 'the appellant is caught in a situation where the amount of his benefit is calculated by reference to inflexible statutory rules'.

Comments - ITEPA 2003 provides that 'the cash equivalent of the benefit of an employment-related loan is to be treated as earnings from an employee's employment for a tax year if the loan is a taxable cheap loan in relation to that year', and goes on to define a 'taxable cheap loan'. The First-tier Tribunal upheld HMRC's view that the loan which the employee received fell within this provision.

J Flanagan v HMRC TC2161

Repayment of voluntary class 3 contributions?

The taxpayer ceased employment in 2002. He had fewer than the 44 qualifying years required to obtain a full state pension, so he decided to make voluntary class 3 National Insurance contributions to build up his qualifying years.

In July 2007, following a white paper published in May 2006, the law was changed so that only 30 years' contributions were needed to secure a full state pension. As a result, the taxpayer cancelled his class 3 contributions, as he had by then made contributions for more than the 30 years required. HMRC refunded the contributions he had made since the May 2006 white paper on the basis that these had been paid in error, i.e. if he had been aware of the white paper, he could have delayed making the contributions until it became clear whether or not the 44-year period was going to be reduced.

The taxpayer appealed, claiming that he had secured 30 years' contributions by 2002 and therefore 'with the benefit of hindsight', the further contributions had been pointless.

Decision:

The First-tier Tribunal said HMRC were neither required nor entitled to refund the contributions

made up to May 2006. The contributions had been made correctly with regard to the legislation at the time. The tribunal judge said that, from the government's point of view, when it reduced the number of contributing years, it could not 'have contemplated that it would be faced with recovery claims from countless people for the recovery of voluntary class 3 payments that they had made in the appellant's situation'.

The taxpayer's appeal was dismissed.

Comments – At the time the reduction in the number of required years was enacted guidance made it clear certain payments of voluntary Class 3 National Insurance Contributions would not be treated as made in error. The matter was then looked at in Bonner v HMRC (and related appeals), [2010] UKUT 450 (TCC),. Judge Berner held that a payment made in ignorance of “a prospective change in law about which nobody outside the policy-making body itself is aware” could not be regarded as a payment made “in error”. This will no doubt not be the last case where individuals have paid voluntary Class 3 contributions in error but will attempt to recover those contributions. Contributions paid before the change in the law in May 2006 cannot be made in error as the law had not yet been changed.

R J Pages TC2007

Pensions auto enrolment (Lecture P736 – 10.03 minutes)

From October 2012, employers will be legally required to enrol their employees into a qualifying pension scheme. Eventually both the employer and employee will be required to make contributions to the scheme. The aim is to ensure that those employees on low to moderate earnings who are not currently making provision for their pensions begin saving for their retirement.

These provisions will affect both those employers who do not currently offer a pension scheme to their employees and those that do. Employers with existing scheme(s) may need to automatically enrol employees who have previously chosen not to take part in the scheme. These employers will also have to review the contributions made on employees' behalf to ensure these meet the minimum amount required by the auto enrolment legislation.

Whilst ‘auto enrolment’ launches on 1 October 2012, the introduction will be phased-in over the next five years with the biggest employers being the first affected. Employers with less than 30 staff will not join until June 2015 at the earliest. The smallest employers' commencement dates are determined by their PAYE scheme reference number.

For detailed guidance, see the Pensions Regulator website.

(http://www.thepensionsregulator.gov.uk/employers/detailed-guidance.aspx)

Affected workers

All employers will be required to enrol their 'workers' (whether full-time or part-time) in a workplace pension scheme if they meet the following conditions:

- are not already in a pension at work
- are aged 22 or over
- are under State Pension age
- earn more than £8,105 a year (in 2012/13), and
- work in the UK

‘Workers’ includes agency workers as well as employees. However a director will only be a ‘worker’ if:

- the individual is employed by the company under a contract of employment, and
- at least one other person is also employed by the company under the terms of a contract of employment

This means that companies with one director and no employees are exempt from the auto-enrolment regime. It is unlikely that the director will have a contract of employment as this would mean the director would be subject to other employment law requirements such as the national minimum wage. However, if the company took on an employee in future both the director and the employee would be classed as ‘workers’ and auto-enrolment would apply.

For ease of reference, workers will be referred to as ‘employees’ from now on.

Those employers who already offer a pension scheme to their employees will be required to review their records to identify those who have not joined the scheme, and include them in the auto enrolment process from the appropriate date. This will include office holders such as directors.

Employees with earnings over £5,564 (in 2012/13) who are between 16 and 22 or who are over 22 but earn between £5,564 and £8,105 can opt to join the pension scheme but are not enrolled automatically.

The employer is required to advise these employees in writing that they can join the scheme. This would be appropriate when communication is issued regarding auto enrolment, so that all employees are contacted at the same time.

Once the employer is within the auto-enrolment regime, new employees must be enrolled on the date their employment commences. Although automatic enrolment may be postponed by up to three months if the pension scheme used is not the National Employment Savings Trust (NEST). NEST is discussed further below.

Opting out for employees

Employees can opt-out of auto enrolment if they wish. This is particularly important for individuals who have been saving for a pension since before April 2012, as they may have elected to protect their accumulated pension savings accrued before that date. In that case (and also for some individuals who elected for enhanced protection in 2006) the benefit of protection is lost if they (or someone on their behalf) contribute to a pension arrangement after the election has been made.

The opt-out must be completed within one month of becoming enrolled in the pension scheme. The employer must take care not to induce the employee to opt-out of the scheme. This means that information about opting out must be considered very carefully before being issued to employees so that it is not construed as inducing them to opt out. It would be appropriate to recommend that employees seek professional advice about their decision.

Employer obligations

Employers must advise employees who will be subject to auto enrolment of the following information in writing:

- the date of enrolment
- the pension scheme that employees will be enrolled into
- how much will be contributed into the pension arrangement (as a percentage of salary or as an amount), and
- how the employee can opt out of the pension

Employers must also:

- accept requests to join the workplace pension, if an employee has previously opted-out or stopped paying. The employer must accept the first such request in any 12 month period; subsequent requests can be accepted at the employer's discretion.
- automatically enrol employees back into the pension scheme at regular intervals (usually every three years) if they meet the eligibility criteria and are not members of an occupational pension scheme

This automatic reenrolment is another danger point for those who previously elected to protect their accumulated pension savings. However, these individuals will be able to opt-out of re-enrolment. If advising an affected employee, the importance of prompt action to opt-out should be emphasised.

The need to review membership of the pension scheme on a three-yearly basis means the employer needs to have a robust reminder system as this date will vary depending on the employee (eg date of joining the employer, date of opting out of the scheme).

If employees are already members of a workplace pension arrangement, the employer must confirm to the employee in writing that the pension meets the required standards which apply after October 2012 (or the relevant staging date).

Staging dates

The date that an employer must implement auto-enrolment varies according to the number of workers that the employer had on 1 April 2012.

Those employers with less than 50 workers at this date are 'small employers' for this purpose. However, where an employer has less than 50 workers but shares a PAYE scheme reference with another employer, the staging date is based initially on the number of employees in the PAYE scheme on 1 April 2012. If this brings forward the date on which auto enrolment starts, the employer will be able to elect for a later start date. There is no requirement to notify the Regulator of a move in staging date under this rule, but it is advisable to so that reminder letters are issued at the right time.

Staging dates in the tax year 2012/13 are as follows:

Date	PAYE Scheme size
1 October 2012	120,000 or more
1 November 2012	50,000 to 119,999

1 January 2013	30,000 – 49,999
1 February 2013	20,000 – 29,999
1 March 2013	10,000 – 19,999
1 April 2013	6,000 – 9,999

Employers with less than 100 workers will not be required to commence auto enrolment until 1 May 2014, and those with fewer than 50 will not start to join auto enrolment until 1 June 2015 at the earliest.

For full details of the staging dates, see the Pensions Regulator website (http://www.thepensionsregulator.gov.uk/employers/staging-date-timeline.aspx).

An employer can bring forward the staging date if it wishes by notifying the Pensions Regulator in writing. However once the date has been brought forward it cannot be pushed back to the original date. It is unlikely that employers will wish to bring forward their obligations under auto-enrolment.

Pension scheme

The employer must enrol employees in either:

- a workplace pension arrangement which meets at least the minimum standards for auto-enrolment (whether it is a defined contribution or a defined benefit scheme), or
- the new scheme set up by the Government, known as NEST

There is guidance on the Pensions Regulator website to help the employer to decide whether an existing pension scheme will meet the standards for auto-enrolment. For defined benefit schemes open to new members the qualification is based on the benefits accrued under the scheme. For defined contribution schemes the test is based on the contribution requirements under the scheme.

If the employer does not have an existing scheme, they will need to seek advice about setting up a scheme in sufficient time for auto enrolment to commence on time. For smaller employers the simplest way to ensure that the scheme complies is to use the Government-backed NEST (National Employment Savings Trust) scheme. This has been set up specifically to cope with the auto enrolment legislation, and would be a simple way for employers to ensure that they comply with the legislation.

For more details of NEST, see the NEST website.

Contributions

Once the individuals have been enrolled in a scheme, the employer must deduct contributions to the pension from employees' pay, and make a contribution themselves; the contributions must be paid over to the pension provider promptly. The contribution rates are discussed below.

The law specifies a minimum total contribution (comprising employer contribution, employee contribution plus tax relief) to the scheme, and also a minimum contribution from the employer. Both of these are expressed in percentage terms, and both rise through the transitional period (this is known as phasing). This means that the total contribution amount is calculated by reference to the employee's pay, which is made up of employee contribution plus employer contribution plus tax relief.

The contribution rates during the transitional period and the final rates will be:

	Duration	Employer minimum contribution	Total minimum contribution
Phase 1	Employer's staging date to 30 September 2017	1%	2%
Phase 2	1 October 2017 to 30 September 2018	2%	5%
Final	1 October 2018 onwards	3%	8%

These percentages are applies to the earnings above the threshold (£5,564 for 2012/13) and up to the upper limit (£42,475 for 2012/13). The indications are that the thresholds will remain linked to the NIC thresholds, and the entry point threshold to the personal allowance for tax.

Example 1

Peter is paid £12,000 per annum. The minimum total contribution after the transitional period is 8%, and this is applied to earnings above the threshold. Using the amount for 2012/13, we get:

Minimum contribution 8% x (£12,000 - £5,564) = £514.88 per annum

Of this, the minimum employer contribution is 3% x (£12,000 – £5,564) = £193.08 per annum

If the employer makes only the minimum contribution, Peter's contribution will be £514.88 - £193.08 = £321.80, but the amount actually paid by Peter will be net of tax relief at source, so he will actually pay £257.44 per annum (£321.80 x 80%)

Example 2

Lucy has a salary of £50,000 a year. The contributions to the scheme are based on the earnings between the upper and lower limits. Using the 2012/13 amounts, this would be:

£42,475 - £5,564 = £36,911

Minimum total contribution 8% x £36,911 = £2,952.88

Minimum employer contribution 3% x £36,911 = £1,107.33

If Lucy's employer decides to contribute 3% of her total salary - £1,500, then Lucy's contribution will be £2,952.88 - £1,500 = £1,452.88 (gross), or £1,162.30 net payment.

Registration

All employers are required to notify the pension regulator what steps they have taken to comply with the new law, even if they have no employees affected by auto-enrolment. This is known as registration, and can be done online via www.thepensionsregulator.gov.uk. There are various tools on this website which can help employers identify what they need to do next.

Summary – How can employers prepare for auto-enrolment

According to the Pensions Regulator website, there are seven key stages to auto-enrolment:

- determine the staging date
- assess the workforce
- review any existing pensions arrangements
- communicate the changes to all workers
- automatically enrol those employees who need to be enrolled
- register with the Pensions Regulator and keep necessary records supporting enrolment and contributions
- contribute to the employees' pensions

Compulsory salary sacrifice arrangements will be incompatible with auto-enrolment as they require member consent before scheme membership is established. Therefore, employers should review the terms of any salary sacrifice arrangements currently in place.

Contributed by Rebecca Benneyworth

French tax issues for holiday home owners (Lecture P737 – 5.21 minutes)

It is estimated that about 200,000 British citizens own second homes in France. As the European debt and Euro crisis continues, it is perhaps not a surprise to see the Government in France looking to raise revenue and President François Hollande has pursued an increase in taxes on foreign-owned second homes which may raise up to €50 million.

The tax on rental income will increase from 20% to 35.5%, while capital gains tax on property sales will rise from 19% to 34.5%. The higher tax is being implemented by the addition of a 15.5 per cent 'social charge'. Commentators have suggested that there may be grounds to challenge the tax as discriminatory under EC law.

Previously, overseas owners from within the EU had been in a better position than French resident second homeowners, who had to pay this tax which goes towards services in France on top of 19 per cent French capital gains tax.

