TAX UPDATE

Tolley®CPD

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Contents

PERSONAL TAX

High Income Child Benefit charge – HMRC Briefing (Lecture P741 – 15.32 minutes)

From 7 January 2013, any taxpayer with income above £50,000 in a tax year who receives Child Benefit, or whose partner receives Child Benefit, will be liable to incur a new income tax charge. This HMRC briefing explains who will be affected, how the charge will work and how HMRC will administer it, including the information HMRC will provide to customers affected by the changes.

Who the charge will affect

Approximately one million taxpayers will be affected by the charge, out of the eight million taxpayers who currently claim Child Benefit. A taxpayer will be liable to pay the charge if any of the following apply to them:

- they have an individual income of more than £50,000 in a tax year and receive Child Benefit, or
- they have an individual income of more than £50,000 in a tax year and live or lived with a partner receiving Child Benefit, or
- where partners each have individual incomes of more than £50,000 and one partner is receiving Child Benefit, the partner with the higher income will be liable to pay the charge.

Taxpayers will also be affected during a tax year if:

- they have an individual income of more than £50,000 in a tax year, and
- someone else receives Child Benefit for a child living with the taxpayer and that person contributes an amount at least equivalent to Child Benefit towards the child's upkeep to the taxpayer.

Taxpayers do not have to pay the charge where:

- they and their partner each have individual incomes below £50,000 in a tax year, or
- they or their partner are not entitled to Child Benefit.

How the charge will work

Anyone who has to pay the charge will need to pay an amount equivalent to some or all of the Child Benefit that they or their partner is entitled to receive. The amount of the charge depends upon the level of their 'adjusted net income', and the amount of Child Benefit that the claimant is entitled to receive.

For those with income between £50,000 and £60,000, the tax charge will be less than the Child Benefit entitlement. They will pay one per cent of the Child Benefit entitlement for every £100 of their income above £50,000.

Example

If the higher earning partners earns £53,550 the excess of £3,550 over the £50,000 threshold will result in a percentage charge of 35% (rounded down to next whole %). If we applied the 35% to the child benefit of £1,752.40 (two children) then the income tax charge would be £613 (rounded down to next whole pound).

What taxpayers need to do

Those affected by the charge have two options:

- **keep receiving** the Child Benefit payments and declare them for income tax purposes, or
- **stop receiving** Child Benefit payments, which would mean that they would not have to pay the income tax charge. They would be able to restart their payments if their circumstances change. Only the Child Benefit claimant can ask to have the payments stopped.

If a taxpayer's income is between £50,000 and £60,000, the tax charge will always be less than the amount of Child Benefit and the claimant might wish to keep getting Child Benefit payments. Those with income above £60,000 will be charged the full amount of the Child Benefit entitlement and might wish to stop receiving Child Benefit payments. Customers will also be able to change their mind about which option they choose.

If customers choose to **keep receiving** the Child Benefit payments they will need to declare the amount of Child Benefit which they or their partner are entitled to receive, by registering for Self Assessment by 5 October 2013 (if they are not already registered) and filling in a tax return each year.

If customers choose to **stop receiving** payment of Child Benefit, they need to let HMRC know before 7 January 2013. They can use a simple online form at hmrc.gov.uk/ stopchbpayments, or phone the Child Benefit Helpline on 0845 302 1444. Alternatively, they can write to: Child Benefit Office, Waterview Park, Mandarin Way, Washington NE38 8QG.

What will happen in 2012-13 tax year?

The charge only applies from 7 January to 5 April 2013 for the 2012-13 tax year. The charge will apply to the amount of Child Benefit which they were entitled to receive from 7 January 2013 to 5 April 2013, unless they choose to stop the Child Benefit payments.

How the charge will be implemented

HMRC will be writing to taxpayers in November 2012 who are likely to have income over £50,000 to explain the changes and tell them what they need to do if they are affected. They will be directed to the HMRC website for more detailed information about the new charge and how to choose whether to stop receiving Child Benefit payments, or to register for Self Assessment and send HMRC a tax return.

If possible, partners should discuss and jointly decide what they wish to do. Those who are unable to discuss the matter with their partner and who are unable to establish whether they need to pay the charge will be able to ask HMRC for limited information about their partner's income and/or entitlement to Child Benefit. HMRC will be able to tell someone whether their partner's income was higher than theirs, or whether Child Benefit was paid, but they will not be able to tell them the exact amount.

Those who pay income tax via PAYE can choose to have the underpayment for 2012-13 and their ongoing in-year liability collected through their tax code in 2014-15. However, they must still complete a Self Assessment return.

HMRC Information, 29/10/2012

High Income Child Benefit charge – Elections not to receive child benefit

Para 1

On 29 October 2012 HMRC issued directions which have the force of law, under section 13A(9) of the Social Security Administration Act 1992 and section 11A(9) of the Social Security Administration (Northern Ireland) Act 1992.

Para 2

(a) You must only make an election or its revocation under either section by telling HMRC in one of the following ways. You must:

- complete the paper or electronic form HMRC provide for the purpose, and return it to HMRC at Waterview Park, Mandarin Way, Washington, Tyne and Wear, NE38 8QG; or
- give HMRC the same information in writing at that address; or
- give HMRC the same information by speaking to an officer of Revenue and Customs by telephone, using the helpline telephone number HMRC provide for the purpose.

(b) Your election will take effect once it is treated as made, that is, both after HMRC receive it and:

- on the Monday after your most recent child benefit payment; or
- on the Monday after the weeks for which we are already processing your child benefit payments; or
- on the day your election nominates, if later than either Monday.

(c) Your revocation will take effect once it is treated as made, that is:

- on the Monday after HMRC receive it; or
- on the day your revocation nominates, if later than that Monday.

Para 3

Your election will never have effect if when HMRC receive it:

(a) an amount of overpaid child benefit is being recovered from you from the child benefit payable to you (under regulation 42A of the Child Benefit and Guardian's Allowance (Administration) Regulations 2003, S.I. 2003/492);

(b) undue benefit paid by another country is being deducted from your child benefit payments (under Article 72 of European Parliament and Council Regulation (EC) No 987/2009).

Para 4

Your election will not have effect from a date in a tax year if:

(a) as a result of that election, child benefit is not then being paid to you at the full rate, but

(b) the high income child benefit charge in question for that tax year would amount to less than the child benefit to which you are entitled in that tax year, and

(c) you tell HMRC about this no later than two years after the end of that tax year, as you would for a revocation under paragraph 2(a).

Background Notes

Paragraph 1 explains why these directions have the force of law.

Paragraph 2 describes how an election not to receive child benefit payments and its revocation must be made, and from when they take effect.

Paragraph 3 sets out that an election will not have effect (and so will not be acted upon) if - when HMRC receives it - an overpayment of child benefit or undue benefit paid by another state, is being recovered from the child benefit.

The child benefit claimant may, if they so wish, make a fresh election after the overpayments have been recovered.

Paragraph 4 provides that where an election has been made by a claimant (whose income or whose partner's income, typically, is between £50,000 to £60,000), that election can be changed retrospectively to the point at which child benefit ceased - provided that the amount of the tax charge would have been less than the amount of the child benefit payable for that period. This would be subject to HMRC being notified of the change, no later than **two years** from the end of the relevant tax year.

Quasi-Legal General, 29/10/2012

Completion of a foreign tax return – reasonable excuse

A German national worked as a dentist in the UK between January and April 2010 and then returned to Germany. In January 2011 HMRC sent her a notice to file a tax return for 2009/10. She submitted the return in October 2011. HMRC issued a late filing penalty, against which the taxpayer appealed.

The dentist explained that she had not received the notice until June 2011. She asked her German tax adviser for help completing the return but he had insufficient knowledge of the UK tax system so she had to engage a UK adviser. The delay had been exacerbated due to enquiries being made by the German tax authorities.

Decision:

The First-tier Tribunal judge concluded that the situation “involved the understanding of two wholly separate and distinct tax systems” which understandably led to the taxpayer having to obtain help from a UK tax adviser and which caused the delay in the submission of the return.

The taxpayer had reasonable excuse for the delay in sending in her tax return. Her appeal was allowed.

Comments – The Tribunal judge commented “In my view, this is an unusual case which falls within an exceptional category. Any tax advisor in the UK would have to satisfy himself as to the German tax position and therein the Appellant encountered difficulties as she had with a German tax advisor who had little or no understanding of the UK tax system. I found as a fact that these facts put this case into the rare category whereby the filing of a return, which in normal circumstances would not amount to a tax obligation of substantial complexity, involved the understanding of two wholly separate and distinct tax systems and was therefore a matter in which the Appellant, understandably required specialist assistance which cause delay.” It is clearly not a circumstance that will be encountered regularly but it demonstrates that the concept of reasonable excuse is considered fairly by the Tribunal.

Ramona Theurer TC2270

SP1/09 will be legislated - finally!

HMRC has set out the approach to be taken in legislating SP1/09 which applies to employees who:

- are resident but not ordinarily resident in the UK;
- are taxed on the remittance basis; and
- carry out duties both in the UK and overseas under a single contract of employment.

The purpose of SP1/09 is to provide a simpler alternative to the mixed fund rules. It allows individuals to calculate their UK tax liability with reference to the total amount transferred out of their overseas account during the tax year as a whole, rather than by reference to each individual transaction. The legislation will place SP1/09 into statute and also make a number of simplifications.

The legislation providing for the special mixed fund rules will apply where an individual meets various conditions:

- they can claim overseas workday relief;
- they have general earnings from one or more employments which are subject to ss.15 & 26 ITEPA i.e. mixed employment income - this replaces the requirement in SP1/09 that they are resident and not ordinarily resident;
- they nominate an account for use as a mixed fund to which the special mixed fund rules will apply; and
- only certain types of income and gains are paid into the account from that point.

Where all the conditions are met, the special mixed fund rules will allow an individual to put aside the transaction by transaction basis of the normal mixed fund rules. They will instead be able to aggregate transfers from the account on an annual basis (or part year, if the account is not a qualifying account for the whole of the relevant year).

Individuals who do not meet the conditions to use the simplified mixed fund rules will be required to operate the existing mixed fund rules in full. The statutory replacement will have a number of detailed aspects.

Qualifying accounts

SP1/09 currently requires individuals to open a completely new account in order to apply the simplified treatment. Under the new rules, an existing account can be nominated as a qualifying account which means that rules will be required to set out how funds held in the account before it was nominated will be treated.

Taxpayers will be able to nominate joint accounts held with a spouse or civil partner in certain circumstances. Any joint account may be nominated as long as the additional account holder does not nominate the account as their own qualifying account or make any economic contribution to the account (apart from generating interest arising on the account).

A SP1/09 account is currently required for each employment. The new rules allow for mixed employment income from more than one employment to be held in a single qualifying account.

Only a single qualifying account will be allowed at a time in order to avoid any complexity which would arise as a result of transfers made between qualifying accounts.

Errors

Where any funds other than permitted types of income and gains are introduced into a qualifying account the account will become tainted and will no longer qualify for the special mixed fund rules from the start of the tax year in which it was tainted. This will be the case whether the funds have been introduced by the qualifying person or by another joint account holder.
However, where funds which have caused the account to become tainted are removed within 30 days beginning with the day on which the individual became aware, or ought reasonably to have become aware, of the payment the account will continue to be treated as a qualifying account.

Any further tainting within 12 months will disqualify the account for the whole of the tax year in which the subsequent tainting took place.

Part years for accounts existing before or after nomination

To allow existing accounts to be nominated as qualifying accounts and to provide clear treatment where accounts cease to be qualifying accounts, the special mixed fund rules will apply to an account only for the part of the year in which it is a qualifying account. SP1/09 does not cover such circumstances scenarios because an individual was required to open a completely new account to use as a SP1/09 account.

If an account becomes or ceases to be a qualifying account part way through the tax year then the special mixed fund rules will only apply to the account for the part of the year in which it was a qualifying account. All transfers out of the account in the rest of the year will be subject to the normal mixed fund rules.

In a year where a UK-resident employee ceases to have mixed employment income but wants to continue using their qualifying account they must withdraw their nomination of the account. At that point the account will cease to be a qualifying account. Where they do not withdraw their nomination any subsequent deposit of employment income would taint the qualifying account because it would no longer be mixed employment income.

Income and gains from employee share schemes

Special mixed fund rules will continue to apply to income and gains from employment related securities (ERS) in the same way as they do currently under SP1/09. There will still be an exception for the sale proceeds from employee share schemes where the employee is able to sell the shares but decides to retain them for a period before disposing of them.

The proposed legislation has been drafted on the basis that ERS income may be deposited into the qualifying account. An alternative approach is also suggested which would be to treat all deposits of ERS income as tainting the account and for them to be subject to the rules for deposits made in error.

Treatment of funds in a qualifying account from a period before nomination

Any transfer of income, gains and capital from funds in a qualifying account that were deposited before it was nominated will be subject to the normal mixed fund rules on the transaction by transaction basis.

Example

A qualifying account nominated in April 2013 holds £10,000 which is made up of:

2012/13	£2,000 capital
2011/12	£5,000 capital
2010/11	£3,000 unremitted overseas income

If on moving to the UK the qualifying person remits the entire £10,000 to the UK they will need to use the mixed fund rules to identify the composition of the £3,000 overseas income.

Types of income and gains permitted in a qualifying account

The restrictions on the types of income and gains that may be deposited into a qualifying account follow the position under SP1/09:

- mixed employment income;
- a capital gain arising when foreign currency is converted into sterling;
- proceeds from the disposal of certain employment-related securities or employment-related securities options;
- bank interest arising on the account.

Apportionment
HMRC will continue to accept apportionment based on the split between UK and non-UK workdays calculated at the end of the year, except where this would be clearly inappropriate. This reflects the current practice provided by SP1/09. Where an individual receives mixed employment income from more than one employment apportionment should be carried out separately for the general earnings of each employment.

Transfers to and from a qualifying account
SP1/09 contains rules which apply to transfers from a qualifying account to the UK, but is silent on the treatment of transfers made to other mixed funds or transfers from sources other than the employment into the qualifying account. The legislation sets out provisions for the treatment of such transfers. Offshore transfers out of a qualifying account will be allowed under the special mixed fund rules.

Special mixed fund rules
The proposed special mixed fund rules set out how remittances and offshore transfers from a qualifying account are to be aggregated at the end of the tax year, and how to apply the existing ordering rules in the mixed fund legislation to these transfers.

Mixed employment income held in a non-qualifying account
Where a non-qualifying account holds mixed employment income, apportionment of that income on a just and reasonable basis is proposed, usually on an annual basis. However, the special mixed fund rules will not apply in these circumstances and the employee will have to apply the normal mixed fund rules. However, they will not be required to do so until the end of the relevant tax year when an apportionment can be carried out.

As previously announced fundamental changes to the mixed fund rules have been ruled out. In particular, there will be no changes to the mixed fund rules in relation to offshore transfers or the ordering rules provided in ss.809Q ITA onwards.

Contributed by Tony Jenkins

Woman with apartment in Spain: whether UK resident

A woman (Y) was born in England in 1955. In March 2000 she began renting an apartment in Spain. She appealed against capital gains tax assessments for 2003/04 to 2006/07 inclusive, contending that she had been resident in Spain and had not been resident in the UK.

Decision:

The FTT reviewed the evidence in detail and dismissed her appeal, finding that she had spent 72 days in the UK in 2003/04 and had spent 108 days in the UK in 2006/07. She had retained her UK bank account, and had continued to receive incapacity benefit from the Department for Work and Pensions.

Judge Walters held that, although she had been resident in Spain during the years in question, she had not 'made a distinct break in the pattern of her life for the purpose of relinquishing her status as UK-resident'. Her personal and economic relations continued to be centred in the UK, and she had remained resident in the UK.

Comments - The FTT upheld HMRC's view that, although the appellant had spent significantly more time in Spain than she had in the UK, she had remained resident in the UK. It was noteworthy that the appellant had continued to claim incapacity benefit from the Department for Work and Pensions despite claiming that she had ceased to be resident in the UK.

This case is another demonstration for the need for a statutory residence test. It also demonstrates how an individual can be dually resident because of the different rules that can apply in different jurisdictions to determine residence. It also demonstrates how a taxpayer can retain UK residence in circumstances where they think that they have lost it.

Ms LD Yates v HMRC TC2220

"Employee owners" – a new type of employee. (Lecture B471 – 7.43 minutes)

Overview of the proposals

The Government proposes that from April 2013, employers will be permitted to offer new types of employment contract to new employees, under which the employees will receive shares in the company in exchange for giving up certain employment rights.

The value of the shares issued will be between £2,000 and £50,000, and the shares will be exempt from Capital Gains Tax when the employee disposes of them.

Employment rights affected

The rights affected by the proposal are:

- The right not to be unfairly dismissed
- The right to request flexible working arrangements and training
- The right to receive redundancy settlement (including statutory redundancy rights)

The rights under unfair dismissal will remain available where the dismissal is discriminatory or "automatically unfair" dismissal such as dismissal for whistle blowing. It is not possible to remove discrimination rights as these are governed by EU law.

Unfair dismissal

The current rights are that employees who have been unfairly dismissed can, within three months, take a claim to a tribunal if they have been with a company for at least two years, unless they were employed before 6 April 2012 in which case it is a year.

The law on unfair dismissal gives employees a legal right to be treated in relation to dismissal in a fair and reasonable manner. The Employment Rights Act 1996 (s.98) lists fair reasons for dismissal:

- capability (including poor performance)
- conduct
- redundancy
- that continued employment would breach a statutory requirement (e.g. a driver losing his licence).

In addition, the law allows for 'some other substantial reason', where an employer has a good reason for dismissing an employee which is not one of the four categories above (which may include reasons such as an irretrievable breakdown in the working relationship).

An employer must also follow a fair procedure in order to dismiss an employee fairly.

Usually an employee must be employed by their employer continually for two years before the protection from unfair dismissal is activated. There are however, automatically unfair reasons for dismissal, most of which apply from the first day an employee begins work. These include dismissal on the basis of:

- Trade union membership/activities/services /recognition
- The right to be accompanied at a disciplinary or grievance hearing
- Jury service
- Leave for family reasons (e.g. adoption and paternity)
- Certain specified types of action on health and safety grounds
- Subject to certain conditions, refusing Sunday work
- Trustee of occupational pension scheme
- Pension enrolment
- Duties relevant to role or candidacy as, or election of, an employee representative
- Making a protected disclosure, e.g. whistle blowing
- Having sought, in good faith, to assert a statutory employment protection right
- National minimum wage
- Flexible working request
- Official industrial action
- Blacklists, e.g. of individuals who are currently or used to be trade union members or are active in trade unions
- Education and training
- Study or training

The dismissal is automatically unfair if the reason relates to certain regulations contained in:

- Working Time Regulations 1998
- Transnational Information and Consultation of Employees Regulations 1999
- Part-time Workers (Prevention of Less Favourable Treatment) Regulations 2000
- Fixed-term Employees (Prevention of Less Favourable Treatment) Regulations 2002
- European Public Limited-Liability (Employee-Involvement) Company Regulations 2009
- Information and Consultation of Employees Regulations 2004
- Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006
- European Cooperative Society (Involvement of Employees) Regulations 2006
- Companies (Cross-Border Mergers) Regulations 2007
- European Public Limited-Liability Company (Employee Involvement) (Great Britain) Regulations 2009
- Agency Workers Regulations 2010

Effect of the new Employee Owner Proposal

Where the unfair dismissal right relates to an automatically unfair reason for dismissal, this right will be unaffected by the employee owner proposal. For example, an employee owner could not be dismissed for whistle blowing or taking maternity leave.

Under the proposal, it would not, however, be automatically unfair for an employer to dismiss an employee owner who requests flexible working, unless they are exercising the right to request flexible working when returning from parental leave.

It would also not be automatically unfair to dismiss someone for having made certain requests for time to train (under the right that is available to an employee in companies of over 250 people) where that employee has been employed for at least 6 months.

Flexible working

The statutory right to request flexible working is set out in the Employment Rights Act 1996 (s.80F). It enables parents of children under 17 (under 18 if the child is disabled) and carers of adults within the home or relatives who have worked for their employer for at least 26 continuous weeks, to make a request to change their working pattern with respect to hours or location of work.

The employer is required to consider the request following a statutory procedure and may only refuse the request if it cannot be accommodated for one of 8 specified business reasons. The Government has committed to extend the current right to request flexible working to all employees during this Parliament. This right would not be extended to employee owners.

Flexible working is beneficial for employees and employers: employees benefit from the ability to manage their work and personal responsibilities more effectively and employers benefit from increased productivity, and staff retention as well as reduced staff absence.

Effect of Employee Owner policy

Employee owners will find it easier to discuss working patterns with their employer because they have a vested interest in the business. The EU Parental Leave Directive requires all employees and employed agency workers to have the right to request flexible working on return from parental leave.

The proposals plan to restrict the right to request flexible working for employee owners to the EU minimum. This means that employee owners will only have the right to request flexible working when they return from the EU derived entitlement to 18 weeks' unpaid parental leave per parent per child. The Directive is silent on how long parents will have after returning from parental leave will have to make a request for flexible working. The proposals restrict this to within 4 weeks of return.

Time off for training

The right to request time to train gives employees a statutory right to request training and places a duty on employers to consider the request and respond in a set timeframe. Employers are neither obliged to pay for the training or the time spent training and may turn down requests if they consider that legitimate business reasons preclude the training activity.

The right that is to be removed is one that is available to employees in businesses with 250 or more employees where the employee requesting the training has worked for the business for 26 weeks continuously (s.63D, Employment Rights Act 1996).

Effect of Employee Owner policy

The removal of this right does not prevent employers from offering training to employee owners. It simply means that employers will not need to follow the administrative procedures specified in this legislation. Employees will still be able to make informal requests to their employer, and there is no restriction on agreed training.

This change only removes the access to an Employment Tribunal for those employees who think their request has not been properly considered according to the statutory procedure.

This policy does not seek to remove the right for employees aged 16 or 17 who have not reached a certain standard in their education to have paid time off for study or training. The Education and Skills Act 2008 sets out that from summer 2013, all young people will be required to participate in education or training until the end of the academic year in which they turn 17. From 2015 all 16 and 17 year-olds will be required to participate in education or training. This can be part-time education or training if they are employed.

Redundancy

Redundancy occurs where an employee is dismissed by an employer because of a need to reduce the workforce. It may, for example, arise because a particular workplace needs to contract or is closing down.

Employees with two years of service who are dismissed due to redundancy (save in very limited circumstances, e.g. share fishermen) are statutorily entitled to a lump sum from their employer, based on their age, length of service (up to a maximum of twenty years) and contractual weekly earnings, subject to a statutory upper limit, payable at, or soon after, the dismissal date.

In the event of an employer failing to make payment or disputing entitlement, employees can write to their employer asking for payment and/or take the matter to an employment tribunal. This action must be taken within six months of the date on which the employment ended.

Effect of the new Employee Owner Proposal

Under the new proposal, an employee owner would not be entitled to the statutory redundancy payment.

Maternity leave

Maternity and adoption leave rights are set out in the Employment Rights Act 1996 (s.71). Employee owners will continue to be entitled to 52 weeks of maternity/adoption leave and 39 weeks of maternity/adoption pay.

The Maternity and Parental Leave etc. Regulations 1999 (reg 11) and the Paternity and Adoption Leave Regulations 2002 (reg 25) set out the requirements for employees to give 8 weeks of their intention to return to work early following maternity and adoption leave.

Effect of Employee Owner policy

Employee owners will be required to give 16 weeks' notice of their intention to return early from maternity or adoption leave, instead of the current 8 weeks' notice. If an employee owner does not give the full 16 weeks' notice an employer can delay the employee's return to work until the 16 weeks' notice period has elapsed. This will give employers who appoint employees through the employee owner status additional notice of an individual's plans. Employers can agree to an earlier return if they are content to do so.

Tax implications

The shares issued will come under the employment related securities legislation and will thus be liable to tax and NIC at the date they are given to the employee.

The consultation document indicates that the shares cannot be included in any tax exempt share schemes. The shares will need to be valued at date of issue to establish the tax and NIC charge due.

When the owner employees sell the shares they will be exempt from capital gains tax without limit.

If employees leave the company, the terms of issue can require that the shares are returned to the company. The proposals suggest that the company would be required to purchase the shares at current value.

Commencement

The proposals are intended to be implemented from April 2013. The scheme would allow a new type of employment contract to be drawn up. This would be optional for employers, and if taken up it might be offered alongside the normal contract of employment, although employers may move over to having all employees recruited after April 2013 on the new style contracts.

Employers will be able to offer the new contract to existing employees, but cannot force them to accept the new terms.

The consultation is available on the Business Innovation and Skills website at www.bis.gov.uk. The consultation closes on 8 November.

Contributed by Rebecca Benneyworth

Local councillor: domestic expenses

A London borough councillor (L) received allowances from the council totalling £11,500 pa, which were accepted as taxable. He claimed deductions of £2,006 in respect of the use of his home as an office, £1,200 for expenditure on communications to his constituents, plus deductions for expenditure on childminding and on various subscriptions and publications. HMRC agreed to allow a deduction of £334 in respect of the use of one room in L's home as an office, but rejected the remainder of the claim. L appealed. The First-tier Tribunal allowed the claim for expenditure on communications (see Decision TC00986), but rejected the remainder of L's claims. Sir Stephen Oliver observed that 'for tax purposes, child care expenditure is not allowable as a deduction in computing taxable earnings. This is because child care expenses are not dictated by the requirements of the job of being a councillor; instead they have to be incurred to meet the personal circumstances of the councillor'. The expenditure on subscriptions and publications was not allowable, applying the 1925 KB decision in Simpson v Tate (9 TC 314). Following this decision, L requested a review of the decision disallowing his claims relating to the use of his home as an office, plus expenditure on childminding and on various subscriptions and publications.

Decision:

The First-tier Tribunal reheard the appeal and upheld its earlier decision. Sir Stephen Oliver noted that HMRC had agreed to allow a deduction of £334 in respect of the use of L's home as an office, and held that he had produced no evidence to justify a larger deduction.

Comments - The First-tier Tribunal upheld its previous decision that the councillor had produced no evidence to justify a deduction of more than £334 in respect of the use of one room in his house as an office. Councillor Lorber has tenacity – it would be apparent to many practitioners and many members of the public that certain expenses are NOT incurred wholly, exclusively and necessarily during the performance of the duties of the employment – clearly it did not do so to Councillor Lorber.

PA Lorber v HMRC (No 3) TC2169

NIC on car provided for employees as not a pool car

A retail partnership made an Astra car available for two of its employees, who were also the daughter and son-in-law of one of the partners. HMRC issued an assessment charging national insurance contributions, and imposing penalties. The partnership appealed, contending that the Astra should be treated as a pooled car, within ITEPA 2003 s 167.

Decision:

The First-tier Tribunal (FTT) rejected this contention and dismissed the appeal.

Comments - Where an employer makes a car available for use by an employee, this is normally treated as a benefit provided for the employee, and the employer is normally required to account for national insurance contributions. ITEPA 2003 s 167 provides an exception to this if the car is a 'pooled car' which 'has been included in a car pool for the use of the employees of one or more employers'. Section 167(3) defines what is meant by 'included in a car pool for the use of the employees of one or more employers'. The FTT upheld HMRC's contention that the Astra car which was the subject of this case did not satisfy these conditions.

Ahmed Brothers (t/a First Stop 2 Shop) v HMRC TC2222

NIC: evidence that no election made

A woman (F) married in 1967 and gave up her job. She resumed working in 1977. Subsequently she discovered that she would not receive a full state retirement pension, and applied to make backdated payments of Class 1 contributions. HMRC rejected her application on the grounds that their records showed that in 1970 she had signed a declaration on form CF9 electing not to pay such contributions (and had made a further election in 1977 electing to pay reduced-rate contributions). F appealed, contending that she had not made either of the elections.

Decision:

The First-tier Tribunal reviewed the evidence in detail and allowed her appeal in part. Judge Short accepted F's evidence that 'she would have had no reason for making an election in 1970 since she had no intention of working on a full or part-time basis'. This was 'sufficiently anomalous as to call into question the integrity of HMRC's records, despite their generally high standard of care'. However, the 1977 election coincided with F having resumed work. F's employer had consistently deducted contributions at the reduced rate and 'had reason to believe that (F) had made a lower rate election'.

Accordingly, it was 'more likely that (F) has failed to recall that an election was made as part of the, no doubt lengthy, paperwork which she completed when she started this employment'.

Comments - There have been many cases in which women have belatedly realised that the result of not having paid Class 1 NICs (or of having paid them at the reduced rate applicable to married women) is that they would not receive a full state pension, and have lodged appeals. In the great majority of such cases which have reached the First-tier Tribunal, the Tribunal has accepted HMRC's evidence that the appellant had made an election not to pay such contributions. This case is worth noting as a very rare case where the First-tier Tribunal found that, on the balance of probabilities, HMRC's records were incorrect. HMRC's records suggested that the appellant had made such an election in 1970, three years after she had given up work. Judge Short's comments may be worth noting and quoting in similar subsequent cases.

Mrs P Franks v HMRC TC2119

Gift aid restricted because conditions not met

A registered charity had two subsidiary companies, both of which were loss-making. The charity claimed gift aid in respect of a donation of £358,279. HMRC disputed the amount of relief due on the basis that £354,379 had been paid to the subsidiaries and only £3,900 to the charity.

The charity's representatives accepted that the donations had been made to the subsidiaries, but said the funds were for the benefit of the charity. They said the trading companies had been set up to provide the funding for the charity's activities and, in effect, all three companies formed on entity.

Decision:

The First-tier Tribunal said this argument was wrong in law: FA 1990, s 25 specified that gift aid could apply only to donations made to charities established solely for charitable purposes. This did not include donations made for the benefit of charities. The subsidiary companies together with the charity did not form one entity but were three separate organizations with different purposes. The reality was that the donations had been made to subsidise the loss-making subsidiary companies. Gift aid was due only on the £3,900 paid to the charity. The taxpayer's appeal was dismissed.

Comments - The First-tier Tribunal upheld HMRC's view that the charity was not entitled to claim gift aid relief in respect of donations which had been made to associated trading companies, which were not themselves charities. Gift aid is a valuable relief and it is widely used. In order to ensure the use of the relief the relevant conditions must be fulfilled and they were not in this case.

Odyssey (Tendercare) Ltd (TC2215)

Disguised remuneration – A reminder (Lecture P742 – 18.25 minutes)

The aim of the disguised remuneration rules is to tackle "arrangements used for the purpose of disguising remuneration in order to avoid or defer income tax or national insurance contributions." The rules are contained in Part 7A ITEPA 2003.

When applying Part 7A the following must be considered:

1. Whether the arrangement comes through the 'Section 554A gateway' and is therefore potentially chargeable under Part 7A.
2. The relevant steps which need to be satisfied for a charge to occur under Part 7 A provided the arrangement comes through the Section 554A gateway.
3. The exclusions and reliefs from the charge.
4. The treatment of the relevant step and the quantum of the charge, subject to any deductions.
5. Commencement.

Section 554A gateway

An arrangement will not give rise to a Part 7A charge on income unless it 'comes through the Section 554A gateway.' To fall within Part 7A there must be:

- a person (described as A) who is an employee, former employee or prospective employee of an employer (described as B).
- a relevant arrangement
- a connection with A's employment

Relevant steps

Assuming the structure comes through the s 554A gateway, there can only be a charge if a relevant step is carried out by a third party and it is it is reasonable to suppose that in essence:

i. the relevant step is taken in pursuance of the relevant arrangement; or
ii. there is some other connection (direct or indirect) between the relevant step or the relevant arrangement.

Broadly speaking, the relevant steps are:

- Earmarking – money or asset is held by or on behalf of the employer with a view to a later relevant step being taken, e.g. funds are provided to an EBT for certain employee(s).
- Payment of sum of money (including a loan) or transfer of an asset
- Making an asset available.

Exclusions and reliefs

The disguised remuneration rules are widely drafted and as a result sections 554 A to D of the legislation inadvertently catch a number transactions. The following transactions are excluded:

- Certain share and share option schemes
- Commercial transactions
- Transactions under employment benefit packages
- Employee car ownership schemes
- Employment income and exemptions
- Income arising from earmarked sum or asset
- Certain pension contributions and income

The quantum of the charge

If the relevant step involves a sum of money, the value of the step is the sum of money. If the relevant step does not involve a sum of money, the value of the step is the market value when the relevant step is taken of the asset which is the subject of the relevant step or if higher the cost of the relevant step.

Commencement

The rules apply to relevant steps taken on or after 6 April 2011 with two exceptions:

- Payment of sum of money to an employee on or after 9 December 2010 but before 6 April 2011 – a charge will follow which is reduced by any repayments by the employee to the third party before 6 April 2011
- If a third person provided security for the loan made on or after 9 December 2010 but before 6 April 2011. However, there will be no charge if the structure is unravelled before 6 April 2012.

Contributed by Priya Dutta, Gabelle LLP

Case Law review (Lecture P744 – 16.37 minutes)

Here we look at some recent case law likely to be of practical interest, as opposed to covering issues you are unlikely to encounter. The decisions are of course subject to appeal.

Slush Puppie Limited v HMRC TC2042

A helpful case on the age-old issue of self-employment v employment, where arguably a new approach was taken on some of the established principles.