While those selling properties in France can offset capital gains tax there against the higher British rate of 28 per cent, HMRC's view is that they will not be able to offset this social charge against it. It is possible that many will not end up paying the full higher charge, as the complicated French system of taper relief reduces the amount that capital gains tax and the social charge is levied on. This starts after six years of owning a property but was changed at the start of the year so that homes only become fully exempt after 30 years rather than the previous 15 years. The practical reality is that those who make a sizable gain on the sale in France are likely to pay the 28 per cent rate in the UK.

Contributed by Francesca Lagerberg, Grant Thornton UK LLP

CAPITAL TAXES

What qualifies for rollover relief?

Daimler-Chrysler UK operated the Mercedes-Benz dealer network in the UK. In 2000, Daimler-Chrysler decided it wished to terminate all the dealer agreements on 12 months' notice. The taxpayer challenged this and as a result, in July 2001, an agreement was reached for termination on just under 24 months' notice.

Under the agreement, the taxpayer became entitled to an enhanced 24-month territory release payment. It then entered into a transfer agreement with L under which L paid the territory release payment as well as a sum to cover the assets of the business.

In its tax return, the taxpayer treated the whole of the transfer price paid by L as relating to goodwill and claimed rollover relief on all of it. The Revenue argued that half of the payment was for goodwill, and therefore qualified for rollover relief; the rest was to compensate the taxpayer for the early termination of its dealership.

The taxpayer appealed to the First-tier Tribunal, which found that the entire payment was for goodwill and was eligible for rollover relief. The Revenue appealed.

Decision:

The Upper Tribunal said that TCGA 1992, s 22 and s 152 showed that the standpoint of the taxpayer was important in determining what the territory release payment had been consideration for. While the payment had been made under the transfer agreement with L, its amount had been calculated in accordance with the provisions of the termination agreement made with Daimler-Chrysler UK, to which L had not been a party. From L's point of view, the payment would have been the cost of buying the dealership from Daimler-Chrysler UK.

The First-tier Tribunal had erred in law in finding that the whole payment had been consideration for goodwill. The only possible finding was that the territory release payment obtained by the taxpayer under the agreement with Daimler-Chrysler UK and transfer agreement had been consideration for agreeing to the early termination of the dealer agreement. That was a disposal of an asset and the asset was a contractual right, not goodwill. HMRC's appeal was allowed.

Comments – The Upper Tribunal upheld HMRC's view that part of the consideration which the company had received was compensation for the loss of an asset, and did not qualify for rollover relief.

As with many cases involving relief from taxation it is crucial that the correct asset or income is identified so that the correct provisions are applied to the asset or income. Identifying the correct asset in a complex transaction is often more difficult as demonstrated in this case where the First-tier Tribunal had erred in law in finding that the whole payment had been consideration for goodwill. This of course was extremely relevant as it was the goodwill which was the qualifying asset for rollover relief.

CRC v Mertrux Ltd, Upper Tribunal

Not so 'bootiful' – Who pays the tax? (Lecture P737 – 5.21 minutes)

The late turkey farmer, Bernard Matthews, left his house in the South of France to his girlfriend, along with a letter of wishes urging his English family to waive their right to 75 per cent of the property as granted by France's forced heirship laws. His children ignored his letter and have unsuccessfully tried to have their £2 million inheritance tax bill on the £12 million property paid out of his English estate.

Mr Matthews had four children, three adopted with his wife (from whom he had separated about 30 years ago) and a child by another woman. Under French law, his children would automatically be entitled to 75 per cent of his Mediterranean villa on his death. He therefore asked them not to contest his wishes and allow the property to go to his girlfriend, Odile Marteyn. In the letter he said he planned to leave the villa as an 'absolute gift' to Miss Marteyn, who he had lived with for 20 years.

In the UK High Court case (*Scarfe and another v Matthews and others, Chancery Division)*, it emerged his three adopted children had refused to accept his dying request and had insisted on their stake of the villa. His natural son, George, had not contested the letter of wishes. The Court concluded, as a matter of construction, that although there was nothing Miss Marteyn could do to force the children to retract their claim to the villa, it rejected the trio's argument that their inheritance tax on the villa should be paid from Mr Matthews's properties outside of France, ruling he had not wanted his adopted children to have any part of the French home.

The Judge noted:

'For this reason, I hold that the adopted children have no right under the English will to have their tax liability discharged, or to be reimbursed if they have paid it.'

Contributed by Francesca Lagerberg, Grant Thornton UK LLP

Market value of loan notes on conversion

An individual (B) exchanged some shares for some loan notes in a public company following a company reorganisation in 1999. In February 2004, B entered into two deeds of variation with the company which had issued the loan notes, removing an option to redeem them in a foreign currency, and thus converting them into qualifying corporate bonds. In March 2004, B redeemed the notes for a total of £328,860. In his 2003/04 tax return, he claimed that he had made a capital loss on the redemption, computed on the basis that the loan notes had a value of £9,866 at the time of their conversion in February 2004. Following an enquiry, HMRC formed the opinion that the redemption had given rise to a capital gain, and issued a CGT assessment. B appealed.

Decision:

The First-tier Tribunal reviewed the evidence in detail and dismissed the appeal, holding that the deeds of variation which converted the loan notes into qualifying corporate bonds did not have the effect of depressing their value in the way that B had contended. The tribunal observed that there was no 'likelihood that any relevant noteholder intended or was likely to transfer the loan notes during the second relevant period. The intention was simply temporarily to drive down the market value of the loan notes at the time when they were converted from NQCBs to QCBs.' The tribunal held that the reference to 'market value' in TCGA 1992 s 116(10) should not be construed as referring 'to a value or price which has been artificially manipulated, solely for tax purposes, in a wholly uncommercial fashion to produce a temporarily depressed value. There was no commercial or economic reason why the value of the loan notes should have been reduced to £9,866. The value thus manipulated is not the value or the price which the relevant statutory provisions, construed purposively, envisage.' Accordingly, the tribunal concluded that the deeds of variation did not have the effect of reducing the market value of the loan notes, and that 'the “frozen” gain which arose on this conversion must be calculated without reference to the artificial depression in value attempted by the deeds of variation'. (The tribunal also held that the assessment was authorised by TMA 1970 s 29 and was not precluded by s 29(5), applying the principles laid down in Veltema v Langham 2004 STC 544.)

Comments - TCGA 1992 s 116(10) provides that there shall be a calculation of 'the chargeable gain or allowable loss that would have accrued if, at the time of the relevant transaction, the old asset had been disposed of for a consideration equal to its market value ...'. The appellant had submitted such a computation on the basis that the loan notes had had a market value of £9,866, although they were redeemed for £328,860 the following month. The First-tier Tribunal rejected the appellant's computation and upheld the assessment which HMRC had issued. The facts are complex, but the tribunal's reasoning is self-explanatory and worth noting.

W Blumenthal v HMRC TC2174

Charitable relief not due

The claimant company, Pollen Estate Trustee Company, acquired four properties as a bare trustee for the beneficiaries of the Pollen Estate Trust. Two beneficiaries of the trust were registered charities, one of which was a hospital.

The company claimed exemption from stamp duty land tax under FA 2003, Sch 8 and s 107 in respect of the proportion of the properties, around 75%, beneficially owned by the charitable beneficiaries and the hospital respectively. HMRC refused the claim. The company appealed.

Decision:

The Upper Tribunal said the relevant land transaction for the purposes of stamp duty land tax had been the acquisition of the entire property and not each separate acquisition of an undivided share by each tenant in common.

It held that where a land transaction involved a number of people acquiring a property through a bare trust, the purchasers should be treated as joint purchasers and the transaction taxed as a single land transaction. Since the properties had not been solely purchased by a charity or charities, relief under FA 2003 Sch 8 was not due.

The taxpayer's appeal was dismissed.

Comments - : FA 2003 Sch 8 provides relief for SDLT for charities. The Upper Tribunal upheld HMRC's contention that the relief was not available where land was acquired by a bare trustee, and not all the trust beneficiaries were charities.

Pollen Estate Trustee Company v CRC, Upper Tribunal

New SDLT disclosure rules

HMRC have claimed success in their attempts to shut down an aggressive scheme for avoiding stamp duty land tax (SDLT), which had been widely marketed by accountancy firms.

The department hopes to have saved more than £170m for the Exchequer, subject to an appeal, after winning its legal case against the misuse of sub-sale relief by the Vardy Property Group, which aimed to avoid paying £290,000 of SDLT on the direct purchase of a £7.25m business park.

The Durham-based group structured the deal through a newly formed unlimited company, which distributed the property as a dividend to the shareholder company, arguing that SDLT rules looked through the unlimited company's purchase and, since the final purchaser had paid nothing for the property, it was not liable for tax.

The First Tier Tribunal found the avoidance scheme was flawed and SDLT was due because the unlimited company had not properly carried out company law requirements for declaring a dividend, and the ultimate owner of the property had indirectly provided the purchase price.

The Revenue's director general of business tax, Jim Harra, claimed the tribunal's ruling "sends a clear message to tax avoiders that we will challenge avoidance relentlessly… It shows that the courts will see through arrangements that are put in place just to avoid tax."

As a result of the taxman's legal victory, the government today introduced new regulations for the disclosure of tax avoidance schemes meant to ensure that sub-sale arrangements have to be revealed to HMRC by their promoters and users.

Schemes involving residential property with a value up to £1 million and the commercial equivalent worth no more than £5 million will have to be disclosed in the same way as arrangements involving more valuable properties.

"This government has been clear that when someone buys a house in the UK they must pay stamp duty," said the Exchequer secretary to the Treasury, David Gauke.

"Today's legislation will mean HMRC will have access to more information about property tax avoidance. They will not hesitate to use it to close down avoidance schemes."

Taxation Magazine, 20 September 2012

Business property relief and FHLS (Lecture P739 – 12.55 minutes)

For an owner-managed business, inheritance tax BPR is a most generous relief. It reduces the value for inheritance tax (on death or in relation to a lifetime transfer) of certain business assets by sometimes 50% but more usually 100%.

HMRC's attitude to the BPR position in relation to FHLs has changed significantly in recent years, culminating in their decision to litigate in the recent Pawson case.

Recap of main BPR rules

BPR is available at 100% in relation to property consisting of a business or interest in a business which is to say the assets of a sole trader or the partnership interest of a partner.

100% relief is also available in relation to any unquoted shares in a company, where 'unquoted' means not listed on a recognised stock exchange.

BPR is available at 50% in relation to 'any land or building, machinery or plant which, immediately before the transfer, was used wholly or mainly for the purposes of a business carried on by a company of which the transferor then had control or by a partnership of which he was then a partner'.

BPR is specifically denied in relation to businesses consisting wholly or mainly of making or holding investments. 'Mainly' in this context means more than 50%.

The 1999 Special Commissioners decision in the case of Farmer set out an 'in the round' approach in which a number of factors have to be considered (detailed on Slide No.5).

Subject to a number of specific exemptions, property has to be owned for two years in order to qualify. Property subject to a binding contract for sale and companies in liquidation do not qualify.

Case law background

Historically, businesses whose income derives from the ownership of land have tended to be unsuccessful before the courts and tribunals when claiming BPR, viz:

- Martin [1995] STC (SCD) 5: The deceased let industrial units on an industrial estate. Her husband was at the property most days from 7am and was there, more often than not, managing the premises. The Special Commissioner held that the business was one of investment and that a distinction could not be made between active and passive investment.
- Powell [1997] STC (SCD) 181: The deceased operated a caravan site hiring out pitches on long and short lettings. She and her family performed daily tasks of site maintenance, which were so burdensome

that she was required to live at the park. Both the long and short lettings were categorised as 'investments'. The Special Commissioner noted that the deceased had "actively managed the caravan park business"; nevertheless these services were held to be incidental to the holding of property as an investment.

- Clark [2005] STC (SCD) 823: A company owned a large number of properties from which it received rents. It also managed 141 dwellings for which it charged a commission. The Company had its own workforce for carrying out building work, maintenance and refurbishment on all the properties. The Special Commissioner held that - as the rents were essentially income from the ownership of property - the business carried on by the company consisted mainly of holding investments.
- McCall [2009] STC 990: The deceased owned a number of fields let for grazing. Her son-in-law spent approximately 100 hours per annum carrying out maintenance work, management and finding tenants. The Court of Appeal of Northern Ireland held it was clear that the landowner derived income from land. The business was one of holding an investment.

HMRC's approach to FHLs

The position in relation to 'furnished holiday lets' has been subject to a relatively recent change in HMRC practice and the relevant extracts from HMRC's manuals are set out in full on Slides 8 and 9.

The decision in N V Pawson (Deceased) [2012] UKFTT 51(TC)

The deceased, Nicolette Vivian Pawson, partly owned a cottage, Fairhaven, near the seaside resort of Thorpeness, Suffolk typically letting it out for one or two weeks at a time. Members of her family also occupied the cottage for three weeks during the holiday season but they paid rent calculated with reference to HMRC's literature on payments for private use.