Mr Sandford was a director and shareholder of a company contracted to distribute Slush Puppie drinks for a number of years sold the business in 2001 to Slush Puppie Limited (SPL). All staff he employed became employees of SPL.

In March 2007 Mr Sandford ceased to be involved with SPL. His advisers argued with HMRC that he was employed by SPL from 2001 and not self-employed (he had been taxed on the basis of the latter). HMRC agreed with that view and the advisers sought repayment of the tax paid with SPL being liable as the employer.

The Tribunal disagreed and held he was self-employed by reference to the following:

1. Attending service meetings or working in close co-operation with SPL "did not show that Mr Sandford was an integral part of that organisation in the sense that employees were".

2. His financial and organisational independence "point strongly away from employment". He was free in principle to take on business from elsewhere and free, having accepted a job, to find someone else to do it.

3. SPL's supervision or control of his work was limited to ensuring compliance with public law obligations.

4. On the issue of mutuality, there was "no obligation on either side beyond the day on which work was undertaken ". Use of a daily rate was "a strong indicator" that matters were based on a daily contract, and use of monthly invoicing for reasons of convenience did not detract from this.

5. The lack of redundancy rights or other employment protection meant that Mr Sandford's business involved financial risk. The Tribunal said that the fact "that no substantial risks materialised in the course of the five years is no indication that they did not exist potentially".

<u>D J Cooper & Others v HMRC TC02120</u>

This case shows that care needs to be taken when creating business structures, as otherwise an unfortunate tax position can arise.

The directors of a family company, together with some other members of the family, formed a partnership to carry on the business of what they called "providing services of its personnel and administrative services". The partnership only had one customer – the limited company. No doubt the idea was to minimise the NIC burden and avoid a company car tax charge, with the use of a partnership running alongside being considered the best approach.

The following points arose:

1. It was accepted by the tribunal that the partnership was valid, being independent from the company in terms of its legal organisation and carrying on a commercial business.

2. Seemingly HMRC did not challenge the arrangement.

3. The partnership provided cars for the use of the partners. The cost was reflected in the fees charged to the limited company for the services provided.

4. Appropriate adjustments were made in the partnership tax computation to reflect private use of the cars.

5. HMRC contended that the cars were provided by reason of the employment, thereby creating the usual income tax and NICs on the scale charge.

6. The tribunal held that notwithstanding the fact that the cars were provided by the partnership, they were also provided by reason of the employment with the limited company. They stated *"This was so, on any realistic view of the arrangements entered into. The partnership would not have existed, commercially, but for the company, its only customer…..The benefit of the cars and car fuel was provided by the partnership 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 partners did of course effectively pay tax for private use via the partnership tax computation, but that was held to be of no consequence. Subject to a possible successful appeal, the company and directors between them face a tax and NICs bill of over £200,000.

<u>Fine v Fine High Court 2012 EWHC 1811</u>

1. The High Court allowed two deeds of appointment to be rectified after they intended to create new IIP trusts out of discretionary trusts. That in itself may not be a surprise, as after all the Courts do have power to rectify documents that do not reflect the true bargain between the parties. The surprise element in this case was that the ultimate reason for changing the arrangements was to avoid the 10 year anniversary charge to IHT applying to discretionary trusts.

2. The rectification must be to set aside a document on the ground of a mistake of either law or fact, provided the mistake is about the effect of the transaction. In *Pitt and another v Holt and another (Court of Appeal 2011 EWCA Civ 197)* it was held that the correct test was that all of the following elements must be present:

   - There must be a mistake on the part of the donor
   - The mistake must be as to the legal effect of the disposition, or as an existing fact that is basic to the transaction
   - The mistake must be sufficiently serious for it to be unjust for the donee to retain the property given to him

3. In this case the mistake involved the deeds of appointment not in fact creating an IIP as intended. They expressly included the statutory powers of maintenance, accumulation and advancement under Section 31 Trustee Act 1925. However, Section 31(2)(ii) applied as it was not specifically disapplied. Consequently, if a beneficiary died unmarried before the age of 18 any accumulation of the interest would be held by the trustees as additions to capital. Then it would not be held for the benefit of the beneficiary or his estate and the interest could not be an IIP in those limited circumstances.

4. Rectification of the two deeds was granted as the mistake resided in the legal effect of the trust documents rather than their fiscal consequences. The intentions of the settlors was clearly to create an IIP and they understood that an IIP meant an entitlement to income.

Holly Chichester v HMRC TC02081

This is a useful case in the much-argued issue of what is a *reasonable excuse* for paying tax late or filing late.

1. Tax was due by 31 January 2011 of £228,013 but was not actually paid until 7 March 2011, with the result that a surcharge of £11,400 was imposed by HMRC.

2. The taxpayer planned to pay the tax on time from a company account as she had a credit balance on her loan account. There was a misunderstanding of the operation of the company bank accounts, however, and she did not realise that she would need to take action for funds to be made available to meet cheques drawn on the company's current account (the other account paid interest and was of a substantial amount).

3. The tribunal accepted that she honestly and genuinely believed the cheque for the tax payment would be honoured.

4. On returning to the UK from being overseas for much of February 2011, the taxpayer contacted HMRC and immediately paid the tax by debit card.

5. In *Intelligent Management UK Limited (TC01541)* the FTT said *"there must be some reasonable belief for the honest and genuine belief. The tribunal does not consider that an irrational or unreasonable belief, even if honest and genuine, would suffice".*

6. In this case, however, the tribunal ruled that :

   - whether a person holds an honest and genuine belief is a question of fact
   - whether a belief is irrational or apparently unreasonable might be a factor in deciding if somebody claiming to have a stated belief does in fact hold the belief, but it is not a factor affecting whether an honest belief amounts to a reasonable excuse
   - if a Tribunal finds that a person, as a matter of fact, held a particular honest and genuine belief, that may amount to a reasonable excuse (on appropriate facts) regardless of whether that belief would be characterised as irrational or unreasonable when viewed objectively

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

Susan Roche v HMRC TC02019

This is an extremely useful case which can be used whenever you consider that *special circumstances* exist to justify a reduction in a penalty. The reduction is under *Paragraph 11, Schedule 24 FA2007.* What is disappointing, however, is that the case went to the tribunal after having gone through HMRC's internal review process without them apparently considering whether special circumstances did exist.

The special reduction to a penalty is covered in *paragraph CH82480 of HMRC's Compliance Manual*, but little worthwhile information is provided:

"If we think it right, because of special circumstances, we may reduce a penalty.

Special reduction is a mechanism to allow further reduction in extreme and exceptional circumstances. It does not include any factor that has already been taken account of in the disclosure reduction.

Special circumstances do not include

- *the ability to pay, or*
- *the fact that a potential loss of revenue from one person is balanced by a potential overpayment by another.*

Reducing a penalty includes staying a penalty, and agreeing a compromise in relation to proceedings for a penalty.

Staying a penalty means to give up on or not enforce the whole penalty. Agreeing a compromise allows us to forego part of a penalty.

Special circumstances will be considered in arriving at the level of the penalty. Such circumstances are expected to be extremely rare as all relevant factors should be taken into account when determining the disclosure reduction and therefore in arriving at the level of penalty.

Any decision to allow a special reduction will be taken at senior level in HMRC"

1. Susan Roche had been made redundant in April 2008 and received a redundancy payment of £194,748. She had subsequently moved house and put the papers relating to the redundancy into storage on the basis that she assumed the redundancy payment would be reflected in the 2008/09 form P60 in due course.

2. She completed her 2008/09 tax return in January 2010 and omitted to include the redundancy payment, a small pension, a small benefit in kind and bank interest of £4,284. HMRC opened an enquiry into the tax return and the taxpayer immediately provided details of the omitted income.

3. HMRC calculated a penalty of £5,490 and offered to suspend an amount of £160 relating to the bank interest. Susan Roche appealed against the penalty, the amount of the penalty and HMRC's decision not to suspend the whole penalty.

4. The Tribunal agreed that the taxpayer had been careless in omitting the redundancy payment and the pension from her tax return. However it went on to consider whether there were special circumstances that should have been taken into account as follows:

54. The jurisdiction of the Tribunal in an appeal relating to special circumstances is limited. We can only apply a reduction on account of special circumstances (to a different extent than that applied by HMRC) if we consider that HMRC's decision is "flawed" when considered in the light of principles applicable to proceedings for judicial review (paragraph 17(3)(b), Schedule 24). HMRC applied no reduction on account of special circumstances. We need to consider whether HMRC, in exercising their discretion not to make any reduction, acted in a manner that no reasonable body of Revenue commissioners could have acted. Did the HMRC take into account any irrelevant factors, or fail to take into account relevant factors, in reaching their decision?

55. In our view HMRC's decision to apply no reduction was flawed.

56. Mr Reeve in his submissions told us that HMRC had considered that paragraph 11 did not apply, as the reason for the inaccuracies in Ms Roche's return was her carelessness. However we find that HMRC did not give proper consideration to the issue of special circumstances. Although both the original letter calculating the amount of penalties (dated 2 February 2011) and the review letter (dated 13 May 2011) mention Ms Roche's redundancy, it is only to state that the redundancy occurred 21 months before the date of the tax return, and that therefore Ms Roche's stress would have diminished by then. No consideration was given to the reasons why Ms Roche had boxed-up her papers, and the stress she was under at the time she packed-up her home – even though these issues were raised by Ms Roche in her correspondence with HMRC.

57. In particular no reference is made in any of HMRC's letters to their discretion to reduce penalties to take account of special circumstances, and there is no statement that they had reached a decision that no such circumstances existed. Nor can the letters be read in any way that might suggest that, although no express reference is made in the correspondence to special circumstances, HMRC had in fact applied their mind to the issue and had reached the conclusion that there were none.

58. We therefore find that HMRC had not given proper consideration to the potential for there to have been special circumstances, and we find that HMRC's failure to turn their mind to this issue amounts to a "flaw".

5. In its summary the Tribunal considered that there were special circumstances which justified a reduction in the amount of penalty:

    - Ms Roche had found herself suddenly and unexpectedly made redundant.
    - Her redundancy occurred at a time when she was part way through refurbishing a derelict house to create a new home. She was therefore placed under severe financial pressure.
    - This occurred during the financial crash, which made it difficult for her to refinance her mortgage or sell her old house and investment property, thus increasing her financial stress. Although it may have been careless of Ms Roche to have boxed-up her redundancy papers (as judged by the objective standard of a reasonable and prudent taxpayer), we can understand why she did so, given the stress that she was under and her desperate need to de-clutter her home to make it as saleable as possible. Because Ms Roche had boxed-up her redundancy papers, they were not available to her at the time she completed her tax return online.

6. The penalties relating to the benefits in kind were quashed; for the redundancy payment they were reduced by 50%; for the pension payment they were unchanged.

Linslade Post Office and General Store v HMRC TC02136

Subject to any successful appeal by HMRC, this case is excellent news in the age-old argument of whether expenditure is wholly and exclusively incurred for the purposes of the business.

1. An individual was in partnership with his brother. His sister claimed that she had contributed funds to the capital of the partnership and had become an equal partner. That claim was dismissed by the High Court.

2. He claimed tax relief on £36,000 of legal fees against his share of the partnership profits, but HMRC argued that the fees were to defend his interests against his sister and this did not meet the wholly and exclusively test.

3. The tribunal held that:

   - The purpose was to preserve the assets and trade of the partnership
   - The expenditure was revenue in nature
   - It was incurred wholly and exclusively for the purposes of the partnership's trade

Contributed by Gerry Hart

CAPITAL TAXES

Avoidance scheme involving subsidiary company

A company (VT) entered into an avoidance scheme intended to take advantage of a perceived loophole in FA 2003 s 45 to avoid a charge to stamp duty land tax on the purchase of a property. Under the scheme, VT incorporated a new unlimited subsidiary company (VP), which contracted to acquire the property from the vendor. After VP had entered into the contract to purchase the property, it reduced its share capital to a nominal amount by a special resolution, and declared a final dividend in specie of the property in favour of VT. VP claimed that its acquisition of the property was exempt from SDLT by virtue of FA 2003 s 45(3), while VT claimed that its acquisition of the property from VP was exempt by virtue of FA 2003 Sch 3 para 1. HMRC issued a ruling that FA 2003 s 45 did not apply to the transactions, so that VP was liable for SDLT on the purchase. (They also issued an alternative ruling that, if s 45 was held to apply, the combined effect of s 45(3) and s 44 was that VT would be liable for SDLT on the full amount of the consideration.) Both VP and VT appealed.

Decision:

The First-tier Tribunal reviewed the evidence in detail and dismissed VP's appeal, finding that VP had failed to comply with Companies Act 1985 s 270, which required the production of initial accounts in support of the declaration of a dividend in specie. It followed that the dividend was unlawful under Companies Act 1985 s 263, and VT 'never became entitled to call for a conveyance of the property as a result of the declaration of the dividend'. Accordingly, s 45 did not apply and VP was liable for SDLT on its purchase. (The tribunal also observed that, if VP had complied with the Companies Act and the dividend had been lawful, the result would have been that VP's acquisition would have been exempt but that VT would have been liable for SDLT on the full amount of the consideration.)

Comments - This avoidance scheme is reported to have been widely marketed, so there was a great deal of money at stake in this case. The First-tier Tribunal upheld HMRC's view that the scheme was ineffective. On the specific facts of this case, the tribunal held that the companies had not complied with the necessary formalities under the Companies Act, so that a purported dividend was unlawful and the subsidiary company was liable for SDLT on its purchase of the property. Of more importance for similar cases is that the tribunal held that, even if the companies had complied with the requirements of the Companies Acts, the parent company which ultimately acquired the property would have been liable for SDLT on the purchase. HMRC's Director-General of Business Tax, Jim Harra, has welcomed the decision.

Vardy Properties v HMRC (and related appeal) TC2242

Entrepreneurs' relief and EMI (Lecture P743 – 5.43 minutes)

Changes announced in this year's Budget brought a couple of improvements to the enterprise management incentive scheme (EMI) although the impact may not be quite as beneficial as first indicated.

Entrepreneurs' relief

On or after 6 April 2012, shares acquired on the exercise of EMI options will no longer need to meet the 5% "personal company" shareholding test to benefit from entrepreneurs' relief and potentially be liable to CGT at 10% rather than the full 28% rate.

Due to the one year holding period requirement, the first disposals of EMI shares that would be eligible to benefit from this more generous provision will be those made on or after 6 April 2013.

How helpful is this?

In reality many EMI plans are "exit-based", meaning that options generally only become exercisable on a sale or flotation of the business.

On a sale, a purchaser will normally wish to see subsisting options exercised and the resulting shares bought out.

Similarly, on a flotation option holders will often wish to exercise shortly before listing and benefit from a sale at a hopefully uplifted price shortly thereafter.

This means that the shares resulting from the EMI option exercise will not benefit from the more generous entrepreneurs' relief regime given they will not have been held for the requisite one-year period.

Share for share sale of a business

Where the sale of the business is on a share-for-share basis, a rollover of the EMI shares may be available such that the qualifying holding period for entrepreneurs' relief may continue to accrue.

Likewise, on a flotation, there are often good commercial as well as tax reasons why senior management should be "locked-in" for a period following listing, during which time they cannot sell their shares.

HMRC have not confirmed to date whether, following any reorganisation, the individual would need to satisfy the 5% holding requirement for the new shares or securities to qualify for entrepreneurs' relief or whether the special EMI rules would continue to apply.

Continuing employment will definitely still be required, but that is in keeping with the participatory nature of the investment that both EMI and entrepreneurs' relief are all about.

A taper relief comparison – could this help?

Many will recall how, within the capital gains tax taper relief conditions, the two-year holding period that was required to receive the maximum relief actually started running from the grant of the EMI option rather than its exercise.

Adopting a similar, but one-year holding period running from the grant of EMI options for the purposes of entrepreneurs' relief, would certainly deal with the difficulties raised by "exit-based" EMI plans.

Option grant increase

The other welcome change introduced by the Budget – but already in force applying to grants on or after 16 June 2012 – is the increase in the individual limit for EMI option grants from £120,000 to £250,000.

This new limit means that EMI options now represent a very real and significant investment in a growing business as it is more than double the old limit.

However, the fact that the overall EMI scheme limit has remained unchanged has had a knock-on-effect.

Under the unaltered scheme limit, no more than £3m of shares in that company can be under EMI options at any time.

This means that, while previously 25 employees could participate in the scheme at the maximum individual limit, now only 12 employees can.

This will, perhaps inadvertently, have the effect of reducing participation levels in EMI, making it more the preserve of the most senior management, rather than a wider group of employees.

In order to keep participation at current levels a similar percentage increase in the scheme limit, from £3m to £6.25m, should be made.