The following services were provided to the holiday makers who stayed at the cottage:

- Use of a television and telephone.
- The property was cleaned before each letting and the garden was attended to.
- The property was fully furnished and heated. The hot water was turned on before visitors arrived and the kitchen was fully equipped.
- A cleaner/caretaker inspected the property regularly and bought cleaning materials for the cottage. Repairs were made as required.
- Clean bed clothes were arranged through a laundry service (but this service only started after Mrs Pawson's death).

Specific reference was made to the fact that the property had been advertised, although this had not kept up with modern developments, such as advertising on the internet.

Evidence was provided by an estate agent who stated that, in her opinion, holiday makers paid a premium rent compared to longer term tenants because of the value of the services provided.

In the three financial years prior to Mrs Pawson's death, a profit was made in all but one year. The loss in that year was as a result of substantial expenditure incurred in decorating and improving the property and had it not been for this expenditure a profit would have been made in that year too.

The tribunal found that Mrs Pawson's business was not an investment business. The following comments were made in coming to this conclusion:

> *45. On the facts of this case there are clearly significant services provided to the occupiers of the property…*
>
> *49. …No doubt some of the services provided in this case are not specifically required to be carried out under the holiday letting contract but such services can hardly be said to be incidental to the holding of the property as in investment.*
>
> *50. We have no doubt that an intelligent businessman would not regard the ownership of a holiday letting property as an investment as such and would regard it as involving far too active an operation for it to come under that heading…*

The decision is difficult to reconcile with the earlier cases because fewer services appeared to be provided here than in many of the previous cases and an emphasis on the 'active' nature of the operation seems to have been given far more weight than in previous decisions.

HMRC have appealed to the Upper Tribunal and the appeal is due to be heard on 18 December 2012.

Contributed by Ian Marston, Gabelle LLP

ADMINISTRATION

Finance Bill 2013

The draft Finance Bill 2013 clauses are due on 11 December 2012, a date which some commentators are now calling "legislation day" under the coalition's announce-consult-publish-enact tax law cycle.

In a written ministerial statement David Gauke confirmed that the draft clauses will be published alongside draft explanatory notes and tax information and impact notes.

Coming six days after the Autumn Statement (5 December), the clauses will put in motion many of the measures announced last March that have been subject to consultation over the course of the summer.

These include:

- Simpler income tax for the simplest small businesses
- Personal service companies and IR35 – Controlling persons
- GAAR
- Statutory residence test

The draft Finance Bill clauses will be open for comment up until 6 February 2013.

FATCA

A consultation document has been published on the agreement entered into between the UK and the US to improve international tax compliance and implement the Foreign Account Tax Compliance Provisions (FATCA).

FATCA requires financial institutions outside the US to report information on US account holders to the IRS. If financial institutions fail to report the required information then 30% US tax would be withheld on all US payments to them.

Complying with FATCA would have posed significant problems for banks, particularly with data protection and due diligence. Accordingly, it was agreed that G5 (France, German, Italy, Spain and the UK) financial institutions would instead report the information to their respective tax authorities, who would then exchange the information to the US under the legal framework provided by existing double taxation and tax information exchange agreements. In return, the US agreed to provide information to the G5 on US accounts held by G5 taxpayers.

A Model Intergovernmental Agreement was published by the G5 and US on 26 July 2012. The UK and the US subsequently signed a bilateral agreement based on the Model Agreement on 12 September 2012. The result is a framework within which:

- The legal barriers to compliance, such as those related to data protection, have been addressed.
- Withholding tax will not be imposed on income received by UK financial institutions.
- UK financial institutions will not be required to withhold tax on payments they make.
- The due diligence requirements are more closely aligned to the requirements under the existing anti-money laundering rules.
- There is a wider scope of institutions and products effectively exempt from the FATCA requirements.
- HMRC will receive additional information from the US Internal Revenue Service to enhance its compliance activities.

Mutual assistance between HMRC & South Africa Revenue Service

The South Africa Revenue Service (SARS) obtained judgment for more than £200m (including penalties and interest) against a company (B) which was registered in the British Virgin Islands. SARS formed the opinion that B's assets had been transferred to another British Virgin Islands company (M), and that more than £7m of this money was held in a London bank account. SARS asked HMRC for help in recovering the amounts due, in accordance with article 25A of the double tax convention between the UK and South Africa. In February 2012 HMRC and SARS obtained freezing orders against B, M, and a Guernsey company (H) which was the registered holder of the shares in B and M. The companies appealed, contending inter alia that article 25A of the convention was ultra vires and that the effect of the HL decision in Government of India v Taylor & Hume [1955] 1 All ER 292, was that SARS' claim was unenforceable in the English courts.

Decision:

The Ch D allowed the appeal by H. HHJ Pelling held that 'HMRC has failed to demonstrate that it has an arguable basis for seeking permission to serve these proceedings out of the jurisdiction on (H)'. He directed that the proceedings should be dismissed 'in so far as they have been brought by SARS', dismissed B's appeal against the freezing order against it, and directed that the case should be relisted for 'further argument as to the scope of the freezing order against (M)'.

Comments - There is a great deal of money at stake in this case. The High Court rejected the companies' contentions that article 25A of the double tax convention between the UK and South Africa was ultra vires. However the Court also held that HMRC were not entitled to proceed against the Guernsey company which carried on business as a trustee, and which was the registered holder of the shares in the other two companies.

Ben Nevis (Holdings) Ltd v HMRC (and related appeals) (Ch D)

Special circumstances for penalty reduction

The taxpayer was made redundant in 2009. She received a termination sum of £53,988. The employer sent the taxpayer two forms P60 for the year, the first of which showed pay £30,760 and tax £8,778.93, while the second showed pay £23,988 and tax £3,797.60. She also received a form P45 which showed the figures for total pay and tax to date as shown on the first P60. She contacted her employer for clarification but received no response.

When she completed her tax return, she used the figures from the first P60 only. After enquiring into her return, HMRC issued penalties on the basis that the taxpayer had been careless in not including the full amount of redundancy payment. They refused to suspend the penalty under FA 2007, Sch 24 para 14, and said that no special circumstances (para 11) applied so that they could reduce it. The taxpayer appealed.

Decision:

The First-tier Tribunal said that the taxpayer had been careless in completing her tax return. Although her employer had failed to help her clarify the payments recorded in her payslips and forms P60, she could have sought help from HMRC or included further information in the white space on the return. So a penalty was appropriate.

The judge agreed that the penalty could not be suspended under para 14 as this was not suitable for dealing with one-off events, such as redundancy. However, with regard to a reduction for special circumstances, he said that the taxpayer had received confusing information about her redundancy payment, and she had made a genuine effort to sort it out. This amounted to special circumstances and a 60% reduction in the penalty was justified.

The taxpayer's appeal was allowed in part.

Comments – Whilst it may seem obvious to a tax professional getting the right result may not be as easy as it first appears. The taxpayer was clearly confused by all the documentation.

White v HMRC TC2050

More evidence required from HMRC

The taxpayer, who was 68 years old, was late in submitting her 2010/11 tax return and paying the capital gains tax due. HMRC imposed a surcharge and penalty against both of which she appealed.

Decision:

In the First-tier Tribunal, Geraint Jones QC, referring to the European Court of Human Rights decision in Jussila v Finland [2009] STC 29, said that it was the responsibility of HMRC to prove that the surcharge and penalty were due.

In this instance, the taxpayer was unable to say how late the tax return had been filed, but HMRC had not attempted to fill in the missing details. The statement of case said that the tax return was dated 8 January 2011, but had been date-stamped as received on 28 March 2011. HMRC said that the taxpayer had not provided any proof that the return had been submitted before 28 March, but Mr Jones said that she did 'not bear the onus of proving the alleged fault'. She did not know the extent of the lateness and HMRC had not produced any evidence to prove the default. The taxpayer's appeal was allowed.

Comments – This is another example of Judge Geraint Jones exercising justice. It demonstrates that simply because HMRC allege that the taxpayers behaviour appears to give rise to a penalty it does not necessarily follow. The onus is quite rightly on HMRC to prove the situation and in the absence of evidence the Judge found in favour of the taxpayer.

J Cox v HMRC TC2084

Failure to account for PAYE

HMRC formed the opinion that a property development company (S) had failed to account for PAYE and NIC on substantial payments to employees, and had failed to deduct tax from payments to subcontractors. They issued determinations under the PAYE and CIS regulations and SSCTFA 1999, and imposed penalties under TMA 1970 s 98A(4), mitigated by 50%. S appealed.

Decision:

The First-tier Tribunal reviewed the evidence in detail and observed that two accountancy firms had

resigned as S's auditors and had qualified their opinions concerning S's accounts. Judge Berner observed that 'in a case of this nature, where so little underlying information has been provided by the taxpayer, it is of course the case that the assessments made by HMRC will not be correct. They are merely estimates. But that does not mean they must be discharged. They are valid and must be upheld except to the extent that the taxpayer satisfies the tribunal as to the correct, or more nearly correct, figures.' He also held that HMRC had been 'over-generous' in mitigating the penalty by 50%. He observed that S had failed to prepare a disclosure report, had not given access to its primary records, and had 'been engaged throughout in a campaign of delay and obstruction'. It appeared that 'not only have a large number of employees been omitted from the annual P35 returns, resulting in a substantial underdeclaration and payment of tax and NICs, but the remainder of the workforce have not been returned on any CIS returns'. In the circumstances, there should only be an abatement of 5% for disclosure, and there should be no abatement for co-operation or seriousness. The tribunal therefore increased the penalty from 50% to 95% of the statutory maximum.

Comments - The First-tier Tribunal held that, in the circumstances of this case, HMRC had been unduly lenient in imposing a penalty at only 50%. The tribunal increased the penalty to 95%. In considering whether to appeal against a penalty, practitioners should bear in mind the possibility that the tribunal might increase the penalty.

Seacourt Developments Ltd v HMRC TC2198

Surcharge on tax paid late

A retired civil servant (K) submitted a 2009/10 return showing a tax liability of £1,842. He failed to pay this amount by 31 January 2011, and HMRC imposed a surcharge. K appealed, contending that the tax due should have been deducted under PAYE.

HMRC produced a copy of K's return, in which K had put an X in the box marked 'if you owe tax for 2009/10 and have a PAYE code we will try to collect the tax up to £2,000 unless you put an X in the box'.

Decision:

The First-tier Tribunal dismissed K's appeal, observing that the X which K had entered in the box had been a valid objection to the tax being collected through his PAYE code, and he therefore had no reasonable excuse for not paying the tax by the due date.

Comments - Where the tax due does not exceed a certain amount (which is currently £3,000), HMRC is normally willing to collect it under PAYE. Unless there are unusual circumstances, it will normally be inadvisable to place an X in the box on the return which instructs them not do so.

D Knowles v HMRC TC2199

Application for disclosure of documents

A UK company sold a 'telebetting' business to an associated Gibraltar company. HMRC assessed the shareholders on the basis that there had been a transfer of assets abroad, within what is now ITA 2007 ss 714–751. The shareholders appealed, and applied for disclosure of various documents held by HMRC.

Decision:

The First-tier Tribunal rejected the application with regard to the majority of the documents in issue, but allowed the application with regard to correspondence and notes of meetings with the Betting Office Licensees Association. Judge Mosedale observed that the shareholders were engaged in 'a fishing exercise to catch fish that are most unlikely to be of any interest to the tribunal hearing the substantive appeal'. (The Tribunal also rejected an application by HMRC that the shareholders should disclose notes of a conference with a well-known QC, holding that the notes were privileged.)

Comments - Judge Mosedale's decision is worth reading as an interesting review of the circumstances in which the Tribunal may accept applications for the disclosure of documents.

PAD Fisher v HMRC (and related appeals) TC2021

The GAAR, anti-avoidance and more (Lecture P740 – 10.37 minutes)

In the world of tax the story of the year has been about tax avoidance of the 'morally repugnant' kind, ie aggressive schemes and where you draw the line between the acceptable and the unacceptable, fired on by media stories involving comedians and when payment is made in cash. The debate has often been fevered, occasionally uninformed, but it does also highlight some unacceptable practices that most would condemn.

The ICAEW has put out its own Helpsheet on this area (http://www.ion.icaew.com/TaxFaculty/25014) which pulls into one place a lot of the HMRC guidance that broadly states if something seems too good to be true it probably is. There is also no doubt that the public mood has shifted. There are more calls for transparency around what individuals and

companies do in relation to tax, and certainly some things that might have been found acceptable in the past would not pass the 'smell test' today. Many entities – and not just the largest – are now thinking far more carefully about their tax activities and how they would stand up to public scrutiny.

We are also in mid-consultation on a GAAR which will almost certainly come into play from next April. It is being built on the back of Graham Aaronson QC's report from last November and will introduce a legislative wording to capture aggressive planning that does not pass a reasonableness test.

DOTAS extended

Meanwhile the Government has announced plans to increase the pressure on advisers who market contrived schemes. This will largely be achieved via extensions to the disclosure of tax avoidance schemes (DOTAS) rules.