Adapted from an article by Amanda Flint and Toby Locke

High value property issues (Lecture B744 – 7.58 minutes)

Overview

From 21 March 2012, a 15% rate of Stamp Duty Land Tax (SDLT) will apply to residential properties with a purchase price above £2 million, which are bought by 'non-natural persons', such as companies. It also includes partnerships with companies amongst their partners or collective investment schemes. The measures also catch joint property ownership where one of the owners is a 'non-natural' person.

This has already had an impact on the top-end of the property market and there has been concern from 'innocent' residential property investors and dealers. A number of taxpayers will own property through corporate structures for other reasons than tax avoidance such as limitation of liability for development projects, enabling fractional ownership of property (including by funds), confidentiality reasons and for financing purposes.

In addition, the Government **is consulting** on the introduction of an annual charge on residential properties valued above £2 million owned by non-natural persons. The Chancellor has also announced that gains on disposals by non-resident non-natural persons of UK residential property and shares or interests in such property will be subject to capital gains tax (CGT) from April 2013.

Also from 22 March 2012, a new SDLT rate of seven per cent will apply to all residential properties purchased for more than £2 million.

The annual charge

The Government is planning an annual charge on residential properties where they are valued at over £2 million and are owned by 'non-natural' persons. The definition of 'residential property' is currently the same as for SDLT but the Government has specifically asked for input into this.

In its consultation document, the Government proposes the annual charge will be:

Property value	**Annual charge 2012/13**
£2 million - £5 million	£15,000
£5 million - £10 million	£35,000
£10 million - £20 million	£70,000
Over £20 million	£140,000

Owners may find that their properties fall in and out of the regime within any given tax year in which case a pro-rata charge will apply.

There will be exclusions from the annual charge, which at present include charities, companies owning land solely in their capacity as trustees (other than bare trusts) and bona fide property development businesses meeting set criteria.

Properties will be valued every five years and the first charge for April 2013 and the following five years will be based on the property valuation as at April 2012.

Property valuations for the annual charge will be self-assessed and submitted to HM Revenue & Customs (HMRC) as part of an annual charge tax return. For the purposes of the annual charge, the property valuation will be the 'market value' definition similar to that for CGT purposes.

The returns and payments will be due 15 days after the **commencement** of the period of account apart from the first period when the rules are brought in, which will be extended to September/October 2013.

The CGT extension

The second Government measure is to introduce an extension to the current CGT regime to include disposals of by non-resident 'non-natural' persons of UK residential property valued at over £2 million, (including interests in such property, or the envelopes in which they are held).

CGT is generally only payable by a UK resident person but a non-resident individual would pay SDLT on the purchase of a residential property, so the Government views the extension of the CGT charge as a counteraction to the perceived avoidance of SDLT where 'non-natural' persons are involved.

In addition to the 'non-natural' person definition for the annual charge, there are further categories for the definition of 'non-natural' person for the purposes of the CGT extension as follows:

- Trustees (excluding bare trustees but including trustees who are individuals)
- Personal representatives
- Clubs and associations
- Entities that exist in other jurisdictions that allow property to be held indirectly

There will be exemptions available similar to those under the current CGT regime.

The measures will apply to the whole of the gain not only the gain accruing after the introduction of the measures in April 2013. This means it will be important to take any action before April 2013 to avoid the CGT charge.

It also includes gains 'that accrue on the disposal of assets (of whatever form) that represent directly or indirectly relevant UK residential property'. Therefore, a disposal of shares in a property-owning company where more than 50% of the value of the asset is derived from UK residential property will be caught. It isn't clear at present whether a sale of shares in the holding company of a property-owning company will be caught. It also isn't clear how this will be policed where offshore jurisdictions are involved.

The consultation document

The April 2013 changes highlighted above are under consultation and so may change. Commentators have already raised some practical concerns about implementation. For example, the annual charge encourages de-enveloping but the CGT extension would be a barrier to this. The whole change will undoubtedly bring additional complexity to the CGT regime and added administration and compliance costs.

There is also the cliff-edge of £2 million, which is likely to see valuations hotly contested between HMRC and taxpayers when so much is at stake once you have tipped over the edge.

The consultation document states that HMRC will 'robustly pursue non-payment of the annual charge'. However, the current proposal looks difficult to pursue and collect outstanding tax from non-resident 'non-natural' persons.

Contributed by Francesca Lagerberg

ADMINISTRATION

Reasonable care – reliance on an agent (Lecture P745 – 12.21 minutes)

The issue

The penalty regime for errors in tax returns etc (FA 2007, Sch 24) provides for a penalty if there is an error in the return which is careless (or deliberate).

The legislation states that an error is careless if "…the inaccuracy is due to failure by [the person] to take reasonable care" (para 3(1)). So what is the position if an error is made in the taxpayer's return by an agent – is reliance on an agent taking 'reasonable care'?

The law on agents

Not surprisingly, there are provisions dealing with the taxpayer's liability to penalties where there is an agent acting on the taxpayer's behalf.

FA 2007, Sch 24, para 18 ('Agency') includes the following (sub-para (1)):

> *"(1) P is liable under paragraph 1(1)(a) where a document which contains a careless inaccuracy (within the meaning of paragraph 3) is given to HMRC on P's behalf."*

However, sub-para (3) states:

> *"(3) Despite sub-paragraphs (1) and (2), P is not liable to a penalty under paragraph 1 or 2 in respect of anything done or omitted by P's agent where P satisfies HMRC that P took reasonable care to avoid inaccuracy (in relation to paragraph 1)…"*

The question therefore arises as to what constitutes reasonable care where an agent is involved.

Hanson v Revenue & Customs

In *Hanson v Revenue & Customs* [2012] UKFTT 314 (TC), HMRC imposed a penalty on the basis of a careless error in the taxpayer's 2008-09 tax return.

The taxpayer disposed of some loan notes in 2008, which gave rise to a chargeable gain. He consulted his accountant, who indicated that a form of hold-over relief would be available to mitigate the CGT charge on the disposal of the loan notes (nb the taxpayer owned a UK holiday letting, and it appears that rollover relief was initially claimed). HMRC opened an enquiry into the return, and rejected the relief claim. It was subsequently accepted that no relief was available, so there was an additional tax liability. The taxpayer appealed against the resulting penalty.

The tribunal considered that there was carelessness on the part of the accountancy firm. However, it was then necessary to consider whether the taxpayer himself had taken reasonable care to avoid the inaccuracy.

The tribunal concluded that he did take reasonable care. The tribunal Judge, Jonathan Cannan, said:

> *"He instructed an ostensibly reputable firm of accountants who had acted as his accountants for many years. The matters on which he instructed them were ostensibly within their expertise. He had no reason to doubt their competence or their advice that relief was available. They were in possession of all relevant facts. In the circumstances of this case the appellant was entitled to rely on [his accountants'] advice without himself consulting the legislation or any guidance offered by HMRC."*

The tribunal held that the taxpayer took reasonable care to avoid the error in his tax return. The appeal was allowed, and the penalty was cancelled.

<u>Shakoor v Revenue & Customs</u>

In *Shakoor v Revenue & Customs* [2012] UKFTT 532 (TC), the taxpayer appealed against a capital gains tax assessment, plus a penalty of 70%. HMRC raised a discovery assessment for 2003-04 in respect of two flats sold by the taxpayer during that year, which were not mentioned on his 2003-04 tax return. The taxpayer did not reside in either flat at any time.

It was argued on the taxpayer's behalf that if there was any negligence, it was on the part of the taxpayer's accountant. Reference was made to an earlier case (*AB v HMRC* [2007] STC (SCD) 99), where it was held that "*We…accept that a taxpayer who takes proper and appropriate professional advice with a view to ensuring that his tax return is correct, and acts in accordance with that advice (if it is not obviously wrong), would not have engaged in negligent conduct."*

The tribunal considered that if the advice of a professional such as an accountant is negligent, that negligence is not to be imputed to the taxpayer. The question is whether the *taxpayer* is negligent. The tribunal contrasted between situations where a taxpayer's accountant has been negligent in failing to carry out *administrative* work such as failing to meet a deadline for filing a tax return, and those where the accountant acts in a professional advisory capacity and the taxpayer relies on the advice given. In the first scenario, it would be difficult for the taxpayer to claim that he is not in default. In the second scenario, the tribunal commented:

> *"However, when a professional acts in a truly professional advisory capacity, the situation is otherwise and reliance upon properly provided professional advice, absent reason to believe that it is wrong, unreliable or hedged about with substantial caveats, will usually lead to the conclusion that a taxpayer has not been negligent if he has taken and acted upon that advice."*

The taxpayer's accountant knew that the taxpayer had not resided at either flat. However, he nevertheless sought to rely upon Concession D49, and later on Concession D37, both of which were inapplicable. The tribunal held that the advice given by the accountant was obviously wrong, and that the taxpayer should have realised that it was wrong, or so potentially wrong to call for further explanation or justification. It was a case of "shutting one's eyes to what either was or ought reasonably to have been seen as incorrect advice."

The tribunal considered the penalty assessment of 70%, and gave some benefit of the doubt to the taxpayer who, in the tribunal's judgement, had been ill served by his professional adviser. The penalty was reduced to 30%.

HMRC's view

HMRC state that the taxpayer should check their agent's work to the extent that they are able to do so. Adopting the approach "I leave it all to my agent" is not, in HMRC's view, taking care, let alone reasonable care.

What if a taxpayer's accountant is not a tax expert? HMRC states (CH84540):

> *"The [taxpayer] has an obligation to choose an adviser who is trained and competent for the task in hand". In addition:*
>
> *"Where a person approaches a general advice organisation, they should check that the individual does have knowledge of the particular subject."*

It is unclear what is meant by "general advice organisation", but the inference appears to be that if the taxpayer is in any doubt about the competence of his agent to deal with a particular tax matter, he should instruct a suitably qualified and/or experienced tax specialist, before the taxpayer can be said to be taking reasonable care.

Contributed by Mark McLaughlin

Proper account of jewellery sales?

The appellant company carried on a retail jewellery business which, inter alia, sold jewellery on behalf of third parties known as "Appro" sales. When Appro items were sold, the purchaser would not receive a normal shop receipt because the sale was made on behalf and as agent of the owner, and the appellant charged the owner commission on the items it sold. The appellant's sole director and shareholder was Mr K. HMRC became aware Mr K had made cash deposits of £114,250 into a Guernsey bank account in 2003 and 2004. The account was in the joint names of Mr K and his mother. Mr K stated those deposits were the proceeds of sale of his mother's jewellery given to him to sell, through the appellant, so he could purchase a flat in France, and they were sold as Appro items which was why he did not have any receipts. He did not, however, charge commission on those items and he sent her all the proceeds. His mother provided a list of the items sold, photographs of herself wearing the items over the years and an affidavit supporting her son's case. HMRC opened an enquiry into the appellant's tax return at the end of which they issued five assessments to additional tax, and they also imposed a penalty. The appellant appealed. The issue to be determined was whether the cash deposits in the Guernsey account were proceeds of sale of jewellery or undeclared profits of the appellant.

Decision:

It was understandable that HMRC found Mr K's behaviour suspicious: he paid large amounts of cash into an offshore bank account over a two-year-period; at the time he operated a retail jewellery business where large amounts of cash were received; the cash came from jewellery sales through his business; and, by his own admission, he was evasive and uncooperative when first questioned by HMRC, although he later invited HMRC to review all the records.

However, on the balance of probabilities the amounts assessed were the proceeds of sale of jewellery given to Mr K by his mother for the following reasons: (i) the affidavit and supporting evidence created no doubt that the mother was the owner of a substantial quantity of valuable jewellery; (ii) she gave the items of jewellery to Mr K to sell so he could buy an apartment; and (iii) it would be surprising if, having taken large amounts of cash out of the business with a view to not including them in the takings, Mr K then paid them into a bank account via a UK account so that they could easily be traced. The penalty assessments also fell away. It followed that the appeal would be allowed.

Comments - This case demonstrates that where unusual business practices are followed it will not be surprising that HMRC contest the results that are derived therefrom. In this case the taxpayer was able to support with evidence the results.

Romark Jewellers Ltd TC2114

Burden of proof lays with HMRC

The taxpayer, a partnership, was issued with a late filing penalty in respect of each of the two partners on the basis that the partnership return for 2007/08 was not received until October 2009. The latest date by which it should have been submitted was 31 January 2009.

The partnership appealed, saying that the return had been filed by the due date. Its accountant surmised that the return had not been processed and a further return was sent after the filing date. In essence, the accountant claimed that fault lay with HMRC.

Decision:

The First-tier Tribunal judge, Geraint Jones QC, referred to the European Court of Human Rights' decision in Jussila v Finland [2009] STC 29 which determined that the burden of proof with regard to penalties and surcharges lay with the authority imposing them. HMRC had demanded evidence from the taxpayer to show that the return had been posted in time. Mr Jones said that while it was possible to obtain proof of posting slips, there was no duty to obtain them. Furthermore, “the enquiry was misplaced because if the respondent intended to impose a penalty, … the onus of proving the default giving rise to the penalty lies upon the respondent”.

In this instance, HMRC could produce no evidence to show that the return had not been submitted.

The taxpayer's appeal was allowed.

Comments – This is another case where Geraint Jones applies principles of fairness to the imposition of a penalty. The responsibility for proving that a penalty is appropriate rests with HMRC rather than the taxpayer having to prove their innocence as amply demonstrated in this case.

The Source Partnership TC2137

Muddled cheques resulted in part penalties

The taxpayer fell behind with submitting her tax returns for the years 2006/07 and 2007/08. Knowing that she and her husband would both have tax to pay for those years, in January 2009, she sent cheques for £10,000 and £1,000 to be paid into her and her husband's accounts respectively. However, due a mix-up for which the taxpayer did not blame HMRC, the cheque for £1,000 was credited to her account and the £10,000 cheque to her husband's account. The result was that when the returns were submitted, her husband ended up with a repayment of £9,330, while she incurred interest and penalties as a result of underpaying tax.

HMRC pointed out that it was the taxpayer's fault that the cheques had been incorrectly credited.

Decision:

The First-tier Tribunal judge accepted that the taxpayer had made a genuine mistake and honestly believed she had paid £10,000 into her account. However, for the year 2006/07, the tax due would still have been paid 12 months late, so the surcharge imposed for late payment must remain.

With regard to 2007/08, taking into account the tax due for the previous year which was covered by the £10,000, this left £3,667 to cover the tax for 2007/08. As the total due was £6,787, this effectively left £3,118 to be paid, so the surcharge should be reduced to reflect that figure.

The taxpayer's appeal was allowed in part.

Comments – Taxpayers can make genuine mistakes but they are still mistakes. However penalties will still be apposite but the Tribunal will exercise judgement in ensuring the penalties are fair based on the circumstances.

M Patterson TC2138

Difference of opinion on HMRC conduct over penalties

The appellant, the Royal Institute of Navigation, did not file its 2008/09 P35 by 19 May 2009, but claimed that it was submitted by 4 August 2009, after a call in mid-July from HMRC about another matter but during which the officer said that the return did not appear to have been received. HMRC said they had not received the return until February 2010 and imposed late filing penalties of £400.

Decision:

The First-tier Tribunal, which comprised Geraint Jones QC and Anne Redston, agreed that on the evidence provided by the appellant the return had been posted on 3 August. HMRC had not proved otherwise and therefore Interpretation Act 1978, s 7 meant that the form was deemed to have been delivered on 4 August. Any penalty would have to be limited to £300.

On the issue of fairness or unconscionable behaviour on the part of HMRC, the two judges were split. The taxpayer accepted that the return was late and a penalty was due, but said that only a £100 fine should be imposed.

A higher amount would be unfair, bearing in mind Hok (TC1286). Furthermore, the fact that HMRC have since agreed to send interim reminders to taxpayers due to send forms P35 “was as close as one would get to an admission by HMRC that the practice which was in place for the 2008/09 P35s had been unfair/unconscionable”.

Mr Jones agreed with the taxpayer's arguments. He said that it was reasonable to assume that, had the taxpayer received a reminder 28 days after the deadline, it would have filed the P35. This was because it had acted on the informal reminder in the July telephone conversation with HMRC, albeit waiting a further two weeks before submitting the return. It was also reasonable to assume that the two-week delay that happened in July would have taken place had the taxpayer been reminded to file 28 days after the 19 May deadline. On this basis, it would have incurred two months' worth of late filing penalties. Mr Jones said that the penalty should be reduced to £200.

Ms Redston disagreed. In essence, she said it was the taxpayer's responsibility to file by 19 May; HMRC had informed the organisation of its failure to do so two months after that date, so there was no unfairness. The fact that HMRC had introduced a new approach for defaulters for 2011/12 did not mean that the department had acted unfairly when it told the taxpayer of its default two months after the deadline. The penalty should be £300.

Mr Jones exercised his casting vote and the penalty was reduced to £200.

The taxpayer's appeal was allowed in respect of the first issue and in part with regard to the second.