In a consultation document, entitled *Lifting the Lid on Tax Avoidance Schemes*, there are proposals to revise and extend the DOTAS regime in order to make it an 'even stronger and more effective weapon in the battle against tax avoidance'.

In brief, the document considers:

- A range of options to improve the provision of information about tax avoidance to the public, in order to raise awareness of the risks of using such schemes. This would include providing warnings about tax avoidance schemes that are mis-sold and/or are proved not to work, setting out the potential consequences for users of those schemes.
- Extending the DOTAS information that must be reported to HMRC, to ensure that HMRC has sufficient information to understand how a scheme works, who is involved in the marketing and implementation of it, and, in particular, who it is intended to be used by.
- Tightening the rules with regards to what constitutes a 'reasonable excuse' for failure to make a disclosure.
- Increasing the disclosure requirements where a promoter is subject to a penalty for failure to provide information to HMRC about a scheme.
- Imposing personal obligations on individuals, alongside the obligation on the respective firm of advisers, to ensure that a promoter's DOTAS obligations are complied with.

The consultation document also considers revisions and extensions to the existing DOTAS hallmarks, setting out proposals for two new additions. These would be specifically targeted at arrangements involving the provision of employment income via intermediaries, that attempt to circumvent the 'disguised remuneration' legislation, and arrangements that involve certain financial products.

While the document also make mention of schemes involving structures and transactions in offshore territories, it is conceded that the seeming complexities in trying to bring these into the DOTAS regime would present complications beyond the scope of this latest consultation, although discussions with interested parties will continue.

The key here, as ever, will be to ensure that the measures remain focused on the original objective, and do not result in unnecessary and impractical administrative burdens on those affected.

The role of advisers

While the avoidance debate rages and tax accountants find themselves in a place usually reserved for estate agents, journalists and politicians, it is important that as a profession we stand up for the things we do well. Without tax advisers many individuals and businesses would not pay the right amount of tax or even be able to find their way through our complex tax system. This was well articulated by HMRC in its *Working with Tax Agents* document back in December 2009 when it said:

'Tax agents play a vital role in the delivery of the tax system. It cannot be stressed enough that the overwhelming majority of tax agents advise their clients appropriately and calculate the right amount of tax. If this were not the case, the tax system as we know it simply would not function.'

It is vitally important that we don't lose sight of this message or let it be forgotten.

HMRC + taxpayer: improving compliance

Meanwhile HMRC is looking to improve compliance. The Government is investing £917 million between 2010 and 2015 to increase tax compliance. This includes illegal tax evasion and avoidance.

HMRC is looking to close the tax gap, which is the difference between the amount of tax that should in theory be collected, against what is actually collected, through a number of key compliance activities. This includes increasing the number of

staff tackling avoidance, evasion and fraud by around 2,500 people by 2014-15. In addition:

- Compliance yield has more than doubled in six years – from £7.4 billion in 2005-06 to £16.6 billion in 2011-12.
- In the three years to March 2012, the amount of tax debt owed has reduced by £10 billion to £15.4 billion.
- HMRC has prevented more than £1 billion in lost revenue through tackling criminals. By March 2012 it had charged 545 individuals with criminal offences, with 449 brought before the courts and 413 convicted – a success rate in court of 92 per cent.

HMRC is running four national campaigns a year between now and 2015, each involving around 200,000 taxpayers. The campaigns will provide opportunities for people voluntarily to put their tax affairs in order and become compliant. For those who choose to remain non-compliant, we will follow up with a range of actions, including prosecutions.

This approach has so far produced nearly £510 million from voluntary disclosures, and more than £120 million from follow-up activity, including more than 18,000 completed investigations. There are also 23 criminal cases underway, with one conviction already secured.

There were 12 specialist taskforces that HMRC had in 2011-12 which are expected to bring in more than £50 million. It will launch a further 20 to 30 taskforces each year from 2012-13, with the first launched at the end of May 2012. They cover markets in London, taxi firms in Yorkshire and the East Midlands, property rentals in East Anglia, London, Yorkshire and north east England and restaurants in the Midlands.

Meanwhile there are a number of agreements with tax authorities in other countries. The Liechtenstein Disclosure Facility requires tax agents and other financial intermediaries to notify HMRC of clients who may have to pay UK taxes.

It was originally planned to raise around £1 billion over five years from 2009, based on an expected 2,000 registrations, but the number of registrations is already almost 3,000 and HMRC is hopeful of collecting up to £3 billion.

In October 2011, the UK and Switzerland finalised a ground breaking agreement on tackling tax evasion. It is expected to come into force in 2013, with Swiss account holders based in the UK having to pay a possible one-off payment to clear past tax liabilities. Swiss banks will also pay about £400 million to the UK in advance as a sign of good faith.

HMRC has deployed 200 staff in six locations across the UK to deal with avoidance and evasion by wealthy taxpayers.

This population is defined as those earning more than £150,000 and those with wealth between £2.5 million and £20 million – around 300,000 people in total. The teams have received specialist training in a range of topics including trusts, dealing with offshore assets and wealth management.

A specialist intelligence unit, with access to a wide range of internal and external data, will identify some of the highest-risk cases. Between 2012 and 2015 these teams will deliver £520 million in revenue.

HMRC has brought together technical experts, intelligence analysts and criminal investigators to build on our existing cyber counter-fraud capability, using technology funded by the Government's four-year National Cyber Security Programme to protect the public purse from attempted fraud.

The cyber crime team will:

- • use specialist forensic tools to gather intelligence against cyber criminals who target our repayment systems
- • provide expert advice on keeping our services and customers secure
- • pass real-time intelligence to operational risk and security teams.

CONNECT

CONNECT is a tool that allows HMRC to cross-match a billion pieces of data to uncover hidden relationships between people and organisations that could not previously be identified. For the first time it can see, at the touch of a button, more information in one place for a single taxpayer. It has the capacity to find anomalies between information such as bank interest, property income and other lifestyle indicators, and compare it to what a customer is paying us in tax. HMRC are using it to direct resources more effectively through better case selection across the compliance spectrum – from organised criminal attack to the identification of common errors.

For example, CONNECT has enabled a much more systematic and targeted approach with regard to Inheritance Tax. HMRC receives around 300,000 paper returns on bequeathed estates every year –

including around 200,000 from estates claiming to be below the tax-paying threshold. Due to the very large number of returns received, it was very difficult to identify high risk cases where more tax was due than what was in fact declared.

HMRC experts developed a single risk code that sifts over 50 million lines of data to spot where estates might have been falsely submitted as exempt. HMRC utilised the massive amount of information it held on property ownership and transactions, company ownerships, loans, bank accounts, employment history, and self-assessment records that had previously been unmanageable. All of this was turned into a single code that indicated when the return was likely to be inaccurate and why.

HMRC interventions on non-taxpaying estates increased many times over; and in the first year of operation, an additional £26 million was raised from Inheritance Tax through the use of CONNECT.

Contributed by Francesca Lagerberg

Real time in the real world (Lecture B736 – 8.39 minutes)

By October 2013, all employers will be required to report to HMRC on or before every occasion that an employee is paid.

Every time an employer makes a payment to employees, the payroll software should automatically gather the information about employees' income and tax/NI deductions that HMRC will require. It should then send this information to HMRC at the same time as a payment is made.

System changes and similarities

There are two main changes to payroll under the RTI system.

1. Employers will be required to submit returns under RTI each time that a payment is made to an employee. The RTI submission must include the details of all employees, including those who are paid beneath the lower earnings limit (LEL), and this may be an area of practical difficulty. If there are no employees paid over the LEL, then there will be no need to file, but should just one employee goes over the LEL, there is a need to report all employees' earnings, not just the one person that has breached the limit.
2. The need for annual forms such as P35, P14, and P38A disappears, with the last RTI return in a year taking their place.

Additionally, if employers are paying their people using BACS, they will have to make sure that the RTI return contains the BACS service user-number.

How was it for the CIPP?

The Chartered Institute of Payroll Professionals (CIPP) volunteered to be early adopters and, as an employer staffed by highly qualified payroll experts, with fairly stable employee numbers, and with regular pay periods, it should have been a simple exercise.

They undertook the following steps:

- undertook a dedicated RTI course to understand what was involved and by when
- payroll manager set about emailing all staff at the CIPP, requesting that they confirm their personal details. The pro forma asked for the following key information.
  - Full name as known by HMRC
  - Date of birth (default dates are not acceptable)
  - National Insurance Number (temporary numbers no longer exist)
- Software requirements: If employers use HMRC's portal, they should note this will not be available from April 2013. Instead, they will need to either use HMRC's Basic PAYE Tool (BPT), or commercial payroll software to submit data to HMRC. The CIPP uses Sage Payroll and after speaking to the Sage team to discuss the pilot requirements, the new RTI-enabled payroll software was installed without delay.
- BACS software - The CIPP needed to update the BACS software which did have a cost implication; the reason for this is what the 'techies' know as the 'BACS hash'. The BACS hash allows the BACS payment schedule to be matched up with the RTI data submitted to HMRC.
- The next stage was to carry out the employer alignment summary – this was quick, easy and most importantly the submission was successfully received by HMRC. Note that not all employers will be requested to do this, as it depends on the number of employees and/or complexity of the payroll.

Casual workers

Someone may need to be brought in to cover a Saturday night, but for their net pay to be paid in cash, RTI requires a submission 'on or before the time a payment is made'.

Domestic staff

If a nanny or au pair is employed then typically a net pay is agreed with them, they are paid each week or month, and the payroll submission may only happen quarterly. Such schemes will be closed from 5 April 2013; from that time all those schemes must operate within RTI. This will be a significant change for those who are affected.

Businesses where troncs are operated

Where PAYE is applied to tronc payments, it is not unusual for the net payments to have already been passed to the deserving staff. But when is the RTI submission due? 'On or before the time a payment is made'.

Advances of earnings

An 'advance' or 'interim payment' is earnings – and PAYE must be applied at that time with the corresponding RTI submission.

Summarised from an article by Ellie Gamble and Sharon Gilkes writing in Taxation

BUSINESS TAX

Latest goodwill issues on incorporation (Lecture B737 – 9.05 minutes)

For several years it has been advantageous for sole traders and partners to consider incorporating their businesses by selling their goodwill to the new limited company. That creates a chargeable gain with CGT at 10% on the funds passing from the company to the sole trader or partner.

In addition, if the business originally started after 31 March 2002 the amount of the goodwill amortised in the company's accounts will qualify for corporation tax relief despite the fact the company is purchasing the goodwill from a (very) connected person. That is a result of the introduction of the tax rules on intellectual property applying from 1 April 2012.

What should the rate of amortisation be? That should follow GAAP rules as there are no specific rules in the tax legislation. In the USA the standard rate of amortisation is 20% per annum over 5 years, on a straight-line basis. It is now understood that HMRC accepts that 1/3rd per annum is reasonable in the UK, thus allowing the cost to be written-off for tax purposes over 3 years.

HMRC enquiries

The tax office receiving the CGT computation on the disposal of goodwill to the limited company within the tax return may well now decide to ask some fundamental questions initially, as a compliance check, with the threat that *"depending on the quality and detail of information provided, colleagues from Shares & Asset Valuation office may still need to contact you for further information relevant to the disposal".*

The initial questions are listed below. However, it would normally be appropriate to supply a detailed valuation of the goodwill with the CGT computation, thereby obviating the need for many of the questions. Indeed it is sensible given HMRC's new approach to deal head on with their likely questions within the valuation report.

The compliance check covers the following:

1. Request for the full accounts for the latest period up to the incorporation, if not already supplied with the goodwill valuation.

2. Details of the activities of the business and any customers who provide over 15% of turnover.

3. Address of any website and details of how new business is obtained.

4. Copies of any brochures or advertisements for the business.

5. Details of properties occupied, including ownership; rights of occupation; rent charged; whether an arm's length arrangement.

6. Latest sales and profit forecasts, with evidence to show that such forecasts were part of the usual business routine and achieved more often than not.

7. Full explanation of your opinion of the goodwill value used, with detailed calculations or any valuation report that underlies it (unless of course already supplied).

8. Copy of any sale agreement and deeds of assignment and/or full details of what was transferred into the limited company and the consideration received (total, shares, cash or loan account etc.) if not clear from the above.

G M Wildin v HMRC TC01782

The taxpayer started an accountancy business in 1981 with no goodwill. He transferred the business in 2003 to a connected company and became liable to CGT on the proceeds.

That is a common event, and of course the old indexation revaluation rules the base cost of the goodwill on disposal had to be the value at 31 March 1982. In his tax return for 2002/03 the taxpayer said the value was £516,940. Not surprisingly HMRC claimed it was £75,000 and amended his return to reflect the lower amount.

What was on the face of it is surprising is that the taxpayer and HMRC agreed that the value of the share of the business in April 2003 was £1.4m, and the department accepted the estimate of the goodwill at that date.