Comments – In the particular tax year that this case related to there was a significant number of penalties issued late for P35s which were filed late. HMRC have subsequently amended their procedures as a consequence of that. However this case demonstrates how two Tribunal judges can differ over the treatment of undisputed facts. The fact that HMRC had introduced a new approach for defaulters for 2011/12 did not mean that the department had acted unfairly when it told the taxpayer of its default two months after the deadline

Royal Institute of Navigation (TC2149)

Evidence helps to defeat penalties

The taxpayer incurred penalties for late payment of PAYE and National Insurance during the year 2010/11, imposed under FA 2009, Sch 56. It was accepted that payments had been late on three occasions, but the taxpayer said that the cheques for months 3, 4, 6, 7 and 8 had been posted in good time to arrive at HMRC by the due date.

The taxpayer produced a post book which was completed by an employee for each item of post. It showed the date of posting, the recipient and what was included in the letter. All post was sent first class. The book showed that the cheques had been posted on 16 July, 18 August, 18 September, 18 November and 17 December but, according to HMRC's records, each one was received several days after the due date.

Decision:

The tribunal agreed that for each of the months in dispute, payment had been received late. The question was, did the taxpayer have reasonable excuse?

The "reasonable expectation" of the taxpayer was crucial, the tribunal said. It may be prudent to allow more time, but there was no reason why an employer should not be entitled to rely on next-day delivery in the ordinary course of first-class post. The taxpayer had reasonable excuse for late payment in months 3, 4, 6, 7 and 8. The appeal was allowed.

Comments – Preparation is the key to victory in many aspects of life – war, exams and all sorts of things. This is a classic example how the taxpayer armed with the evidence was able to prove that the appropriate obligations had been fulfilled. As the Tribunal judge pointed out one must be able to rely on certain eventualities such as delivery of the post rather than having to plan for all permutations.

Browns CTP Ltd TC2244

Right of appeal: application to partnerships

A married couple carried on business in partnership, with the husband as the representative partner. They failed to submit their 2009/10 partnership return, and HMRC imposed penalties. The wife lodged appeals, contending firstly that the returns had been posted and additionally that because of ill-health, she had not taken an active part in the business during 2009.

Decision:

The First-tier Tribunal struck out the appeal. Judge Brannan held that the effect of TMA 1970 s 93A(6)(a) was that only the representative partner had the right to bring an appeal.

Comments - The First-tier Tribunal upheld HMRC's view that only the representative partner has the right to lodge an appeal.

Mrs L Jarvis v HMRC TC02160

Paper return filed late so online return submitted within extended time limit

An individual (D) submitted his 2010/11 tax return, on paper, in December 2011. HMRC imposed a penalty of £100. In January 2011 D's agent submitted the return electronically, and appealed against the penalty, contending that no penalty was due because he had submitted the electronic return before 31 January.

Decision:

The First-tier Tribunal dismissed the appeal. Judge McKenna held that 'if a paper tax return is filed late, it is not possible to avoid a penalty by filing a further tax return online before 31 January'.

Comments - The First-tier Tribunal upheld HMRC's view that if a paper return is filed after 31 October, a penalty is due even if an online return is subsequently filed before 31 January. The lesson of this case is that in such circumstances, one should only file a paper return if there is no possibility of filing an online return within the extended time limit.

G Dajani v HMRC TC02191

Application for decision to be anonymised

The taxpayer, a well-known broadcaster, took part in a marketed tax avoidance scheme which HMRC deemed not to work. He appealed against the department's subsequent amendment to his tax return.

He applied for the appeal hearing to be heard in private, with the resulting decision published in anonymised form. The reasons for his application included that there was considerable media interest in tax avoidance schemes, in particular in their use by celebrities. He had already attracted media interest for other reasons, much of it hostile, and was concerned that if the fact that he had used a tax avoidance scheme became public knowledge, this would increase the adverse media comment, possibly even damaging his career and reducing his earning capacity.

Decision:

The First-tier Tribunal said that "the presumption of a public hearing is nowadays stronger than it might have been perceived even a few years ago". The fact that the taxpayer was rich or in the public eye was no reason for a private hearing. It was important that the tax system be seen to be operated even-handedly. Granting anonymity to individuals who were rich or famous might be seen as allowing them to buy protection from scrutiny, in a way that was not available to other taxpayers. This would not be right.

The taxpayer's application for a private hearing was dismissed.

Comments - The First-tier Tribunal rejected the broadcaster's application for his appeal to be heard without his identity being revealed. Judge Bishopp's comments are self-explanatory. It is worth reading the case report as Colin Bishopp went into a substantial amount of detail and the history of such applications before delivering his decision.

Mr A TC2217

Application to strike out appeal

HMRC formed the opinion that an accountant's tax returns had substantially understated his income, and had omitted income from property transactions. They issued a notice under FA 2008 Sch 36 requesting information and documents. The accountant failed to comply with the notice, and HMRC imposed penalties and issued amendments to his self-assessments. In July 2010 the accountant appealed, contending that his records had been destroyed in a flood. Subsequently the First-tier Tribunal issued directions, which the accountant failed to comply with. In August 2012 HMRC applied to the Tribunal requesting the appeal to be struck out on the grounds that the accountant had failed to comply with the directions.

Decision:

Judge Scott granted the application, observing that the accountant had 'repeatedly failed to comply' with the tribunal's directions, and that in view of the accountant's conduct, the appeal against the amendments had 'no realistic prospect of success'.

Comments - Fortunately, it is somewhat unusual for HMRC to suspect a practising accountant of deliberately understating his own income. This is one of the rare cases where HMRC did harbour such suspicions, and where they also formed the opinion that the accountant was deliberately delaying proceedings by refusing to disclose documents or comply with the Tribunal's directions. The Tribunal decided that, in view of the accountant's repeated failure to comply with Tribunal directions, the appeals should be struck out.

C O'Brien v HMRC TC02258

Penalty is appropriate

In a long-running saga which had progressed through the courts to the Court of Appeal, , the taxpayer, a solicitor, was found to be negligent with regard to the partnership's tax affairs. An offer to settle the case was agreed, although HMRC maintained the right to impose a penalty, which they subsequently did. The taxpayer appealed against the penalty before the High Court and then the Court of Appeal, but to no avail.

Following the Court of Appeal decision, the First-tier Tribunal held a hearing to decide whether the taxpayer could raise a challenge on human rights grounds that HMRC had delayed notifying the penalty and also whether the penalty was appropriate.

Decision:

The First-tier Tribunal said that the taxpayer had not previously brought up the matter of delay and it was now too late to do so. He should have done this at the appeal before the Special Commissioners in 2009.

On the size of the penalty, the tribunal judge noted that HMRC had allowed an abatement of 30%. This was appropriate given the degree of the taxpayer's co-operation with HMRC and the seriousness of the taxpayer's negligence. No further abatement was required.

The taxpayer's appeal was dismissed.

Comments – The case has appeared many times in the Courts and this may not be the final appearance as the taxpayer in question is tenacious and may well have other attempts through the Courts. It demonstrates that when taking actions through the Courts the taxpayer has to consider many aspects as it may be too late after theevent.

Stockler TC2099

Penalty for failure to declare capital gain

A property developer had acquired the shares in a newly incorporated UK company in 1993. In October 1994 he sold the shares to a Bahamian company. The consideration was expressed to be £20,000. The vendor did not declare a gain on his tax return.

HMRC subsequently issued an assessment charging tax of £744,000 on the basis that the disposal was not at arm's length, so that the shares should be valued at their market value. The vendor appealed, contending that the disposal should be treated as having been at arm's length.

Decision:

The First-tier Tribunal reviewed the evidence in detail and rejected this contention, finding that the vendor's evidence was 'implausible' and that 'his memory was selective'. Accordingly the Tribunal dismissed the appeal in principle, subject to agreement as to figures (see decision TC00722). HMRC had also imposed a penalty of 35% of the tax originally charged — i.e. a penalty of £260,400. The Tribunal subsequently determined that the tax due had been £849,449, and increased the assessment accordingly. The Tribunal upheld the penalty in its original amount, equating to about 30.6% of the tax due. Judge Bishopp held that the Tribunal should be 'reluctant to increase penalties save in clear cases'.

Comments - The First-tier Tribunal upheld a penalty of more than £250,000 on a property developer who had failed to declare a capital gain. This is stark reminder of the sheer size of the penalties that can be payable with tax geared penalties.

OI Iny v HMRC (No. 2) TC2216

Penalties for failure to make payments of PAYE

A company persistently paid its PAYE and NIC after the due dates, and HMRC imposed penalties under FA 2009 Sch 56. The company appealed, contending that the penalties were excessive because payments which it had made should have been allocated to its liability for the current tax month, rather than to its liability for the previous tax month.

Decision:

The First-tier Tribunal rejected this contention and dismissed the appeal. Applying dicta of Lord Macnaghten in Cory Bros & Co Ltd v Turkish SS Mecca, HL [1897] AC 286, 'when a debtor is making a payment to his creditor he may appropriate the money as he pleases, and the creditor must apply it accordingly. If the debtor does not make any appropriation at the time when he makes the payment, the right of application devolves on the creditor'. On the evidence, the company had chosen to make its payments a month late, and to allocate its payments to the debt for the previous month.

Comments - If an employer pays each month's PAYE a month late, it will incur a penalty for each month. Therefore, where an employer has fallen into arrears, it should try to avoid further penalties by ensuring that payments are allocated to its current liability, rather than allowing HMRC to set them against its oldest debts. We have referred in previous cases involving the penalties for late paid PAYE penalties to the importance of the allocation of the payments of PAYE when some are late – this case illustrates those principles. Look at the HMRC guidance on this

AJM Mansell Ltd v HMRC TC2279

Interest on overdue tax

Section 86 of the Taxes and Management Act 1970 provides, so far as material; “(1) The following , namely (a) any amount on account of income tax which becomes due and payable in accordance with section 59A(2) of this Act and (b) any income tax or capital gains tax which becomes due and payable in accordance with section 55 or 59B of this Act, shall carry interest at the rate applicable under section 178 of the Finance Act 1989 from the relevant date until payment”

The taxpayers were members of the Scottish Equitable Personal Pension Scheme, which was a scheme approved under Pt XIV of the Income and Corporation Taxes Act 1988 (the 1988 Act). Acting on the advice of their financial adviser, they entered into arrangements whereby the funds representing the value of their pension funds held for them by Scottish Equitable were transferred to retirement annuity trust schemes established in Guernsey for their benefit. Under the terms of a reciprocal agreement entered into between the United Kingdom and Guernsey, provided certain conditions were met, a member of a personal pension scheme approved under Pt XIV of the Act might transfer the funds representing his rights under the scheme to a duly constituted retirement annuity scheme in Guernsey.

Under the relevant Guernsey regulations, to be eligible to join such a scheme, the person concerned had to become resident in Guernsey. Acting on advice, the taxpayers purported to meet that requirement by acquiring the lease of a property in Guernsey, but they never actually took up residence there. The relevant UK conditions were set out in a practice note entitled Pensions Schemes Office PS 121, which only contemplated a transfer where, on a change of job, an individual moved from Guernsey to the UK or vice versa. The taxpayers had no intention of taking up employment in Guernsey, but their advisers confirmed to Scottish Equitable that the conditions for a transfer had been met and accordingly the transfers were made on the strength of that representation. The conclusions of an enquiry by the Revenue and Customs Commissioners (the Revenue) into the transfers were that the pension fund transfers had not met the requirements of the reciprocal agreement between the UK and Guernsey. Consequently, the transfers breached the rules of the Scottish Equitable Scheme which did not permit transfers to be made unless they were to a scheme approved by the Revenue, a condition that would have been met had the terms of the reciprocal agreement been satisfied.

Consequently, the Revenue made assessments under s 647 of the 1988 Act which made payments out of a scheme approved under Pt XIV of the 1988 Act chargeable to income tax under Schedule E unless the payment was authorised by the rules of the transferring scheme. In addition to seeking to charge interest on the tax so assessed, the Revenue sought to impose penalties equivalent to 45% of the tax payable under s 95 of the Taxes Management Act 1970 (the 1970 Act) on the basis that the taxpayers had been negligent in delivering incorrect tax returns in the mistaken belief that the terms of the reciprocal agreement had been met.

The First-tier Tribunal (Tax Chamber) (the FTT) found that the taxpayers had not been negligent on the basis that they had reviewed the relevant explanatory notes issued in the UK and Guernsey and had contacted the Guernsey authorities to clarify the position. The FTT found that they had made an honest mistake in focusing purely on the Guernsey requirements and not considering PS 121, which their own adviser had not considered before the representation as to the UK conditions having been met had been given to Scottish Equitable. Consequently, the FTT concluded that the determination to impose the penalties should be set aside, a course of action that was clearly open to it by virtue of s 100 of the 1970 Act.

However, it went further, stating: “that there should be no penalties or interest, for the reasons given above, in the circumstances.” The Revenue appealed to the Upper Tribunal (Tax and Chancery Chamber) (the tribunal).

Relying on s 86 of the 1970 Act, the Revenue submitted that the FTT did not have the jurisdiction to decide that no interest would be payable. The Revenue submitted that the word “shall” was used to indicate that there was no discretion as to whether interest is applied to any amount of tax paid after the due date and that that was further reflected in the fact that the statute provided no right of appeal against the application of interest in such cases.

Decision:

The appeal would be allowed.

The Revenue's submissions would be accepted. The amounts assessed in respect of the unauthorised payments from the Scottish Equitable scheme under s 647 of the 1988 Act had clearly come within the scope of s 86 of the 1970 Act and therefore interest was payable on them. There was no discretion on the part of the FTT to determine that interest should not be payable and the FTT had made a clear error of law in doing so.

The parties appeared by written submissions only.

Comments – The conditions that were applicable to the arrangements were not met and consequently amounts were assessed in respect of the unauthorised payments. It is logical that these should bear interest so it was illogical that the FTT should decide that the interest was not payable.

Revenue and Customs Comrs v Gretton [2012] UKUT 261 (TCC)

Unfair penalty

The taxpayer company believed that it had filed its end-of-year employer return form P35 in time for the 19 May deadline. It was not until it received a late filing penalty for £500 in September that it realised there must have been a problem with the return. It then filed the return on 14 October and appealed against the penalty on the ground that it should be reduced to £100.

Decision:

The First-tier Tribunal found that the company had logged on to HMRC's system in April to file its P35, but that it did not actually submit it, probably as a result of human error.

Turning to HMRC's delay in advising the taxpayer of the penalty, the tribunal judge, Christopher Hacking, did not accept that it was reasonable for the Revenue to wait five months before issuing the penalty notices. He said:

“It seems to the tribunal reasonable to contend from the tenor of the legislation cited above that a purpose of the legislation was to provide a disincentive to delay in filing returns: the greater the delay — the greater the penalty.

Had it been the intention to impose a larger fixed penalty no doubt quite different language would have been used. In circumstances where the taxpayer is unaware of its default the continuing imposition of monthly penalties operates unfairly and in the finding of the tribunal in a way not intended by parliament."

The judge had no doubt that, had the taxpayer been made aware of the problem at an earlier date, the matter would have been resolved sooner and a smaller penalty incurred. He went on to say that it was unreasonable for HMRC not to have informed the taxpayer that a penalty would be imposed for late filing "at the earliest practical opportunity".

On the other hand, the judge said that even if the taxpayer had been told that it had not submitted its return in the first month after the deadline, based on what had happened in this case, discussions with HMRC would have ensued and a second month's penalty would have been incurred.

In the circumstances, the tribunal decided a penalty of £200 was appropriate.

The taxpayer's appeal was allowed in part.

Comments – With failures due to human error it is crucial that penalties which are levied are seen to be fair. Clearly if HMRC are are going to take a long time to raise the penalty it is likely to be substantial. This is another case albeit not in front of Geraint Jones QC where the Courts have applied fairness to what would otherwise be a penalty at too high a level for the circumstances.

MOH Properties Ltd TC2273

Late payment of PAYE—reasonable excuse—special circumstances

During 2008–2009 the appellant company started making late payments of PAYE as a result, inter alia, of the economic downturn. After writing to and telephoning the appellant, HMRC imposed penalties on it. The appellant appealed contending it was unaware of the new penalties regime. The issue arose as to whether the appellant had a "reasonable excuse", or "special circumstances" existed, for the purposes of FA 2009 Sch 56, paras 9(1) and 16.

Decision:

Although in the general economic downturn trading conditions had become more difficult, they were the consequences of normal trading, albeit in adverse economic conditions. The appellant did not seem to exercise reasonable foresight, nor display a proper regard for the date on which its PAYE was due and payable. In addition, HMRC had not acted unreasonably. It followed the appellant did not have a reasonable excuse for its failures to make PAYE payments on time; Dina Foods Ltd v Revenue and Customs Comrs [2011] UKFTT 709 (TC) approved.

A failure by HMRC to consider whether to exercise their discretion under FA 2009 Sch 56, para 9 meant that their decision was "flawed" for the purposes of para 15. Paragraph 9 imposed a requirement that HMRC should consider whether a penalty should be reduced in making a penalty assessment pursuant to para 11 for the following reasons.

First, the assessment under para 11 had to specify the amount; and HMRC had to apply the mandatory quantification provisions of Sch 56 paras 5 and 6 and also to consider whether a reduction under para 9 should be made. Thus, a reduction because of special circumstances went directly to the quantum of the penalty.

Secondly, when Parliament conferred a discretion on a statutory body, that body had to consider whether it was appropriate to exercise that discretion; it could not fail to take account of its discretion or simply ignore it.

Third, the exercise of HMRC's discretion under para 9 had to be initiated by HMRC. Fourthly, the format of Sch 56 suggested that the issue of special circumstances should be considered prior to the issue of the penalty assessment under para 11.

Fifthly, liability for a penalty was removed entirely if a taxpayer satisfied either HMRC or the First-tier Tribunal that there was a reasonable excuse for the default. There seemed no reason why Parliament should not have required circumstances falling short of a “reasonable excuse” to be taken account in mitigation of a penalty, albeit that the circumstances would have to be special.

Sixthly, the fact that para 9 stated that HMRC “may reduce a penalty” did not imply that a valid penalty might exist without HMRC considering whether a reduction on account of “special circumstances” should be made.

Lastly, it would be strange if a decision in respect of “special circumstances” could be flawed (as para 15(3) contemplated) but a failure to think about the issue at all (either in assessing the penalty or subsequently) was not.

On the facts HMRC's penalty assessment was flawed because they failed to consider whether “special circumstances” existed. However, the fact that the appellant was unaware of changes in the penalty regime, particularly when its business was facing pressure from the economic downturn did not constitute “special circumstances”—that phrase meant something more than circumstances that were simply unique or particular to the individual taxpayer. The correct test was to determine whether the circumstances were out of the ordinary, something uncommon. It had to operate on the particular individual and was not a mere general circumstance that applied to many taxpayers by virtue of the scheme of the provisions themselves. It followed that the appeal would be dismissed; Hardy v Revenue and Customs Comrs [2011] UKFTT 592 (TC), Rodney Warren & Co v Revenue and Customs Comrs [2012] UKFTT 57 (TC), Roche v Revenue and Customs Comrs [2012] UKFTT 333 (TC) and White v Revenue and Customs Comrs [2012] UKFTT 364 (TC) applied; Agar Ltd v Revenue and Customs Comrs [2011] UKFTT 773 (TC) not followed.

Appeal dismissed.

Comments – The process for the imposition of penalties in respect of late PAYE includes certain safeguards. HMRC have power to reduce penalties below the statutory levels set by the legislation. This power is discretionary and may be exercised in cases where HMRC “think it right because of special circumstances” to reduce a penalty. HMRC's penalty assessment was flawed because they failed to consider whether “special circumstances” existed. However the Court did not overturn this.

Algarve Granite Limited v Revenue and Customs Comrs TC 2142

BUSINESS TAXES

Establishing a home office claim (Lecture B742 – 19.10 minutes)

Many sole traders, partnerships or small corporates choose to operate from home. Whatever the chosen trading vehicle, it should be possible to establish a claim for tax relief on part of the home expenses.

There is no specific legislation on this, and instead it is a question of applying general principles to create a valid claim. The HMRC manuals make several references to this subject at *Business Income Manual 47800*.

The deductions for sole traders are where the HMRC manual focus but we should be able to extend these principles to individuals trading through a company and working from home.

In their manuals HMRC state that an expense is only allowable if it is incurred 'wholly and exclusively for the purposes of the trade'.

If an expense is incurred for more than one purpose, a deduction is still allowed for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade.

HMRC state that wholly and exclusively **does not mean** that:

- business expenditure must be separately billed, or
- part of the home must be permanently used for business purposes and not used for any other purpose at any other time.

Wholly and exclusively **does mean** that when part of the home is being used for the business then that is the sole use for that part at that time. Thus if the part of the home used for business purposes is also, at the same time, used for some other non-business purpose, no deduction is due.

The question is whether there are periods when part of the home is being used solely for business purposes. If part of the self-employed person's home is set aside solely for business use for a period, they can claim as a deduction the costs they incurred on that part during that period. It will be most unlikely that they have a separate bill for that specific part and usually this exercise will involve apportioning the total relevant bill between the period of solely business use and the remainder of the time covered by the expense.

So to claim a reasonable deduction for home office costs the trader should have a room at home which is just used for business purposes when they are working from home, for example a study or a spare bedroom.

Working on the kitchen table is unlikely to meet the wholly and exclusive criteria – what if your spouse is in and out of the kitchen whilst you are working? What if you are working and preparing supper at the same time?

It is very important that the "study" has some non-business use when you are not working so that your principal private residence is preserved for CGT purposes. For example the trader's children may use the computer and printer in the evenings for school projects.

Business Income Manual 47815 explains how to apportion expenditure where a self- employed person's home is used partly for business and partly for other purposes.

The courts have approved apportioning household expenses. Templeman J in Caillebotte v Quinn [1975] 50TC222 at page 227F-G said:

"… it is possible to apportion the use and cost of a room on a time basis, and to allow the expense of the room during the hours in which it is used exclusively for business purposes, in the same way as it is possible to calculate the business expenses of a car which is sometimes used for business purposes exclusively and sometimes used for pleasure."

HMRC accept that there is more than one method of arriving at a reasonable apportionment and their guidance is not intended to be prescriptive. The results may differ in detail, but they are equally acceptable. This does not apply in all cases. Some methods may be more appropriate for a particular type of expense. For instance apportionment by area may be adequately considered by reference to the number of rooms in use, alternatively in an open plan environment a calculation by reference to floor area may be necessary to isolate the identifiable area used solely for the purposes of the trade. If two different methods produce substantially different figures, then that is likely to be a sign that one may more closely reflect the underlying facts and that the other method is flawed.

The extent of business use is a question of fact. Enquiries are only likely to be worthwhile where the amount claimed is significant and appears to be inconsistent with the nature of the taxpayer's business.

Different traders organise their businesses in different ways. An architect trading from home is likely to have a greater home office claim than say a builder.

The factors to be taken into account when apportioning an expense include:

- Area: what proportion in terms of area of the home is used for business purposes?
- Usage: how much is consumed? This is appropriate where there is a metered or measurable supply such as electricity, gas or water.
- Time: how long is it used for business purposes, as compared to any other use?

The method of apportioning an expense depends on the relative importance of each of these factors.

Business Income Manual 47820 looks at some of the types of expenditure that may be allowable. Expenses broadly fall into two categories, fixed costs and running costs.

Fixed costs relate to the whole house and have to be paid even if there is no business use. These include costs such as, Council Tax, mortgage interest, insurance, water rates, general repairs and rent.

If part of the home is set aside solely for business use for a specific period then a part of these costs is allowable. It will normally be appropriate to apportion these expenses by area and time.

Running costs are where the total bill may vary with the amount of business use. They include cleaning, heat and light, telecommunications costs and metered water.

There are several examples given by HMRC of this new approach in para BIM47825 of which Example 6 is the most important

Example 6

Gordon, an architect, dedicates a room solely for use as his office between 9am and 5pm daily. The room contains a workstation, office furniture and storage for his drawings. He uses the room for an average of 4 hours each day, though often this is spread over his working 8 hour day as he has a number of regular site visits to make. In addition it is not uncommon for Gordon to accommodate clients in his office to discuss plans, outside of normal hours.

The room is available for domestic use outside of business hours and his family regularly make use of the room for around 2 hours each evening.

After apportioning costs by reference to the number of rooms in the house, Gordon calculates the room uses £300 of variable costs (electric and oil) and £600 of fixed costs (council tax, mortgage interest, insurance). In apportioning these costs by time Gordon claims £680 in total, made up of 4/6 of variable costs (£200) and 8/10 of fixed costs (£480).

The claim equates to 75% of the total costs attributable to the room (£680/£900), which Gordon views as a more straightforward but equally reasonable basis for future claims, should his circumstances remain unchanged.

In this example it is very relevant that Gordon's family use the room in the evening. As the room is not exclusively business, full principal private residence relief should be available when Gordon sells his home.

It is also very important that the eight hours of business use are exclusively business. It is this exclusivity that gives the taxpayer access to the wholly and exclusive deduction.

Example 6 would appear to be a reasonable starting point for use of home as office claims.

If we were to make some assumptions as regards the backing numbers for the fixed costs in example 6 the following might be reasonable:

	£
Mortgage interest (£750 per month)	9,000
Council tax	2,400
Property insurance	600
	12,000
Relating to study (5% of floor area)	600
Business proportion (8 out of 10 hours)	480

It can be seen from these backing numbers that mortgage interest is a key factor in use of home as office claims.

In the example 75% of the £480 claimed relates to mortgage interest (£9,000 x 5% x 8/10 = £360). Consequently if your mortgage is low then your use of home as office claim will be low. If however your mortgage is high then you will have a high use of home as office claim.

The claim will also depend on the square footage of your home office. In smaller properties the study may represent 10% or more of the area of your home.

Indeed if we assume that 8 out of 10 hours is a reasonable usage percentage, the mortgage interest element of a use of home as office claim would be broadly….

Mortgage (rates were around 6% when HMRC example published)	5% floor area	10% floor area
	£	£
£100,000	240	480
£200,000	480	960
£300,000	720	1,440
£400,000	960	1,920
£500,000	1,200	2,400

It can be appreciated that clients with higher mortgages on smaller properties would have the makings of a reasonable home office claim.

In any event it is obvious from HMRC guidance that they require a more scientific approach to use of home as office. This may be in the clients favour.

Illustration 1

Tom, an accountant, dedicates a room solely for use as his office between 9am and 5pm daily. The room contains a workstation, office furniture and storage for client files. He uses the room for an average of 4 hours each day, though often this is spread over his working 8 hour day as he has a number of client visits to make. In addition it is not uncommon for Tom to accommodate clients in his office to discuss matters of a confidential nature.

The room is available for domestic use outside of business hours and his family regularly make use of the room for around 2 hours each evening.

Tom lives in central London and he estimates that his study represents approximately 15% of his property square footage. Tom's mortgage is £500,000.

Tom calculates the fixed costs as follows

	£
Mortgage interest (£1,650 per month)	19,800
Council tax	3,200
Property insurance	1,000
	24,000
Relating to study (15% of floor area)	3,600

Business proportion (8 out of 10 hours)	2,880

The apportioned variable costs amount to £620 so Tom has a "Use of Home as Office" claim of £3,500.

On the face of it this seems a high claim but Tom can substantiate all the elements using HMRC example 6 as a basis. Maybe we should consider making disclosure in the "Any other information" space on the self assessment return stating that Example 6 of BIM 47825 has been used as the basis for a home office claim of £3,500.

Illustration 2 – Renting rather than owning

What if Sam was renting a two bedroom flat in Clerkenwell with one of the bedrooms being used exclusively for his IT business? It may be that the bedroom is one of five principle rooms in the flat – so we have a 20% deduction. There are no PPR issues with exclusive use on rental properties so full business could result in a large home office claim.

Sam calculates the fixed costs as follows

	£
Rent (£3,000 per month)	36,000
Council tax	3,000
Property insurance	1,000
	40,000
Relating to "business bedroom" (20%)	8,000
Business proportion (100%)	8,000

The running costs could push the home office claim close to £10,000!

Seems high but what could Sam rent a serviced office for in the centre of London? Not too dissimilar I would think and working from home could have strong commercial advantages – especially if the hours were long and clients contacted Sam day and night.

With any decent home office claim it is important to be able to support your claims. In our first year of acting for Sam we should do the calculation above – after ascertaining the financial costs and the clients usage of the business bedroom. It may be prudent to factor in some private use but that would depend on the circumstances. With WIFI and I-pads etc it may be quite feasible that the bedroom is exclusively business and any private internet usage is done from the lounge area on their I-Pad. It all depends on what the clients lifestyle is like and that is what we need to ascertain at the start.

Once we have done the year one claim we then need to check every year whether his circumstances have changed. If not the original home office claim stands for another year.

Given the high level of home office claim it may be prudent to disclose in "Any other information" on the SAR that "Box 20 – Rent, rates, power and insurance" includes a home office claim of £10,000 (say) and outline the basis of your calculation.

Home office for corporates?

Clients trading through a company can have the same effective treatment but they need to set up a rental agreement between the company and the individual (or husband and wife if property jointly owned).

Rental payments can prove advantageous as the company may deduct the rents in arriving at its corporation tax profit, provided that such rents do not exceed a commercial arm's length amount. It is advisable to put in place a formal rental agreement and have independent rental valuations carried out by a suitably qualified expert on a regular basis. Failure to instigate this may lead to an HMRC challenge on the deductibility of the rents.

It may be easier to keep a note of the rental rates that local serviced offices charge. Serviced offices are very common and rental rates tend to be based on the size of the office space. It should also be noted that the serviced office rental rates are generally inclusive of utilities and insurance so the comparison is reasonable. If your rental charge is in line with local serviced office rentals it should satisfy the market value test.

In order to prevent the loss of Principal Private Residence relief on the ultimate disposal of the home it is advisable to state in the agreement that the facilities are only let to the company for designated hours each week, for example, 9.00am to 5.00pm Monday to Friday.

If Tom (example above) was to trade through a corporate he may choose to set the home office rentals at £4,750 per annum. Assuming this did not exceed market value of the office space then his company would get a deduction for the rental payments.

Tom would need to declare the rent of £3,500 on his self-assessment property pages. As he has a source of property income he would get deductions for any costs "wholly and exclusively" incurred for his property business. Effectively the same basis as a self-employed person – so the £3,500 as calculated above. The home office rental profit would be £nil.

If Tom were to simply put costs through the company without a formal rental agreement, HMRC may regard the costs as extra salary. In this regard Tom would not receive deductions for mortgage interest etc as these are not wholly, exclusively and necessarily incurred for his employment.

Hence a "non-exclusive" rental agreement is key to securing tax deductions for home office costs. This should also be supported by company minute confirming their intent to let on a non-exclusive basis and that the rental charge is considered to be no higher than market rate for a similar space.

VAT Issues on home office costs

Consider a sole trader that has a loft conversion to enable them to work from home. The conversion costs £20,000 plus VAT. Can the sole trader recover the VAT?

I do not see anything that would preclude the trader recovering a proportion of the input tax on the conversion. Discuss what the trader has actually got in terms of space and what they use that space for. If is primarily office space then an input tax claim of up to 90% might seem reasonable. Never 100% as we do not want any part of our home being used exclusively for business – CGT PPR.

If the sole trader deregistered for VAT at a later date there would be no input tax adjustment by way of a deemed supply on business assets – the costs were services not goods.

If the house was sold whilst still registered for VAT there would be no VAT issues.

If I was trading via a corporate I would be reluctant to ask the company to pay for the conversion so VAT input tax recovery is not an option. If the company were to pay for the conversion there are likely to be direct tax issues with the property value increasing by way of company spending. I guess there are still some advantages in remaining unincorporated!

Conclusion

In the past "use of home as office" claims may have been fairly arbitrary – say £10 per week. Modern day claims should however not be arbitrary – we may be able to substantiate significant claims for our clients.

HMRC offer a standard £3 per week without any questions asked but this is on the low side when clients are actually trading from home. The £3 per week might be reasonable for a trader that spends the whole of their working day away from the "home office" and only has the odd administrative task to perform at home in the evening. It would not be reasonable for a trader that spends the majority of their working day in the "home office".

Going forward it is worth having a note on file of key information in order to ascertain the reasonableness of the claim. The information collated needs to be targeted towards completing the following table:

	£
Mortgage interest	X
Council tax	X
Property insurance	X
	X
Relating to study (?? % of floor area)	X
Business proportion (8 out of 10 hours)	X

We would then need to add the variable elements such as light and heat, telephone etc.

Most claims should be reasonable but there will be a number which are significantly lower (or higher) than what they should be.

Motor racing company: fine imposed by governing body allowed as a deduction

The FIA, which is the governing body for Formula 1 motor racing, imposed a penalty of £32m on a company (M) which had broken the rules of the FIA's international sporting code by obtaining information belonging to a rival company (F). M claimed that this penalty should be allowed as a deduction in computing its profits. HMRC rejected the claim, and M appealed.

Decision:

The First-tier Tribunal allowed the appeal (by Judge Hellier's casting vote). Judge Hellier observed that the penalty was 'one which (M) was contractually obliged to pay under contractual obligations undertaken for the purposes of its trade; it did not result from the action of an external regulator, but from a body to whose dictates it had agreed to submit as part of its trade and in order to gain income; it arose from the action of employees in pursuing a course of conduct normally for the benefit of its trade, not from actions unconnected with its trade'. He expressed the view that 'the protection of fairness in motor sport organised by FIA does not carry the same sort of public interest as that protected by a regulator of a profession based on trust'.