The taxpayer later wished to amend his appeal to include evidence in relation to the 2003 valuation, to show it was excessive. HMRC objected to the taxpayer being given leave to make the amendment because all parties had agreed the £1.4m valuation.

The matter proceeded to the First-tier Tribunal, to decide if the taxpayer should be allowed to amend his grounds of appeal. The judge found there was no reason **not** to allow the amendment. It would not cause undue delay, and the extra costs were not significant.

Contributed by Gerry Hart

SEIS guidance from HMRC (Lecture B738 – 12.36 minutes)

HMRC has issued guidance under SEIS, with many of its comments based on its experiences under EIS. Given the generous batch of tax breaks available under SEIS, great care is needed to ensure no problems arise.

Investment requirements

Shares must be paid up in full, and in cash, when they are issued.

One of the most common reasons for investments failing to qualify for relief under EIS, which may also apply to SEIS, is that shares are issued to investors without the company having received payment for them. This sometimes happens when a new company is registered at Companies' House and shares are issued to members as part of the registration process, but the company takes some time to set up a bank account and the shares are not paid for until that has happened.

HMRC advise companies and investors to ensure that any shares on which it is intended SEIS relief will be claimed, are not issued during the company registration process but are issued only at a later date when the company is able to receive payment for them.

Shares must be full-risk ordinary shares, and may not be redeemable or carry preferential rights to the company's assets in the event of a winding up. Shares may carry limited preferential rights to dividends, but may not include rights where either:

- The rights attaching to the share include scope for the amount of the dividend to be varied based on a decision taken by the company, the shareholder or any other person. (this exclusion covers only those shares which carry preferential rights and does not therefore prevent the voting of dividends in respect of non-preferential shares, nor does it prevent shareholders from choosing to waive a dividend payment should they wish to do so.) ; or

- The right to receive dividends is 'cumulative' – that is, where a dividend which has become payable is not in fact paid, the company is obliged to pay it a later time, normally once funds become available.

There must be no arrangements to protect the investor from the normal risks associated with investing in shares, and no arrangements at the time of investment for the shares to be sold at the end of the relevant period.

The shares may not be acquired using a loan made available on terms which would not have applied other than in connection with the acquisition of the shares in question.

The shares must not be issued under any 'reciprocal' arrangements, where company owners agree to invest in each other's companies in order to obtain tax relief.

There must be no arrangements (either at time of issue of the shares or later) to structure a company's activities with the main purpose of allowing a party other than the company to benefit from the tax advantaged finance which the scheme is intended to incentivise; or where those activities have no commercial purpose other than to generate tax relief.

Investor requirements

An investor may be eligible for tax relief providing:

He has subscribed for shares which have been issued to him and which at the time of issue were fully paid for. You may subscribe via a nominee.

He with associates does not own over 30% of the issued share capital or voting rights, at any time from incorporation to the 3rd anniversary of the date the shares were issued.

He is not employed by the company at any time during the period from date of issue of the shares, to the third anniversary of that date. For this purpose, the investor is not treated as employed by the company if he is a director of the company.

When relief will be withdrawn or reduced

HMRC will withdraw tax relief if, at any time during the three years from date of issue of the shares:

- you become employed by the company without being a director of the company
- your holding in the company exceeds 30% as above
- the company loses its qualifying status

Tax relief will be either withdrawn or reduced if at any time during the three years from date of issue of the shares any of the following occurs (there is a requirement to notify HMRC within 60 days of the event):

- You dispose of any of the shares (other than to a spouse or civil partner – in those circumstances the shares are treated as though the spouse or civil partner had subscribed for them).
- You or an associate receive 'value' from the company, or from a person connected with that company. The rules to do with receiving value from the company are similar to those for EIS. It can include the company repaying any of its shares or securities which you hold; repaying a

debt owed to you, if that repayment is in connection with the issue of shares; you receiving a loan or benefit from the company; or the company selling an asset to you at less than market value (or you selling an asset to the company at more than market value). How much tax relief is withdrawn will depend on the amount of the value received. Insignificant amounts of value received can be ignored, and there is also scope for relief to be retained if the value received is made good by the investor as soon as is practicable.

How does a company qualify?

For its investors to be able to claim and keep the SEIS tax reliefs relating to their shares, the company which issues the shares has to meet a number of requirements. Some of these apply only at the time the relevant shares are issued. Others must be met continuously, either for the whole of the period from date of incorporation to the 3rd anniversary of the date of issue of the shares, or in some cases, from date of issue of the shares to the 3rd anniversary of their issue. If the company ceases to meet one or more of those conditions, investors may have their tax relief withdrawn.

There are requirements as to how the company must use the monies it has raised via the issue of relevant shares.

Company requirements to be met at the time of issue of the shares

The company must be unquoted at the time of issue of the shares. For SEIS rules the Alternative Investment Market (AIM) and the PLUS Markets (with the exception of PLUS-listed) are not considered to be recognised exchanges, so a company listed on those markets can raise money under SEIS if it satisfies all the other conditions.

It must have fewer than 25 employees. If the company is the parent company of a group, that figure applies to the whole group.

It must have no more than £200,000 in gross assets. If the company is the parent company of a group, that figure applies to total of the gross assets of the company and its subsidiaries. Shares in, and loans to, subsidiaries, are ignored for this purpose.

The company must not have had any investment from a Venture Capital Trust (VCT), or issued any shares in respect of which it has submitted an EIS compliance statement.

The company is restricted as to the amount of money it may raise under SEIS. It may not receive more than £150,000 in total under the scheme. That figure of £150,000 must also take account of any other State Aid received by the company in the three years preceding the relevant share issue which is de minimis aid according to EU regulations. (HMRC would not expect this to be common and if the company has had any such de minimis State Aid it will have been advised accordingly by the body responsible for administering that aid.) If the relevant issue of shares takes the total over £150,000, then the excess will not qualify for relief.

Any trade being carried on by the company at the date of issue of the relevant shares, must be less than two years old at that date. That condition applies whether the trade was first begun by the company, or whether it was first begun by another person who then transferred it to the company. The company need not have started trading when it issues the shares.

The company must not have carried on any other trade before it started to carry on the new trade.

Company requirements to be met continuously from date of incorporation

The company must not be controlled by another company or another company and any person connected with it; and there must be no arrangements in place for it to be controlled by another company. However, if for genuine commercial reasons a company needs to put a new holding company above itself, it may do so without investors losing tax relief subject to certain conditions. The conditions are the same as those which apply for EIS.

It must not be a member of a partnership.

The company may have subsidiaries, but if it does they must all be subsidiaries in which the company has more than 50% of the ordinary share capital and which are not controlled (by other means) by any other company.

The company may not control another company which is not a qualifying subsidiary, and there must be no arrangements in place which would allow that to happen.

Company requirements to be met continuously from date of issue of shares

The company must be UK resident, or have a permanent establishment in the UK.
If a single company, it must exist wholly for the purpose of carrying on a qualifying trade. If it is the parent company of a group, the group's business is looked at as though it were one business which must, in the main, meet the requirements of the scheme.

There is no requirement that the company or group must begin a qualifying trade within any specified period of time. However the company issuing the shares should be clear about what the intended qualifying trade is, and that should be apparent from

the use to which the monies raised by the relevant share issue are put.

How the money is raised by the relevant share issue must be used

Within three years of the date of the relevant share issue, all the monies raised by that issue must be spent for the purposes of a qualifying business activity, carried on either by the issuing company or by a 90% subsidiary. If this condition is not met, investors will lose their tax relief. The condition will be considered to be met if an insignificant amount is used for a non-qualifying purpose, or remains unspent.

Monies raised by a share issue are not regarded as being spent for a qualifying business activity if they are used to buy shares or stock in a company. This does not prevent the issuing company from investing the monies in a subsidiary, providing that the monies are thereafter used by a 90% subsidiary for the purposes of a qualifying business activity.

The payment of dividends to shareholders is not regarded as being for the purposes of a qualifying business activity.

A qualifying business activity is any of the following:

- carrying on a new qualifying trade
- the activity of preparing to carry on a new qualifying trade which the company intends to, and begins to carry on
- carrying on research and development which will lead to or benefit a new qualifying trade

HMRC assistance in advance of an issue of shares

HMRC operates an advance assurance facility for SEIS as it does for EIS. This facility allows companies to submit details of their plans to raise money, their structure and their activities in advance of an issue of shares, so that the SCEC can advise on whether or not the proposed share issue is likely to qualify for relief.

Although companies are not required to use it, HMRC recommend using the Form SEIS(AA) to make such an application. Companies are not required to obtain such an assurance, but companies, particularly those using the SEIS for the first time, may consider it prudent to do so. It gives an opportunity to spot any problems before shares are issued, and an assurance from the SCEC is also useful for companies to show to potential investors.

Formal company approval following an issue of shares

Before investors can claim any tax relief, the company must complete form SEIS1 and send it to the SCEC. The form contains a declaration that at the time of completion, the company has already met the requirements of the scheme to the extent that those requirements have to be met at the time of issue of the shares; and that it expects to meet all other requirements.

The company cannot submit an SEIS1 until either:

- it has been trading for at least four months
- if not yet trading, it has spent at least 70 per cent of the monies raised by the relevant issue of shares

If the SCEC accepts that the company, its activities, and the shares all meet the requirements of the scheme, it will issue the company with a certificate to that effect, and will supply claim forms (SEIS3) for the company to send to the investors so they can claim tax relief.

This process must be followed for every issue of shares in respect of which it is intended SEIS relief will be claimed.

How to claim relief

The investor cannot claim tax relief until the company has sent in a claim form as described above. A claim may be made in the Self Assessment tax return for the tax year in which the shares were issued. If the investor has an SEIS3 for a year for which he has not yet received a tax return, he can request a change to the PAYE tax code, or an adjustment to any Self Assessment payment on account due. He will still have to make the claim itself on your tax return when you get it.

If the shares were issued in a year for which it is too late to make or amend a Self Assessment, or if the claim is for capital gains re-investment relief, the investor must also complete the claim part of the claim form and send it to his tax office.

He can claim relief up to five years after the 31 January following the tax year in which the investment was made. This is a longer period than for most reliefs, to take account of the fact that it is partially dependent on what the company does.

Contributed by Gerry Hart

The Chartered Institute of Taxation (CIOT) has warned that entrepreneurs setting up, or investing in, companies may not be aware they could exclude themselves from access to the seed enterprise investment scheme (SEIS) by purchasing a shelf company from a corporate provider.

The institutes expressed its concerns following publication of HMRC guidance in relation to the Finance Act provisions about the SEIS.

"Denying SEIS relief for shelf companies seems bizarre and illogical," said John Barnett, chairman of the CIOT capital gains tax and investment income sub-committee.

"Enterprise investment scheme companies are not subject to the same requirement, so why deny relief to SEIS companies? These will, by definition, be smaller start-ups, which are likely in this way to use a shelf company," Barnett added, criticising "one of many nit-picking points that bedevil venture capital reliefs."

Taxation Magazine, 24 September 2012

Whether loans made to participators

A company (AC) operated an 'employee participation scheme', designed to give shares to 'selected key employees'. Such employees entered into a 'facility agreement'.

HMRC considered that the effect of the agreement was that the employees became indebted to the company. They issued assessments charging tax under what is now CTA 2010 s 455. AC appealed, contending that the effect of the HL decision in Potts' Executors v CIR, 32 TC 211, was that it should not be treated as having made loans to the employees.

Decision:

The First-tier Tribunal rejected this contention and dismissed the appeals, finding that the effect of the agreement was that AC 'agreed with each employee to purchase shares on the employee's behalf from the trustee using the appellant's money, which money the employee agreed to repay at a later (uncertain) date'. Judge Mosedale specifically declined to follow obiter dicta of Lord Simonds in Potts' Executors v CIR, and held that a 'loan' should be construed as including 'a payment by A to C at B's request where there is a legal obligation on B to reimburse A the amount paid'.

The agreement here was 'a contract which gave rise to a debt from the moment it was completed which was when the trustee was paid'. Judge Mosedale observed that the tribunal should not 'give a strained and unnatural reading of "debt" to compensate for a wide definition of "participator" resulting in situations being caught by the anti-avoidance provision which may not have been the object of the anti-avoidance legislation'.

Comments - CTA 2010 s 455 provides for a charge to tax 'if a close company makes a loan or advances money to a relevant person who is a participator in the company or an associate of such a participator'. This decision focuses on the definition of a 'loan', rather than on the definition of an 'advance'.

It is noteworthy because Judge Mosedale specifically declined to follow obiter dicta of Lord Simonds in the 1950 case of Potts' Executors v CIR, and expressed a strong preference for the analysis propounded in the dissenting judgment of Lord Morton in the same case.