Comments - There is a significant amount of tax involved in this case. HMRC formed the view that the effect of the HL decision in McKnight v Sheppard ([1999] STC 669) was that the company could not deduct the fine in computing its profits. (In McKnight v Sheppard, the HL upheld the Special Commissioner's decision that there is 'a difference between a commercial loss incurred in trading and a penalty imposed for a breach of the rules committed in that trading'.) The appeal was heard by a Tribunal of two members, who disagreed with each other: the company's appeal was allowed by virtue of Judge Hellier's casting vote. The case report is worth reading for a detailed consideration of the treatment of fines and penalties and the fact that the two judges could take such different views.

McLaren Racing Ltd v HMRC TC2278

Restricted securities for bonuses

Two cases, USB AG v HMRC and Deutsche Bank Group Services v HMRC, covering similar issues were heard recently by the Upper Tribunal. Both taxpayers were investment banks that had entered into arrangements to provide bonuses to employees. The aim was to avoid income tax and National Insurance on the payments.

For the UBS scheme, a Jersey-registered company, ESIP Ltd, was incorporated from which UBS awarded restricted shares to its employees. The bank said they were within ITEPA 2003, s 423. UBS did not control ESIP. A similar arrangement was used by Deutsche Bank, with its offshore company called Dark Blue Investments Ltd.

The First-tier Tribunal determined that the sums used to buy the shares were, in effect, payments to which the employees were legally entitled regardless of the money being used to acquire shares. They said that these payments were therefore liable to income tax under ITEPA 2003, part 7 and National Insurance.

The taxpayers appealed.

Decision:

With regard to UBS, the Upper Tribunal decided that it could not be said that the employees became entitled to immediate payment of the sums used to buy the restricted shares. It was rather a right to a future payment, although in fact, by prior agreement with the employees, the money was used to acquire shares for the employees. The shares were earnings from employment with UBS, but they constituted non-monetary earnings.

With regard to HMRC's argument that Ramsay applied, the tribunal judge disagreed, and said that the “existence of a tax avoidance motive is, in itself, irrelevant, although it may of course throw light on matters such as the commerciality of the arrangements made, or the likelihood of pre-planned events occurring”. UBS's appeal was allowed.

Turning to Deutsche Bank's appeal, the Upper Tribunal ruled that, as with UBS, the employees had no present right to present payment of the bonuses until they received the beneficial interest in the shares. However, because the Dark Blue's major shareholder acted in accordance with Deutsche Bank throughout, the effect was that the decisions relating to the scheme were made by the bank. The exemption in s 429 did not apply.

Deutsche Bank's appeal was dismissed.

Comments - There is a considerable amount of money at stake in these cases, although there have been significant subsequent changes to the legislation, including the introduction of ITEPA 2003 s 431B. HMRC will be disappointed that the Upper Tribunal has allowed the appeal by UBS, rejecting the view of the First-tier Tribunal that the scheme failed both on technical grounds and under the 'Ramsay principle'. Advisers with an interest in this area will also be interested in that the Upper Tribunal held that the Deutsche Bank scheme failed on technical grounds, in that the companies involved in the scheme were associated at the relevant time and thus failed to meet the conditions of ITEPA 2003 s 429.

UBS AG v HMRC and Deutsche Bank Group Services (UK) Ltd v HMRC (Upper Tribunal)

Exceptional problems did not save loss of Gross Payment status

The taxpayer's gross payment status under the construction industry scheme was cancelled by HMRC because the company had paid its October 2010 PAYE tax and National Insurance late.

The company claimed there were exceptional circumstances beyond its control which constituted reasonable excuse for the delayed payment. The director explained that, since 2009, he had been trying to obtain an overdraft facility from his bank, HSBC, and that the director had to inject £18,000 of his own savings to enable the business to meet its commitments. Eventually, in 2011, an overdraft facility was arranged although, in the meantime, the company had to write off a substantial debt.

The director added that it was important to the company's reputation to have gross payment status and that it helped it win contracts.

HMRC said that "while the concept of reasonable excuse was not defined in the legislation, in HMRC's view there had to be exceptional circumstances which were beyond the taxpayer's control". Cashflow difficulties were not exceptional because the taxpayer should have made suitable contingency plans to deal with them.

Decision:

The First-tier Tribunal disagreed with HMRC that there had to be exceptional circumstances for there to be a reasonable excuse. However, the judge agreed that the effect of losing gross payment on the business was not relevant, and cashflow difficulties in themselves were not conclusive, so it was necessary to look at the actions the taxpayer had taken to counter those problems.

The tribunal judge noted that the payment terms of one contract turned out to be 90 rather than 30 days stipulated by the taxpayer's standard invoice terms. He also accepted that a debt had to be written off and that it had taken longer than anticipated to organise the overdraft facility.

The judge said the taxpayer had not "passively accepted the situation the company was in but was attempting to improve matters". Viewed as a whole, the circumstances constituted reasonable excuse.

The taxpayer's appeal was allowed.

Comments – The Construction Industry Tax Deduction Scheme has a sanction that can be applied unlike other taxes – namely the loss of gross payment status which can have a dramatic effect on the cash flow of a business in the Construction Industry. There are specified circumstances which will be ignored within the 12 month period that will be examined. The Courts have had a recent history of applying the reasonable excuse provisions where the business is able to demonstrate that it has made substantial efforts to ensure payment rather than passively reacting to lack of funds.

P S R Control Systems Ltd (TC2155)

Low salary, high dividend (Lecture B743 – 16.10 minutes)

It can be shown that the most tax efficient way of extracting profit from a company is to take a salary of around the lower earnings threshold for NIC and the balance of post-tax profits as dividends. It is worth informing HMRC each month that no PAYE liability exists by visiting http://www.hmrc.gov.uk/payinghmrc/paye-nil.htm.

This is true at all levels of profits, including where corporation tax rates are above 20%.

Low salary/high dividend is tried and tested and does not breach any National Minimum Wage rules providing the director does not have a formal employment contract with their company.

The director should however ensure that any "loss of earnings" insurance policies count dividends as earnings if the policy was ever called upon.

Exposure to income shifting rules?

From 6 April 2010 the personal allowance has been reduced by £1 for every £2 of income in excess of £100,000 thus creating a marginal tax rate of 60% for income between £100,000 and £112,950. In addition, a new higher rate of income tax of 50% has applied to those earning in excess of £150,000.

The higher rate of tax on dividends in excess of £150,000 is 42.5% (translating to 36.11% of the net dividend). With increasing higher rates of personal tax in 2010/11 a greater emphasis might well be placed on diverting income to spouses and civil partners.

In the case of a close company this diversion of income is obtained by ensuring that the non-working spouse owns some of the ordinary shares. Diverting income to the non-working spouse has been widespread for many years – particularly after HMRC's loss in the infamous *Jones v Garnett* case. Given the increase in tax rates in 2010/11 further share transfers are likely to be common place.

Example

Theo runs a management consultancy company which makes annual post tax profits of £200,000. Theo's wife Georgina works in the business part time and is paid a personal allowance salary. Theo also has a personal allowance salary, a company car and private healthcare for the family. Historically the company has paid all the post tax profits out as dividends.

Theo owns 80% of the shares whilst Georgina owns the remaining 20%. Georgina's shareholding has been sufficient to utilise her basic rate band in previous years but the situation has changed in 2010/11. Theo's earnings are in excess of £150,000 and as such he will pay the higher dividend rate of 36.11% on dividends breaching the £150,000 mark. This is a 45% increase in tax rates on the dividends exceeding £150,000 (25% v 36.11%).

If Theo were to transfer a further 15% of his shares to his wife he will avoid the 36.11% tax rate – a saving of approximately £3,500 in tax in 2010/11.

As long as Theo's wife has free use of her dividend income there should be no issues with the settlements legislation.

Dividends checklist

Writing in AccountingWeb, Jennifer Adams sets out a checklist for ensuring that dividend payments will meet with HMRC's approval and then goes onto consider dividend waivers.

The dividend procedure is just a matter of making the correct journal entries to show the final amount declared in the correct place on the balance sheet – yes?

Not quite. HMRC are increasingly contending that such dividends are in reality earnings under the s62 ITEPA 2003 (salary sacrifice) rules and to persuade them otherwise needs proof that a set procedure for the declaration of dividends has been followed.

The following check sets out points to consider when preparing such a procedure:

1. The dividend must be legal

Companies Act 2006 (CA 2006 (s830) states that *'a company may only make a distribution out of profits available for the purpose'* – it is vital that director/shareholders appreciate what this means. Namely that even if the bank account is in credit the company needs to have sufficient retained profits to cover the dividend at the date of payment.

'Profits' in this instance are '*accumulated realised profits less ....accumulated, realised losses'*(CA 2006 (s830 (2))

Any dividend paid in excess of this profit, or out of capital or when losses are made is 'ultra vires' and, in effect, 'illegal'.

The financial status of the company therefore needs to be considered each time a payment is made. If regular amounts have been withdrawn (including the monthly payments our clients all insist on drawing in lieu of salary) then the amounts are deemed 'illegal' if at the date of each payment the management accounts show a trading loss or the profit cannot support the payment. HMRC will argue that *'in the majority of such cases'* the director/shareholder of a close company will be aware (or had reasonable grounds to believe) that such a payment as dividend was 'illegal' (CTM20095 (27 and 29) and *It's A Wrap (UK) Ltd. v Gula & Anor [2005] EWHC 2015).*

Full accounts are not required for the calculation of an interim dividend. Accounts of the detail that enables *'a reasonable judgement to be made as to the amount of the distributable profits'* at the date of payment are acceptable (CTM20095 (17)) (also see *'Proper Declaration of Dividend'* below).

A significant consequence of payment of an 'illegal' dividend could arise if the company goes into liquidation and the liquidator or administrator routinely reviews the conduct of the directors over the three years prior to insolvency. If it is found that a dividend has been paid 'illegally' then CA 2006 s847 provisions apply and the directors will be expected to repay the amount withdrawn. (See *Bairstow v Queens Moat Houses plc [2001] 2 BCLC 531* and *'Do directors actually have the right to receive any remuneration - 30/01/2010*). HMRC will actively pursue this route being as they are often the largest unsecured creditor. All members should read '*First Global Media Group Limited v Larkin [2003] EWCA Civ 1765)'* to appreciate how far HMRC will go in this matter and the importance of correctly dated and produced documentation.

2. Proper declaration of dividend

Directors can authorise payment of interim dividends (see new *Table A s30 (1*)) but final dividends need to be approved by ordinary resolution confirmed by a simple majority of shareholders; following CA 2006 this can now all be done in writing – no meetings are required.

Therefore suggest a standard text is prepared confirming due consideration of accounts and authorisation of the dividend (whether interim or final) which is signed and dated by the director at the time each payment is made. Indicator publishes 'Essential Documents for Saving Tax' which contains an example of draft minutes and written resolution that could be adapted for use.

3.Dividend payment date

Dividends are treated as paid on the date that the enforceable debt is created; where there is no such debt, the date of payment is used. Therefore the relevant date for an interim dividend is the actual date of payment because a resolution is not needed to confirm payment; such a dividend can be varied or rescinded.

Note that HMRC consider the date of payment of interim dividends to be the date of entry in the company's books. (see CTM 20095 (8))

A final dividend becomes an enforceable debt when approved by resolution therefore the relevant date is the date of declaration unless a later date is specified. (see *Potel v CIR (1970) 46 TC 658* and SAIM5040).

Many believe that backdating documents to confirm consideration of profit and payment of dividend is a paperwork tidying up exercise but technically it is fraud (see '*Back dated dividends (again) – 12.06.2008* and '*First Global Media Group Limited v Larkin [2003]' EWCA Civ 1765)*

4. Dividend vouchers

A single dividend tax voucher covering the whole tax year is permissible.

Dividend vouchers do not have to be presented at the time of payment.

The Income and Corporation Taxes (Electronic Certificates of Deduction of Tax and Tax Credit) Regulations 2003 (SI 3143/2003) authorises the electronic delivery of dividends. See the ICSA guide Communications with Shareholders 2007.

When to use a dividend waiver

Dividends are paid at the same rate for each category of share in accordance with the number of shareholdings held. Such inflexibility could mean the distribution of profits not being made in the most tax efficient manner or produce difficulties for a shareholder who does not want or need the payment - a dividend waiver may offer the solution.

How it works

The shareholder voluntarily waives entitlement to their share of the dividend, allowing the distributable profits to be divided between the remaining shareholders in the proportion of their holdings.

Scenario 1

ABC Ltd has distributable profits of £50,000 and wants to pay a dividend of £400 per share; the shares are held by three brothers as follows:

A 50 shares

B 25 shares

C 25 shares

A can waive his dividend and B and C will receive £10,000 each with no matters arising; A's dividend remains within in the company.

Scenario 2

Same details as above with A waiving his dividend but B and C receiving an increased amount of £15,000 each (£600 per share). HMRC may challenge this waiver contending that A has settled £2,500 on each of his brothers and he will be taxed thereon on the grounds that an element of bounty is present. Although the actual total amount of dividend paid (£30,000) is less than the amount of distributable profit (£50,000), if A had not waived his dividend the company would not have had enough distributable profits to pay the increased £600 per share (£600 x 100 = £60,000).

<u>When will HMRC become interested?</u>

Comments made on AccountingWeb show inconsistency in HMRC's approach to dividend waivers despite instruction given in the *'Trusts, Settlements and Estates Manual'* (TSEM 4225). However:

- In practice HMRC are only likely to take the above settlement point where the waiver is considered to create a tax advantage.
- They will try to argue that the waiver indirectly provided funds for an 'arrangement' or 'settlement' under Income Tax (Trading and Other Income) Act 2005 Pt 5 Chpt 5 s623; an element of bounty being needed for the settlement provisions to apply.
- If the transfer is between spouses HMRC will deem the settlement to be one of income and unless there is an outright transfer/gift of ownership of the shares protection under s624 (husband and wife exemption) will not apply**.**
- Buck v HMRC also confirmed that a company may legally distribute all of its distributable reserves/shares to a single shareholder if all of the other shareholders waive entitlement but again in the taxman's eyes that could represent bounty and if present the settlement provisions would apply.

<u>Specific points</u>

1. A formal deed of waiver is required, which must be signed, dated, witnessed and lodged with the company
2. It is imperative that the waiver be in place before the right to the dividend arises because a waiver *after* payment is a transfer of income which constitutes a settlement. Therefore an interim dividend must be waived before being paid; a final dividend is payable once approved at an AGM unless confirmed to be payable at a future set date.
3. HMRC would prefer to see a commercial reason for the waiver (again see Buck v HMRC). Therefore, best to state in the deed that the waiver has been made to allow the company to retain funds for a specific purpose.
4. Dividend waivers should be used sparingly - don't waive every year. HMRC will look more closely at arrangements which are repeated, the practical effect of which reduces the overall tax payable (again see Buck v HMRC).
5. Nothing should be given in consideration of the waiver.
6. A waiver may cover a single dividend, a series of dividends or dividends declared during a specified period of time.

7. Ensure that the dividend declared per share times the number of shares in issue does not exceed the amount of the company's distributable reserves (see scenario 2 above).

Are there any other options?

The shareholder who does not want the dividend will have to transfer his shares to another shareholder(s) before the dividend is declared. This will mean no further involvement in the company and would be more difficult to reissue shares to him at a later date; the procedure also needs Board approval.

Re-categorise the shares into A and B shares with the same rights except for dividends; then declare a dividend on the A share only. The owner of the B –type shares will not receive dividends for the time being but remains involved with the company.

Final Note

A waiver of dividends will not be chargeable to IHT as a transfer of value if made within 12 months before the right to the dividend arises. (IHTA 1984 s15).

Dividend waivers - SR Buck v HMRC

The controlling director of a company owned 9999 of the 10000 shares in it. His wife (who was not a director) owned the remaining share. The director waived his entitlement to a dividend in respect of his 9999 shares, so that his wife received an enhanced dividend in respect of her share. The Revenue issued an amendment to the director's self-assessment, charging tax on the basis that the basis that the dividend waiver constituted a 'settlement', so that the income represented by the waived dividends was treated as belonging to the director for tax purposes. The director appealed.

The Special Commissioner dismissed the appeal, holding that 'a definite plan, including a relatively simple one, to use a company's shares to divert income falls within the meaning of an arrangement'. The Commissioner observed that 'there was no commercial purpose for either of the waivers and it would surely not have taken place on an arm's length basis'. The director had retained an interest in 'the property from which the dividend arose'.

What is key here is that there were not sufficient profits available to cover dividends on all shares – were the waiver not to have been in place.

VAT

Leasing or letting of immovable property: serviced office accommodation

The taxpayer leased serviced offices in London. The landlord treated the supplies of immovable property and services as exempt from VAT. The taxpayer considered that the supplies of services by the landlord were subject to VAT and applied to HMRC to reclaim the VAT paid in respect of them. HMRC refused on the ground that the lease and the supplies of services constituted a single supply which was exempt from VAT. The taxpayer appealed to the First-tier Tribunal which referred the matter to the European Court of Justice.

Decision:

The ECJ said that, for VAT purposes, every supply should normally be regarded as distinct. Furthermore, a supply should be regarded as a single supply where two or more elements of that supply were so closely linked that they formed a single economic supply, which it would be artificial to split.

The leasing of immovable property and the supplies of services linked to that leasing might constitute a single supply from the point of view of VAT. The fact that the lease in this instance gave the landlord the right to terminate it if the tenant failed to pay the service charges supported that view. The fact that the services could be supplied by a third party did not prove conclusively that they could not constitute a single supply.

The ECJ said it was for the domestic court to determine, in light of its comments, whether the transactions in question were so closely linked so as to constitute a single supply of the leasing of immovable property.

Comments – The recent judgment of the CJEU in Field Fisher Waterhouse LLP v HMRC (Case C-392/11), which concerns the VAT liability of services provided to tenants under a property lease, arguably diverges from the approach taken in Tellmer. This creates uncertainty for taxpayers with disputes concerning single versus multiple supplies which have heavily relied on Tellmer. The judgment is also noticeable because the important issue of embedded input VAT, for which HMRC made submissions, was not addressed by the Court.

Field Fisher Waterhouse LLP v CRC (C-392/11), European Court of Justice

Whether letting income exempt

A married couple operated a motel, which provided bed-and-breakfast accommodation. They also owned an adjacent building containing several self-catering studio flats, some of which they leased to the local authority. They accounted for VAT on the receipts from bed-and-breakfast accommodation but did not account for VAT on the income from the studio flats. HMRC issued a ruling that the studio flats were excluded from exemption under VATA 1994 Sch 9 Group 1 Item 1(d).

Decision:

The tribunal dismissed the couple's appeal, holding that 'the premises as a whole should be classified as a hotel or similar premises and therefore the studios were subject to VAT'.

Comments - The First-tier Tribunal upheld HMRC's view that the studio flats were part of a 'similar establishment' to a hotel or boarding house, so that they were excluded from exemption.

Mr & Mrs C Ward v HMRC TC02179

Company acting as trustee of pension funds

A company, which was a member of a group, acted as trustee of several pension funds, where the employers had become insolvent. It reclaimed input tax on services supplied by actuaries, solicitors and accountants. HMRC rejected the claim and the representative member of the group appealed.

Decision:

The FTT allowed the appeal, holding that the services had been supplied for the purposes of the company's business of providing independent professional trustee services. However, the FTT also held that the company was required to account for output tax on the basis that it had made an onward supply of the advisers' services. Judge Sinfield observed that the result was 'something of a Pyrrhic victory' for the company.

Comments - The FTT held that the company was entitled to reclaim input tax, but was also required to account for output tax on its onward supply of the advisers' services, so that the net effect was that it was not entitled to the repayment which it had claimed. Lee Squires and Fiona Bantock state (see p 18), 'this case highlights the importance of documenting the capacity in which a taxable person is receiving and paying for supplies. It also contains some interesting commentary on the principles of fiscal neutrality and equal treatment.'

JIB Group Ltd v HMRC TC2224

Horse: input tax deduction

A woman who competed in dressage events incorporated a company, which registered for VAT and reclaimed input tax on the purchase of a horse. HMRC rejected the claim on the basis that the company was not carrying on any economic activity.

Decision:

The FTT dismissed the company's appeal against this decision. Judge McKenna noted that the company's accounts had not declared any turnover, and observed that the company did not give 'the impression of a serious undertaking but rather of an undertaking conducted principally to further the competitive career and enjoyment of the company's director'. The company did not appear to be 'conducted in accordance with sound and recognised business principles'.

Comments - Input tax is reclaimable on business activities, but cannot be reclaimed on a personal hobby. The FTT upheld HMRC's view that the company was not carrying on any economic activity, and was therefore not entitled to the VAT repayment which it had claimed.

Goodman Equine Ltd v HMRC TC02243

Wedding VAT

The owner of Drumtochty Castle granted the appellant a licence to operate its business from the castle. The business involved using the castle for marriage services and receptions, as well occasional conferences and corporate dinners. Guests could stay overnight and take part in activities such as fishing, clay pigeon shooting, cycling and archery.

The appellant provided the facilities, but not the catering, although it did recommend certain caterers with whom it worked frequently.

A dispute arose over the VAT chargeable.

HMRC said the issue was whether the supply was one of composite wedding services or whether there was a supply of an interest in land for a fee. The main activity was the supply of services in relation to the use of the castle as a prestige wedding venue, for which the appellant charged a substantial facility fee. Clients were supplied with a package of services paid for under a single contract rather than a bare let. HMRC ruled that the standard rate of VAT should apply. The appellant argued that the fee was exempt because it was a land-related supply, ie the renting of the castle.

Decision:

The First-tier Tribunal found that the arrangements entered into between the appellant and its clients constituted the “active commercial exploitation of the castle as part of an overall package”. They did not provide exclusive rights of possession or occupation. The facilities and services provided constituted a package of closely linked wedding function services, similar to those found in parts of the hospitality sector, such as country house hotels. From the viewpoint of “the average consumer”, it would be difficult to differentiate between the services offered by the appellant and similar ones available from other hotels.

The tribunal concluded that all the elements of the single supply of services which comprised the wedding package should receive the same VAT treatment. Even if the use of the castle were the main element, as there would be no grant of a licence, it would be standard rated, and if the other elements were ancillary they too would be standard rated, because they either follow the predominant element or because they are elements which if looked at separately would be standard rated.

The taxpayer's appeal was dismissed.

Comments - The principles in this case are similar to the topical issue of whether hairdresser chair rental arrangements could be classed as land related, said independent VAT consultant Neil Warren.

The key question is to consider the benefits for which the customer is paying in relation to a supply: what goods or services he expects to receive in return for the fee he has paid. “In this case”, added Neil, “the payment was relevant to much more than just the rental of a building. As quoted in the tribunal report, it did not have the 'flavour' of a land-related supply.”

Drumtochty Castle Ltd TC2111

Sale of toasted sandwiches

A company sold toasted sandwiches and 'meatball marinara'. HMRC issued a ruling that the sales were standard-rated. The company appealed. The First-tier Tribunal dismissed the appeal, finding that the sandwiches and marinara had been heated 'for the purposes of enabling them to be consumed at a temperature above the ambient air temperature'.

Decision:

The Upper Tribunal upheld this decision. Arnold J specifically declined to follow dicta of Parker LJ in C&E Commrs v John Pimblett & Sons, [1988] STC 358, observing that counsel for both parties accepted that they were inconsistent with European law, which required an objective test rather than a subjective test. He also held that, although previous tribunals had reached inconsistent decisions concerning similar products, there had been no breach of the principle of fiscal neutrality.

Comments - This is an important decision because the Upper Tribunal specifically disapproved the 1988 CA decision in John Pimblett & Sons, where Parker LJ had applied a subjective test. Arnold J observed that counsel for both sides accepted that European law required that the relevant test should be objective rather than subjective. He upheld the First-tier Tribunal decision that the supplies here were standard-rated. The decision here suggests that several earlier cases including Ainsleys of Leeds Ltd (VTD 19694) and Warren (VTD 19902) were wrongly decided as a result of earlier tribunals applying the dicta of Parker LJ in the John Pimblett case. (See also page 6.)

Sub One Ltd (t/a Subway) v HMRC (Upper Tribunal)

Company operating football grounds and organising leagues

A company (G) owned and operated several football pitches, and organised various leagues. HMRC issued a ruling that it was required to account for VAT on its supplies, in accordance with HMRC Brief 04/11. G appealed, contending that it was making separate supplies, that part of the consideration which it received was attributable to supplies of pitch hire, and that these supplies were within VATA 1994, Sch 9 Group 1 Note 16 (so that the exclusion in Item 1(m) did not apply and the supplies were exempt).

Decision:

The First tier Tribunal allowed these contentions and allowed G's appeal. Judge Reid also expressed the view that, if there were deemed to be a single composite supply, the predominant element would be the exempt supply of pitch hire, rather than the taxable supply of league management services.

Comments - This is a significant decision because the First-tier Tribunal specifically disapproved the policy which HMRC set out in HMRC Brief 04/11. The Tribunal held that the company had been entitled to treat some of its turnover as relating to supplies of pitch hire which were exempt from VAT. Judge Reid also expressed the view that, if there were deemed to be a single composite supply, the predominant element would be the exempt supply of pitch hire, rather than the taxable supply of league management services.

Goals Soccer Centres PLC v HMRC TC2253

Lease of apartment in hotel: whether exempt

A company (S) developed a hotel complex in Cornwall, and entered into a management agreement with another company (G) which agreed to maintain the hotel. In 2010 S sold a long lease of an apartment in the hotel to a couple, charging £400,000 plus VAT of £70,000. The agreement stipulated that the couple could not occupy the apartment for more than eight weeks in any year, and could only sublet the apartment through G. The couple reclaimed input tax on their purchase of the apartment. HMRC rejected the claim on the basis that the couple were making an onward supply of the apartment to G, and that this supply was exempt from VAT. The couple appealed, contending that their supply to G was excluded from exemption by VATA 1994 Sch 9 Group 1 Item 1(d).

Decision:

The Tribunal accepted this contention and allowed their appeal. Judge Mosedale held that 'there is nothing on the face of Item 1(d) that requires the supply to be to the person who actually uses the accommodation', and concluded that 'the application of Item 1(d) does not depend on the customer being able to, and actually physically using (sic) the services supplied'.

Comments - VATA 1994 Sch 9 Group 1 Item 1(d) provides that 'the provision in a hotel, inn, boarding house or similar establishment of sleeping accommodation or of accommodation in rooms which are provided in conjunction with sleeping accommodation ...' is excluded from exemption. HMRC has taken the view that the effect of the word 'provision' is that this exclusion only applies where the recipient of the supply is the final consumer, and does not apply where (as here) the recipient is an intermediary who will make an onward supply of the accommodation. However, Judge Mosedale rejected HMRC's interpretation of the legislation and held that the supply made by the appellants here fell within the exclusion, so that the couple were entitled to reclaim input tax.

ND & RC Roden v HMRC TC2263

Splitting the business (Lecture B745 – 16.29 minutes)

Many clients have an interest in more than one business – and a challenge occurs when one of these businesses is VAT registered, and the other is trading below the VAT registration threshold (or neither is registered). If the business trading below the VAT limits is mainly dealing with members of the public (i.e. who cannot claim input tax) then it is usually in the interests of the owners to avoid VAT registration if possible.

However, HMRC has very extensive powers to rule that two or more businesses could be treated as a single business, effectively bringing all entities into the VAT system. It will take this course of action if it considers that the separation of business activities has been carried out in an 'artificial' manner, with the primary intention of the arrangement being to avoid VAT.

For tax advisers, there are many opportunities available to advise clients about the correct manner of properly setting up separate business activities – but it is important that clients follow through any advice given with proper action. A review of tribunal cases on this subject highlights that most arrangements that fail are due to the fact that the owner(s) did not create a clear division between their different business activities.

HMRC approach to separate business activities

A number of issues are considered by HMRC in deciding if an arrangement is 'artificial':

Is the avoidance of VAT the main motive for an arrangement?

Are the different businesses closely bound to one another by 'financial, economic and organisational links'?

Note – the key word in the above statement is 'and' i.e. HMRC has to prove there is a financial, economic and organisational link between the two entities. This means all three must be proved - the onus is on HMRC to show this is the case. A 'yes' answer to the above questions could produce a ruling from HMRC that only one business actually exists and the VAT registration limits will then be considered based on the combined taxable sales of the businesses. The key issues as far as 'financial, economic and organisational links' are concerned are considered in HMRC's notice 700/1/07, para 13.6

Financial links

- financial support given by one part to another part
- one part would not be financially viable without support from another part
- common financial interest in the proceeds of the business.

Economic links

- seeking to realise the same economic objective
- the activities of one part benefit the other part
- supplying the same circle of customers.

Organisational links

- common management
- common employees
- common premises
- common equipment.

Definition of artificial

The dictionary definition of 'artificial' is something that is not real. In effect, therefore, the key question an adviser should ask when discussing the separation of business activities with a client is:

'Is this a genuine business arrangement made for commercial reasons and with commercial motives – or is it an artificial measure designed to avoid paying VAT?'

In many situations, the answer to the above question will be very clear – for example, different businesses may have different ownership structures established through normal commercial arrangements. HMRC must be able to show that the avoidance of VAT was a motive for creating an arrangement.

Bed and breakfast activity was a separate business – A,D and J Forster (TC 1319)

HMRC used their powers to issue a direction that a bed and breakfast (B&B) activity run by Mrs Forster was not a separate business to the farming partnership that was VAT registered and trading from the same location.

The two businesses maintained separate books of account,

Mrs Forster had her own bank account, which she used for the B&B business

The B&B activity paid for the costs of window cleaning, laundry, and maintenance costs of the farmhouse, as well as for soft furnishings, carpets, pillows, blankets, mattresses etc.

The B&B business engaged and paid for a cleaner and a gardener who worked in the spring and summer for approximately three hours each week.

Neither Mr Forster nor John Forster were involved in running the B&B, and if Mrs Forster was ill or went on holiday, the B&B operation was closed.

HMRC felt justified in issuing a direction to treat them as one business, on the basis that they were not sufficiently operated on an arm's length basis i.e. they were 'closely connected by organisational, financial and economic links.'

A key factor in the HMRC approach was the absence of any charge by the farming partnership for either rent or a contribution for utility bills.

The Tribunal ruled in favour of the taxpayer, noting that Mrs Forster had been running the B&B business since 1975, a business she took over from her parents in law i.e. it was an existing business she took over rather than one that had been artificially separated from the farming partnership.

B&B activity not a separate business to farming partnership (Howard and Jennifer Patrick – TC1699)

A partnership between Mr and Mrs Patrick was VAT registered and also included income earned from self-catering cottages.

As a separate activity, Mrs Patrick operated as a sole trader, offering a bed and breakfast service, trading below the VAT registration limit, about £61,000 annual turnover, but using the same cottages as used by the partnership for self-catering services as well as rooms in the farmhouse.

The arrangement had a number of pitfalls that made it easy for HMRC to issue a direction that there was an artificial split of the two entities to avoid VAT i.e. output tax should also be declared (moving forward) on the bed and breakfast income.

A major pitfall was that the bank account for the bed and breakfast activity was in the joint names of Mr and Mrs Patrick; adverts to encourage stays promoted both activities in the same advert; a combined insurance policy in the name of the partners also included the bed and breakfast activity.

A key failure in the arrangement was also the inclusion of the self-catering cottage in the farm partnership, a move that was clearly designed to ensure the remaining bed and breakfast income earned by Mrs Patrick was below the VAT registration limit. This illustrated an artificial split designed to save VAT rather than a split based on logical commercial principles.

The positive result for the taxpayer was that there was no argument put forward by HMRC that there never had been two businesses i.e. output tax was only due on future bed and breakfast income (effective from the date specified in the direction) rather than on a retrospective basis.

Message - if HMRC identify a business structure that has been artificially split, then any direction they issue to correct the situation can only be made from a current or future date. However, if they can prove there has only ever been one business e.g. muddled records, unclear splits of organisation, they may seek to backdate the date of VAT registration for the entity on a retrospective basis i.e. to the date when the VAT registration limit was first exceeded.

Don't forget that to issue a direction, HMRC must be able to prove financial, organisational and economic links i.e. all three links, not just one or two.

<u>JAMES YARLETT (TC1117) - it's the legal entity that counts</u>

The taxpayer had an interest in two very different trading activities, namely an electrical retail business and a separate restaurant venture. Neither business traded above the VAT registration threshold on a solitary basis, but the combined turnover of the two businesses exceeded the threshold for a period in 2006. And because both entities were deemed to be sole trader activities of Mr Yarlett, this created a retrospective liability to register for VAT from 1 September 2006 until 31 December 2007. HMRC also issued a 15% late registration penalty on tax owed of about £14,000 for the period in question.

The taxpayer put forward a weak case that the restaurant business was actually a partnership with a lady called Mrs Wagstaff who provided financial support to him when the restaurant venture ran into problems, but it was clear that this was a loan rather than partnership arrangement. He lost the case.

Comment

It is often forgotten that a VAT registration includes all business activities within the same legal entity i.e. sole trader, partnership, limited company etc. There is no such thing as a VAT registered business only a VAT registered person.

Contributed by Neil Warren