Aspect Capital Ltd v HMRC TC2112

Freedom of establishment

A UK company (P) claimed consortium relief in respect of losses incurred by a UK branch of an associated Netherlands company. HMRC rejected the claim on the basis that the effect of ICTA 1988 ss 403D and 406(2) was that P was not entitled to relief for these losses. P appealed, contending that the relevant provisions of ss 403D and 406(2) contravened EC law. The Upper Tribunal directed that the case should be referred to the CJEU for a ruling on the interpretation of Article 49 of the TFEU. The CJEU held that what is now Article 49 'must be interpreted as meaning that where, under the national legislation of a Member State, the possibility of transferring, by means of group relief and to a resident company, losses sustained by the permanent establishment in that Member State of a non-resident company is subject to a condition that those losses cannot be used for the purposes of foreign taxation, and where the transfer of losses sustained in that Member State by a resident company is not subject to any equivalent condition, such provisions constitute a restriction on the freedom of a non-resident company to establish itself in another Member State.' Such a restriction 'cannot be justified by overriding reasons in the public interest based on the objective of preventing the double use of losses or the objective of preserving a balanced allocation of the power to impose taxes between the Member States or by a combination of those two grounds'.

Comments - As was widely expected, the CJEU has upheld Advocate-General Kokott's Opinion and held that the UK legislation contravened the EC Treaty.

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

Compensation on post office closure

The taxpayer was a sub-postmaster, who received a compensation payment of £74,177 in 2008/09 as a result of the closure of the post office she ran. She did not declare the payment in her tax return for the year. HMRC opened an enquiry into the return and concluded the amount was chargeable to tax.

A statutory review upheld the department's decision and the taxpayer appealed to the First-tier Tribunal, arguing the payment was compensation for loss of her business and was partly capital, partly revenue.

The taxpayer contended that she was not an employee of Post Office Ltd, but was contracted to the company to provide its services. She had bought the business for £50,000 and had spent another £24,850 on improving the premises and discharging an obligation on a long-term lease when the post office closed down.

HMRC argued that, while they agreed that she was not an employee of Post Office Ltd, the taxpayer's role of sub-postmaster meant that, under ITEPA 2003, s 5, she should be considered an office-holder.

The department's view was that the compensation payment was chargeable to income tax under ITEPA 2003, s 401(1), because the pack sent to the taxpayer by Post Office Ltd stated the amount was 'discretionary payment for your loss of office'.

Decision:

The tribunal agreed with HMRC that the taxpayer should be considered an office-holder, and found that, in the absence of evidence to suggest the compensation was other than as described by Post Office Ltd, the payment fell within the scope of s 401(1) and was chargeable to income tax.

The tribunal did not consider that 'expenditure of the type described by the appellant would serve to displace our view that payment was in connection with the termination of an office'. The taxpayer's appeal was dismissed.

Comments – This case is one of a number of cases dealing with the termination of the position of a sub-postmaster. The holder is often of the genuine opinion that the receipt of the compensation is part of their trading profits but it is clear that the position is an office and therefore the compensation is within s401 (1). This will not necessarily be the last case of its type.

I Owolabi (TC2020)

Compensation or trading receipt?

A solicitor (L) occupied premises on the route of the Edinburgh Tramway. He received compensation of £4,000 for possible disruption caused by the construction of the tramway. HMRC issued a ruling that this was a trading receipt.

Decision:

The First-tier Tribunal dismissed L's appeal. Judge Mure observed that 'the inclusion within the scheme of businesses, but not private individuals, suggests that it is a surrogatum for business turnover'.

Comments - The First-tier Tribunal upheld HMRC's view that the compensation which the solicitor received was a trading receipt. The nature of the receipt was that it was made to compensate businesses partly for the loss of business following from the construction.

J Lints v HMRC TC2168

Availability of capital allowances?

The appellant, who ran yacht charter business in his spare time, entered into an agreement with a management company (“B”) to rent and charter the vessel in Italy. Under the agreement B was granted sole management rights over the vessel, and B received 22% of the net income and a fixed fee for each charter for “technical management”. The appellant was responsible for the insurance of the vessel and B was responsible for, inter alia, maintenance, embarkation and debarkation of crews, passenger check-in and check-out, clearing the vessel and supplying accessories. The appellant claimed capital allowances on the yacht and sought to set off losses against general income in accordance with TA 1988 s 380. HMRC disallowed the claim and amended the appellant's tax return for the year ended 5 April 2007. HMRC also made discovery assessments under TMA 1970 s 29 for the years ended 5 April 2004–2007 on the ground that the appellant had been negligent in not making full disclosure of the business. The appellant appealed. The issue arose as to whether the vessel chartering constituted a provision “of plant or machinery for leasing in the course of a trade” within the meaning of TA 1988 s 384(6). The appellant argued that the way the vessel was chartered through bareboat leasing, ie it did not come with a skipper, and the additional services provided by B—including assisting with safe embarkation and debarkation and advice on weather and routes—amounted to a provision of services rather than the provision of plant or machinery for leasing.

Decision:

In determining whether vessel chartering constituted a provision “of plant or machinery for leasing in the course of a trade” within the meaning of TA 1988 s 384(6), the question was whether the nature and extent of what was being provided to customers was something other than the provision of the yacht for leasing.

The fact that the charters did not come with a skipper did not dispose of that issue. It was firstly necessary to establish the nature of the relationships between the parties. On the facts B acted as the appellant's agent in concluding charters of the yacht and the end customer. There was no agreed price over an agreed period, and the fact that B sought approval from the appellant on pricing matters and updated him on bookings status did not indicate that B was the charterer. In addition, the grant of “sole management rights” was consistent with B acting as an agent. Thus the core of what was being provided to the customers was the lease of the yacht and the other elements, including the services provided by B, were either inherent in the provision for leasing or ancillary to it. In addition, the provision of marina berth and customer parking did not detract from the core of the arrangement being the customers' hire of the yacht. Although location and ambience of the marina might help narrow down the location of the desired yacht, customers were ultimately interested in, and were paying for, the hire of the yacht. It followed that the appellant was unable to set the losses derived from the capital allowances on the yacht against his general income.

The appellant's view that the losses were not in respect of provision of plant for leasing because of the additional services which were being provided and the approach he took on the basis of that view was not conduct which fell below what might be expected of a reasonable taxpayer. However, HMRC could not have reasonably been expected to be aware of the under assessment until 22 September 2008 at the earliest when the appellant gave further detail about the yacht charter and mentioned it was a bareboat charter, but that a skipper could be employed privately by the charterer. Yacht charters where a skipper was provided would on the face of it give rise to the entitlement to relief against general income. Accordingly, HMRC were entitled to raise the discovery assessment on the basis of the second alternative pre-condition set out in TMA 1970 s 29(5). The appeal against the discovery assessment for 2003–04 was allowed on the grounds that it was out of time, but the other appeals would be dismissed.

Appeal allowed in part.

Comments – Capital allowances are a valuable relief in business and a key part of the business equation. There are a number of strict conditions that apply particularly by reference to leasing trades – In this case although the taxpayer alleged that bareboat leasing was taking place the Tribunal were of the opinion that it was leasing in the course of a trade and it followed that the set off of losses derived from capital allowances was not available.

Johnson v Revenue and Customs Comrs TC 2094

Who is a qualifying person for AIA purposes?

Mr and Mrs S and a company S were the owners of Hoardweel Farm. There was no formal partnership between the parties. Annual investment allowances of £16,027 were shown in the farm accounts to 31 July 2008.

Referring to CAA 2001, s 38A, HMRC disallowed the claim on the basis that the farm was not a qualifying person as not all the partners were individuals, i.e. one of the partners was a limited company. The taxpayer appealed on the basis that S was not a partner in the Hoardweel Farm Partnership as it did not trade.

Decision:

The First-tier Tribunal did not agree that the company could be treated as a separate entity with no interest in the farm. It may have been effectively dormant for some years, but it was required to make tax returns when it received taxable income or gains. Furthermore, the accounts did not show Mr and Mrs S as the only partners, but included the company as using a partnership capital account.

The taxpayer's appeal was dismissed.

Comments - It has been clear since the introduction of the annual investment allowance in 2008 that certain persons would not qualify. Only individuals, companies and partnerships of which all the members are individuals qualify. It was therefore an unsurprising decision in the circumstances.

Hoardweel Farm Partnership (TC2097

Costs of defending ownership of business

Two brothers operated a small shop in partnership. Their sister (R) began High Court proceedings, claiming that she was also a partner. The High Court dismissed the claim. The partnership claimed a deduction for the cost of defending the proceedings. HMRC rejected the claim on the basis that it was capital expenditure and related to a partnership dispute.

Decision:

The First-tier Tribunal allowed the partnership's appeal, specifically distinguishing C Connelly & Co v Wilbey [1992] STC 783 (which HMRC had cited as an authority), on the grounds that that case related to a dispute between two partners, whereas in the present case the court had found that R had

never been a partner. Judge Kempster observed that the High Court proceedings had been 'a failed claim by an outsider (R) against the assets and profits of the firm' and the partners had been resisting 'an unjustified claim in order to preserve the assets of the business'.

Comments - When considering the deductibility of legal expenses one must consider the nature of the underlying litigation. This is an important decision because the First-tier Tribunal specifically rejected HMRC's attempt to extend the scope of the decision in the 1992 case of C Connelly & Co v Wilbey. As Judge Kempster observed, that case was clearly distinguishable because it related to a dispute between members of a partnership. In the present case, however, the partners had had to incur expenditure in order to protect their business from 'a failed claim by an outsider'. The facts were therefore more akin to the 1940 case of Southern v Borax Consolidated Ltd, and the expenditure was allowable as a deduction.

Linslade Post Office & General Store v HMRC

Contribution to legal costs incurred by parent company

Two brothers (SB and DB) controlled a Delaware corporation (BC). They, and BC, each owned one-third of the shares in a UK company (BL), which owned 95% of the shares in another UK company (P).

In 2000, the US government began legal proceedings against BC, SB and DB, for supplying goods to Cuba in violation of the Trading With the Enemy Act 1917 and the Cuban Assets Control Regulations. BC, DB and SB were convicted on some of the charges against them: BC was fined $250,000, while DB and SB were each fined $10,000. P made a contribution of £3,807,294 to the legal costs which BC had incurred, and claimed that this should be allowed as a deduction in computing its profits.

HMRC rejected the claim on the basis that the expenditure had not been wholly and exclusively incurred for the purpose of P's business.

Decision:

The First-tier Tribunal dismissed P's appeal against this decision. Judge Clark held that there had been a 'duality of purpose' and that '(P's) expenditure in making a contribution to the legal costs was not wholly and exclusively for the purposes of its trade'.

Comments - The First-tier Tribunal upheld HMRC's view that the expenditure here was not wholly and exclusively for the purposes of the UK company's business, but was partly for the purposes of the American parent company and the controlling shareholders.

Purolite International Ltd v HMRC TC 2151

Prepayments of interest

A company director (C) was offered the opportunity to invest in a property development company (S). He borrowed £1,000,000 from a finance company (T) and subscribed for a £1,000,000 loan note in S. On 5 April 2002 C made a payment of £899,995 to T, which was described as a prepayment of interest due on the loan (which had been expressed as lasting for 30 years). On his 2001/02 tax return, he claimed tax relief on the basis that this was a payment of interest. HMRC rejected the claim on the basis that the payment was partly of capital rather than interest, and issued an amendment to C's return. C appealed. In the meantime, C had entered into a similar transaction and made a similar payment, also described as a prepayment of interest, in March 2003. C claimed relief for this payment in his 2002/03 return, and HMRC began an enquiry. Following negotiations, a meeting took place between C, his professional advisers, and two HMRC officers in November 2005. One of the HMRC officers proposed a compromise agreement whereby relief should be given for 50% of the disputed payments in the tax years in which they were made, with relief for the remaining 50% being spread over the life of the loans. Later that month HMRC sent a draft agreement, on these lines, to C's solicitors. In December 2005 C sent a signed copy of the agreement to HMRC, and paid £404,258 to HMRC in accordance with the agreement. HMRC formally accepted C's offer in November 2007. Meanwhile, C had entered into similar transactions in 2006/07, and had made a payment of £2,594,028, again as a prepayment of interest due on a 30-year loan, on 4 April 2007. On his 2006/07 tax return, C claimed tax relief on the basis that this was a payment of interest. HMRC began a further enquiry into this return. They subsequently issued a closure notice rejecting the claim, and in January 2009 they issued discovery assessments for 2001/02 to 2005/06 under TMA 1970 s 36, resiling from the previous agreement on the grounds that there had been a 'material non-disclosure'.

C appealed, contending firstly that the payments were genuine prepayments of interest, and alternatively that the effect of the agreement reached in December 2005 was that the discovery assessments were invalid.

Decision:

The First-tier Tribunal reviewed the evidence in detail, accepted both these contentions and allowed C's appeals. Judge Berner accepted C's contention that he had decided to make the prepayments 'on investment grounds, whilst appreciating that tax is an element in calculating the value of any investment decision'. The payments were of interest rather than capital, and were not paid at 'a rate in excess of a reasonable commercial rate'. Furthermore, the discovery assessment for 2001/02 was invalid because the assessment for that year had been settled by an agreement under TMA 1970 s 54. The liability for subsequent years had not been agreed under s 54, but HMRC was still bound by the settlement agreement which they had reached in December 2005 relating to the transactions in 2002 and 2003. The December 2005 agreement had not included any requirement for C to give any undertaking not to enter into similar subsequent transactions, and C's failure to mention that he was contemplating entering similar transactions in the future did not mean that the agreement could be treated as void.

Comments - ICTA 1988 s 787 (which has subsequently been superseded by TIOPA 2010 Sch 7 para 52) provided that relief was not due for payments of interest if arrangements had been made 'such that the sole or main benefit that might be expected to accrue to that person from the transaction' was a consequent reduction in tax liability. The First-tier Tribunal rejected HMRC's contention that the payments here were caught by this provision. The tribunal also held that HMRC was bound by an agreement which two of their officers had reached at a meeting in 2005.

GP Curran v HMRC TC2194

VAT

UK courts to decide

The taxpayer companies, including Littlewoods, were catalogue-based home shopping businesses. This involved agents who earned income on third party purchases.

Between 1973 and 2004, commission on third party purchases was incorrectly treated as consideration for services provided by the agent to Littlewoods. It should have been treated as a discount against the consideration for past purchases. As a result, the companies overpaid VAT and claimed for repayment under VATA 1994, s 80.

HMRC paid simple, rather than compound, interest on the repayment. Littlewoods said that compound interest should be paid and claimed sums amounting to about £1bn.

The High Court considered that Littlewoods' claims should be dismissed, but referred the matter to the European Court of Justice to confirm whether or not EU law required national law to provide for payment of compound interest.

Decision:

The European Court of Justice ruled that it was for national law to determine, in compliance with the principles of effectiveness and equivalence, whether the principal sum must bear simple interest, compound interest or another type of interest.

Comments – This decision means that the taxpayer companies with outstanding claims for compound interest 'will have to hold their breath a little longer for the matter to be resolved — at least until the High Court makes a determination on whether other taxes provide more generous remedies', said Lorraine Parkin, head of indirect tax at Grant Thornton UK LLP. She added that encouragement might be derived 'from the fact that the European Court of Justice has not completely dismissed the notion of compound interest and has referred the matter back to the UK court'.

Littlewoods Retail Ltd v HMRC (and related applications) (CJEU Case C-591/10)

Do not rely on others

Gemini was subcontracted to provide scaffolding for halls of residence at two universities. Haymills and Leadbitters were the main contractors for these projects. In December 2007, HMRC visited Gemini and found that it had not accounted for VAT on supplies it made to the contractors because neither had included VAT in the self-billed invoices they issued retrospectively to Gemini.

The VAT officer subsequently advised Gemini that although the hire of scaffolding must be standard rated, supplies of the erection and dismantling of scaffolding should be zero rated when the project was the construction of a university hall of residence. A fair and reasonable apportionment was therefore required. This was incorrect as under VATA 1994, Sch 8 group 5, zero rating only applies where such services are supplied 'in the course of construction'. Only the main contractor makes supplies in the course of construction; a subcontractor such as Gemini does not, and so as a matter of law, all its supplies should be standard rated.

He suggested that Gemini submit VAT-only invoices to the contractors, which it did, and passed on the VAT to HMRC. The officer then realised that his advice regarding the zero rating of elements of the scaffolding was wrong and VAT was due on its erection and dismantling. This VAT was obtained from one contractor and paid to HMRC, but by this time the other contractor had gone into administration, so Gemini was unable to collect the extra VAT through a VAT-only invoice. HMRC said the VAT remained due and that Gemini was responsible for its payment. Gemini appealed.

Decision:

The First-tier Tribunal sympathised with Gemini's predicament but said that the problem originated from the company accepting incorrect self-billing. Had the contractor not gone into administration, the VAT may well have been obtained from that business, but this was not sufficient for HMRC to operate VATA 1994, s 29 and pursue the contractor, rather than the subcontractor, for the outstanding tax. Gemini should pay the VAT due.

The tribunal judge suggested that it may be appropriate for HMRC to take into account their officer's incorrect advice concerning zero rating if they decided to charge interest or penalties.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant points out two learning points from this case. First, 'a supplier has the responsibility for getting the VAT liability right on all of its income sources, it is not acceptable to rely on a customer, even where the customer is raising a self-billed invoice' and second, 'in the case of a new charitable building, such as a church, or new building for a relevant residential purpose, e.g. student accommodation, it is only the services of a main contractor that are zero rated, not those of subcontractors working for the main contractor'.

Gemini Riteway Scaffolding Ltd TC2053

Public houses: option to tax

Two companies owned a large number of public houses, which they had opted to tax. The public houses contained both commercial and residential accommodation. In accounting for VAT, they reclaimed input tax on various expenses relating to the upkeep of the public houses. HMRC issued a ruling that 10% of the rent should be treated as relating to the domestic parts of the premises, and that as an option to tax did not apply to residential property, the companies were not entitled to credit for that part of the input tax. The companies appealed, contending that the whole of the rent should be treated as relating to the commercial parts of the public houses.

The First-tier Tribunal rejected this contention and dismissed the appeals. Judge Tildesley observed that 'the portion of rent attributable to the residential element of a single supply of mixed commercial and residential premises is excluded from the scope of the option to tax. This in turn preserves the exemption from VAT for the portion of rent attributable to the residential part and splits the single supply between exemption from VAT for the residential part and standard VAT rating for the commercial part.' On the evidence, he held that 'an element of the rent was directly attributable to the residential accommodation' and found that the companies' 'assertion that the residential accommodation within public houses was provided free of charge to tenants was not corroborated by documentation issued to tenants'.

The Upper Tribunal upheld the First-tier decision as one of fact.

Comments - The Upper Tribunal has upheld the First-tier decision that part of the rent related to the domestic accommodation in the public houses, so that the companies were not entitled to credit for the corresponding part of their input tax.

Enterprise Inns plc v HMRC (and related appeal) (Upper Tribunal)

Misunderstanding the option

Atchem was registered for VAT with effect from March 2004. In May 2008, the company acquired another shop as an investment property. The shop came with a tenant in place and the seller had opted to tax the property. On the basis that Atchem, as the buyer, would also make a VAT option, the sale was treated as a transfer of a going concern and no VAT was charged on the price. Subsequently, the company collected rent from the tenant, but did not charge it any VAT or account for VAT to HMRC until February 2011.

At a routine VAT inspection, HMRC asked to see evidence that the company had opted to tax the property to support the treatment of the sale as a transfer of a going concern. In December 2010, the company submitted a late application to opt to tax the property, asking for this to take effect from May 2008. HMRC refused to backdate the application. The company appealed.

Decision:

The First-tier Tribunal concluded that the company had not understood that for the property to be bought as a transfer of a going concern, it was necessary to opt to tax. This requirement became clear to the company only when HMRC asked to see evidence that it had opted to tax the property. The failure to charge and account for VAT until February 2001 was consistent with the company not having opted to tax.

The taxpayer company's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said, 'this case highlights the need for great care and attention to be given to land and property matters' in relation to VAT.

Atchem Ltd TC2064

Green fees dispute rolls on

The taxpayer was a non-profit-making golf club. An issue arose as to the VAT treatment of green fees paid by visiting non-members playing on its course. For many years, the club had accounted for VAT on them in line with the VAT tribunal decision in Keswick Golf Club (and related appeals) (15493). But in 2009, it submitted a repayment claim on the basis that the fees were exempt under article 132(1)(m) of the EC VAT Directive.

HMRC refused the claim, saying the fees were liable at the standard rate.

The First-tier Tribunal found in favour of the taxpayer. The judge held that excluding supplies to non-members from the scope of the exemption in VATA 1994, Sch 9 group 10 item 3 contravened article 133 of the directive.

The Revenue appealed on the ground that the tribunal erred in law.

The issues were whether UK law correctly implemented article 132(1)(m), which itself depended on the interpretation of article 133(d) and article 134(b).

Decision:

The Upper Tribunal said that, in the circumstances, it would 'feel considerable unease in refusing to refer the matter to the ECJ'. Despite the likely delay this would cause, the reasons to do so were sufficient to outweigh that disadvantage.

The case was referred to the European Court of Justice for a decision as to the interpretation of article 133(d) and also article 134(b).

Comments - Article 132(1)(m) of Directive 2006/112/EC requires Member States to exempt 'certain services closely linked to sport'. Articles 133 and 134 provide certain restrictions on the scope of this exemption (Article 133 being discretionary and Article 134 being mandatory). In the UK, VATA 1994 Sch 9 Group 10 Item 3 provides that where the supplier operates a membership scheme, supplies to non-members are not exempt. The question of whether this restriction was compatible with the EU provisions was called into question in the 1990s, but the Manchester VAT Tribunal found in favour of Customs in the Keswick Golf Club case. The VAT Tribunal chairman who decided that case has subsequently changed his views, and the Upper Tribunal has decided that the case needs to be referred to the CJEU. Golf clubs which have accounted for VAT on 'green fees' charged to non-members should consider taking the opportunity to submit repayment claims if they have not already done so. HMRC's current practice is set out in HMRC Brief 30/11, issued on 27 July 2011.

CRC v Bridport and West Dorset Golf Club Ltd, Upper Tribunal

Penalty mitigated by 100%

A painter (W) became liable to register for VAT from January 2007 but failed to do so. HMRC discovered this in 2011 and imposed a penalty. W appealed, contending that the penalty should be mitigated because he had accounted for income tax on the full amount of his turnover, whereas if he had registered for VAT at the appropriate time, he should only have accounted for income tax on the VAT-exclusive part of his turnover.

Decision:

The First-tier Tribunal accepted this contention and mitigated the penalty by 100%.

Comments - HMRC imposed a penalty on the grounds that the appellant had failed to register for VAT. However, the First-tier Tribunal accepted the appellant's contention that the penalty was unfair because he had already accounted for income tax on the full amount of his turnover, and if he had registered for VAT at the appropriate time, he would only have been required to account for income tax on the VATexclusive part of his turnover. The tribunal therefore mitigated the penalty in full. See the comment by Graham Elliott in Tax Journal, dated 14 September 2012.

R Wells v HMRC TC2172

Partnership introducing clients to fund managers

A partnership introduced wealthy clients to fund managers. Initially it accounted for VAT on its supplies. Subsequently it submitted a repayment claim on the basis that it should have treated its supplies as exempt under VATA 1994 Sch 9 Group 5 Item 5. HMRC rejected the claim but the tribunal allowed the partnership's appeal, finding that it 'introduced clients to the fund managers and acted as an intermediary between the clients and the fund managers for the purpose of acquiring and maintaining the portfolio of investments on behalf of the clients'.

Decision:

The First-tier Tribunal accepted the partnership's contention that it was supplying intermediary services which qualified for exemption.

Comments - The First-tier Tribunal accepted the partnership's contention that it was supplying intermediary services which qualified for exemption.

Bloomsbury Wealth Management LLP v HMRC TC02063

What is the supply - goods or services? (Lecture B739 – 19.24 minutes)

The global economy has created a number of VAT challenges e.g. in relation to electronic supplies or supplies of computer software. Are these supplies

relevant to goods or services? And why is it important as far as VAT is concerned?

In this session, we will therefore consider the difference between goods and services, and some practical VAT issues in dealing with both arrangements when we trade overseas.

Example 1

- John is VAT registered in the UK and sells washing machines to Pierre, who is VAT registered in France. The goods leave the UK and travel to Paris.
- Betty is VAT registered in the UK and advises Pierre on how to advertise and sell the washing machines that he has bought from John.

John's sales to Pierre are zero-rated but Betty's sales are outside the scope of VAT. A condition of a zero-rated sale of goods to a customer in the EU is that the customer must be VAT registered and this VAT number must be shown on sales invoices relevant to the sale. Betty's sales to Pierre are outside the scope of VAT because Pierre is 'in business' and therefore they qualify as B2B sales under the general rule i.e. the place of supply is based on where the customer is located i.e. in France.

Note – it is possible for a sale of services to an overseas EU customer to still be outside the scope of VAT even if he does not have a VAT registration number. This is because the key question with services is whether the customer is 'in business' rather than 'is he VAT registered'

Goods or services

The HMRC definition of a supply of services is 'something other than supplying goods' (VAT Notice 700, paragraph 4.5) – which is a very long list!

However, the definition is extended to include the phrase 'done for a consideration', which is good news because it means there is no VAT to worry about on a free supply of services, such as an accountant doing the year end accounts for a local charity without making a fee charge.

The difference between goods and services is clear in most cases because goods are usually tangible and can be seen by the customer.

To give everyday examples, a computer, handbag and cricket bat are clearly goods. In contrast, a hairdresser, opera singer and accountant are obviously supplying services because the customer is receiving no goods and is enjoying the skills of the individual in question.

However, there are a number of borderline situations, usually when computer related supplies are involved – see Example 2

Note - an electronic newsletter is standard rated

When VAT was introduced to the UK in 1973, there was no way of receiving information by email or electronic means – the facility did not exist.

So when VATA1994, Sch. 8 was introduced into the legislation, the zero-rating for printed matter in Group 3 was only relevant to printed matter on paper i.e. newsletters, magazines, books etc. That situation has remained unchanged for the last 40 years, so if a business makes a charge for electronic publications, these supplies will be standard rated.

Example 2

Betty from Example 1 produces a monthly newsletter for £600 per year that gives UK subscribers advice and tips on marketing. The newsletter has always been posted to subscribers in paper format but with effect from 1 January 2013, it will be e-mailed to each subscriber on a monthly basis. What is the VAT position?

The paper copy of the newsletter qualifies as a supply of goods, eligible for zero-rating as printed matter under VAT Act 1994, Schedule 8, Group 3.

The e-mail arrangement means the customer is now receiving a supply of electronic services – and the supply is standard rated. The subscription should be increased to £600 plus VAT from 1 January 2013.

Computer software supplies

What is the situation regarding computer software supplies?

To give a simple example, if I go into my local store and buy a copy of a standard accounting software package from the shelf, such as Sage Line 50, this is a supply of goods. This is because the software is a mass-produced item that is freely available to all customers. In effect, personal and home computer software, game packages etc are all classed as a supply of goods.

In contrast, if I order a 'specific' software product for my own requirements (i.e. to create a unique programme just for me), this is a supply of services. The expertise of the person(s) producing the package means I have paid for a supply of services.

As another practical example of the importance of deciding if supplies relate to goods or services, think of an importer's predicament as he buys the latest technology product from the USA – does he have to declare his product as an import of goods (pay VAT at the time of import into the UK and reclaim this amount as input tax on his VAT return). Or is he making an import of services, in which case he can import the product VAT free (B2B purchase), and deal with the VAT on his next return using the reverse charge system? (output tax is declared in Box 1; input tax reclaimed in Box 4 – subject to normal rules).

The rules in the above situation are helpfully clarified by HMRC in Notice 702, para. 7.5 i.e. 'normalised software' (such as Sage Line 50) is treated as an import of goods but 'specific software' represents a supply of services.

Export of computer software – goods or services?

The same approach about whether a supply is a mass-produced or specific software product applies to computer supplies sold abroad – see Example 3 to illustrate this point.

Example 3

Steve is based in the UK and has designed a complex accounting software package for his car manufacturing client in Greece, charging £10,000. The package will enable the customer to calculate the cost of every vehicle it makes. The package is hand-delivered to the customer in Greece on a very powerful disc.

Steve is making a supply of services (customer designed software product) to a business customer outside the UK and his fee is outside the scope of VAT.

Again, the decision about whether a supply is of goods or services is crucial to the VAT compliance procedures of Steve. If he is making a supply of goods, he must retain evidence that the goods have left the UK (proof of export). The absence of export proof would give HMRC the power to treat the goods as being supplied in the UK – i.e. with a 20% VAT assessment!

Transfer of ownership – HP or lease?

Here are two other situations when a supply of 'goods' applies:

- any transfer of the whole property in goods
- the transfer of possession of goods

I will consider the above definitions in relation to a common situation encountered by practitioners, relevant to hire purchase (HP) and leasing agreements.

The key point with an HP agreement is that the intention of the agreement is that ownership of the goods will pass to the hirer at some point in the future, usually when the final payment has been made. The transaction therefore relates to a supply of goods.

The first instalment paid to the HP company usually includes a deposit on the asset and full payment of the VAT on the value of the goods. The hirer can reclaim input tax (subject to normal rules), even though he is paying for the goods over a longer period of time.

Contrast the above situation with the common lease hire arrangement for a car:

Example 4

John pays £400 per month to lease a car for three years and will then return it to the leasing company at the end of the period. In this situation, there is neither a transfer in the property of the goods, nor in the possession of the goods.

The monthly instalments of £400 therefore relate to a supply of services and should charge VAT at 20% (£80). As long as the vehicle has some business use, HMRC allows 50% input tax recovery (£40), again subject to normal rules.

The above examples are very clear – but the approach to adopt in any difficult situation is to study the written agreement in detail and the intention of the scheme as far as ownership is concerned. To give a legislative reference, Directive 2006/112/EC, Art 14(2)(b) rules there is a supply of goods where "in the normal course of events" ownership will pass at the latest upon payment of the final instalment.

Land

Another situation when a supply of goods is evident relates to a supply that involves 'the grant, assignment or surrender of a "major interest" in land.'

A major interest in the UK relates to either a freehold sale or a lease exceeding 21 years (20 years in Scotland).

In effect, this means that the rental of a property (landlord and tenant basis) involves a supply of services.

Flat rate scheme

Think of the implications to the flat rate scheme calculations with regard to computer software and deciding if a supply relates to goods or services:

Example 5

Nicola is VAT registered in the UK and uses the flat rate scheme. She makes two sales to Pierre, who is VAT registered in France:

- sale of a computer for £1,000
- sale of a piece of specific computer software that Nicola has designed for Pierre – charge of £2,000

The sale of goods to a VAT registered business in another EU country is zero-rated, as long as the goods leave the UK and proof of shipment is retained by the supplier. The sale of computer software to a non-UK business is the sale of a service where the place of supply (general B2B rule i.e. 'business to business') is based on the location of the customer i.e. France. In such cases, the sale by the UK business is outside the scope of VAT and the income is therefore excluded from the flat rate scheme. Income that is exempt or zero-rated is included in the flat rate scheme calculations i.e. £1,000 for the computer sale in this example.

Contributed by Neil Warren

Bad debts and credit notes (Lecture B740 – 14.38 minutes)

Every business hopes that bad debts and credit adjustments will not be a major problem. In the world of VAT, the subject of bad debts (and non-payment of sales invoices, a slightly different issue) has recently enjoyed a good run for its money – I will consider three recent cases in the courts, all lost by HMRC.

Basic rules

As an opening comment, if a business uses the cash accounting scheme, then bad debt relief is not a problem. This is because no output tax is payable on unpaid sales invoices with the scheme – just as input tax can't be claimed by a scheme user until a supplier has been paid. Without going into lots of detail about the scheme, it can be used by a business with annual sales of £1.35m or less (taxable sales excluding VAT).

So for a business that does not use the cash accounting scheme, output tax is usually declared on the VAT return relevant to the sales invoice date i.e. output tax is effectively being paid to HMRC on debtors.

In terms of bad debt relief i.e. recovering the declared output tax from HMRC on a future VAT return because the customer has not paid his dues, here are the key rules:

- A sales invoice must be at least six months overdue for payment. So if a sales invoice is raised on 31 March on 60-day payment terms, the earliest possible claim will be on the VAT return covered by 30 November.
- The invoice in question must be written off in the accounts of the business i.e. a credit to the customer's sales ledger account and a debit entry to a bad debt account on the profit and loss account.

The VAT return

Somewhat strangely, the bad debt relief claim is included as an increase in the Box 4 input tax figure rather than a decrease in the Box 1 output tax figure. And there is no reduction in the value of the Box 6 'outputs' figure either because you have still made a supply of either goods or services – it is just that you have not been paid for them.

Case 1 - Bad debt relief on a VAT only invoice

Imagine the following situation:

John is VAT registered as an accountant (sole trader) and reversed his car into a lamppost one morning causing a lot of damage to the vehicle. Fortunately, he has fully comprehensive insurance cover so the repair bill of £3,600 (i.e. £3,000 plus VAT) will not be a problem.

In such cases, the procedure will be that the car repair business will invoice the insurance company for the net amount of £3,000 and the VAT element will be invoiced to John with a VAT only invoice because he can claim input tax. This is correct because the car repair business has still supplied services to John – it is just that the insurance company has picked up the tab.

But what happens if John disappears to Spain and never pays the VAT bill to the garage?

In such cases, HMRC's view has always been that the car repair business can only claim bad debt relief on 1/6 of the VAT only invoice i.e. the VAT

fraction relevant to a 20% rate of VAT. In other words, he will claim £100 in my example.
The First Tier Tribunal in the case of Simpson and Marwick (TC0662) supported this view, in relation to VAT only invoices raised by a firm of solicitors, also linked to insurance claims. The taxpayer appealed to the Upper Tribunal…..and the argument of a 100% VAT recovery won the day i.e. £600 in my example.

It will be interesting to see how HMRC react to the case outcome – but it is definitely an opportunity for a possible windfall for businesses such as solicitors and car repairers if they've been stung by unpaid VAT only invoices in the past and only made a partial claim for bad debt relief.

Case 2 - The disputed invoice

Imagine another practical situation: I raise a sales invoice for £1m plus VAT in relation to some VAT consultancy work, the date of the invoice being September 2006. The client disputes the invoice and, some six years later after a lengthy litigation process, it is agreed in March 2012 that my fee should be £200,000 plus VAT. What are the VAT issues?

The above situation, with a change of dates, amounts and the nature of services, actually applied in the case of Cumbria County Council (TC1463), in relation to services provided to the Department for Environment Food and Rural Affairs (DEFRA) during the foot and mouth crisis many years ago. Here are the key issues, using my example as an illustration:

- I raise a credit note, once the court had agreed the final value of the debt in March 2012, for £800,000 plus VAT i.e. to reduce the output tax on my March 2012 VAT return. The legal basis for the credit note is VAT Regulations 1995/2518, Reg 38 – see Box 1

- HMRC's alternative view is that I have incurred a bad debt of £800,000 plus VAT and a VAT adjustment is therefore out of time in accordance with the bad debt relief regulations – see Box 1

Box 1 - The regulations considered in the Cumbria County Council case

VAT Regulations 1995 – SI1995/2518, Reg 38 – the credit note option

- this regulation deals with situations where '(1)(a) there is an increase in consideration for a supply, or (b) there is a decrease in consideration for a supply which includes an amount of VAT and the increase or decrease occurs after the end of the prescribed accounting period in which the original supply took place'
- '(3) Subject to paragraph (3A) below the maker of the supply shall (a) in the case of an increase in consideration, make a positive entry, or (b) in the case of a decrease in consideration, make a negative entry, for the relevant amount of VAT in the VAT payable portion of his VAT account'

VAT Regulations 1995 – SI1995/2518, Reg 165A – time limit for a bad debt relief claim

- 165A(1) – 'a claim shall be made within the period of 4 years and 6 months following the later of (a) the date on which the consideration (or part) which has been written off as a bad debt becomes due and payable to or to the order of the person who made the relevant supply; and (b) the date of the supply.'

Note – in effect, Reg 165A means that the latest claim date for a sales invoice raised on 28 February 2012 on 30-day payment terms will be September 2016. The time limit in Reg 165A was 3 years and 6 months until 1 April 2009.

The taxpayer's argument won the day and this seems logical. It was common ground i.e. accepted by both HMRC and the taxpayer, that a Regulation 38 adjustment was not time-barred like a bad debt claim. And because the original output tax declaration had been correctly made by the taxpayer on his original invoice (the fee he thought was due at the time), there was no issues with VAT error adjustments – in other words, there was no VAT error on a past return that is also capped at four years (or three years until April 2009).

Case 3 - Change in values of a supply

To complete a hattrick of VAT cases lost by HMRC, let's think about bingo clubs and the liability of their income split between participation fees (the right to play bingo – now exempt from VAT but standard rated for the periods in question) paid by the customer and a stake, which was a contribution towards the cash prizes and which are outside the scope of VAT.

In the case of Carlton Clubs Plc (TC1389), the taxpayer raised an internal credit note in 2009 to recalculate its output tax liability for the period 1996 to 2003, based on a different calculation method in relation to the split between standard rated and outside the scope supplies. In other words, a greater proportion of fees collected from customers became relevant to the stake rather than participation fees.

The amount of VAT involved was £718,732 and HMRC disallowed the adjustment as being 'out of time' under the VAT error adjustment rules (i.e. four

years since 1 April 2009 but three years until this date).

However, the taxpayer again referred to Regulation 38 (no time bar) and claimed that the internal credit note was adequate evidence to support the adjustment in his VAT account i.e. as a 'decrease' in the consideration for the supply. The taxpayer argued (successfully) that no error had occurred at the time of the original VAT returns being submitted because the output tax declaration was correct at the time.
It was only when HMRC subsequently issued Business Brief 7/2007 on 1 February 2007 stating that an alternative calculation basis should be used and also allowed on a retrospective basis.

Message - A simple issue in the world of VAT can encounter many twists and turns – who would have thought we would have three cases in such a short period of time, on an issue that most advisers thought was fairly simple, all lost by HMRC?

As a final planning tip, if you (or a client) use the flat rate scheme, be aware that there is scope for an extra bit of VAT to claim back in bad debt situations. Have a look at HMRC Notice 733, section 14.

Contributed by Neil warren