TAX UPDATE

Tolley® CPD

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Personal Tax

Payments to employee for use of car: whether 'remuneration'

A company provided the services of apprentices and trainees to employers, and supervised their training. It employed about 160 training advisers, who had to visit the trainees at their places of work. It paid these advisors a mileage allowance, plus an annual payment which was described as a 'lump sum' but was actually paid in 12 monthly instalments. Initially it accounted for NICs on these payments. Subsequently it submitted a repayment claim on the basis that the effect of Social Security (Contributions) Regulations, SI 2001/1004, reg 22A was that it had not been required to pay national insurance contributions on these payments. HMRC rejected the claim on the basis that the payments were not 'relevant motoring expenditure' within reg 22A(3), because they were not directly linked to mileage, and were 'earnings' on which contributions were payable.

The First-tier Tribunal allowed the company's appeal. Judge Barlow held that the payments 'were paid as motoring expenditure'; they were not 'additions to salary' and 'were not paid as earnings'. The Upper Tribunal reversed this decision.

Decision:

The CA restored the decision of the First Tier Tribunal. Etherton LJ held that the fact that the payments were not directly linked to mileage was not conclusive, since the scheme was designed to prevent staff from making a personal profit by maximising their mileage.

Comments: The CA has allowed the company's appeal against the Upper Tribunal decision and restored the First-tier Tribunal decision, holding that the payments were 'relevant motoring expenditure' within SI 2001/1004, reg 22A, so that the company had not been required to account for NICs on them. Advisers have suggested that this decision opens the way for NIC reclaims by affected companies. It may however be appealed to the Supreme Court in light of the victory at the Upper Tribunal for HMRC.

Cheshire Employer & Skills Development Ltd (aka Total People Ltd) v HMRC (EWCA)

Inadequate system for recording private mileage

The taxpayer company provided company cars and fuel cards to certain categories of employees. The cars were available for private mileage. Employees were expected to maintain records of business and private mileage but, after an employer compliance review, HMRC said the system was inadequate and in some cases it was impossible to calculate an employee's business and private miles.

The inspector assessed the employer to Class 1A National Insurance in respect of car fuel made available to employees for private mileage and also imposed penalties. The taxpayer appealed.

Decision:

After reviewing the evidence, the First-tier Tribunal decided that the company's system was "not sufficiently robust to ensure a reliable reimbursement by the employee of the cost of fuel for private purposes". There was no evidence to show that the employees understood the difference between business and private mileage.

The tribunal said the fuel benefit charge should apply to employees, apart from those who owned a car for private use or who could show they had other vehicles available for non-business purposes, and the company was liable to Class 1A National Insurance on the fuel provided for private motoring.

With regard to penalties, the tribunal concluded that the company intended to comply with the legislation, even though the system it deployed had some shortcomings. HMRC's investigation had taken some time and the company had been fully co-operative.

On balance, the company had "behaved more as a reasonable and prudent business" than otherwise, so the tribunal decided no penalties were due.

The taxpayer company's appeal was allowed in part.

Comments – The legislation on the benefit of private fuel is very precise. The Tribunal took a balanced view of the situation – determining that the benefit was applicable but in light of the effort by the employer albeit that it fell short of what was required that no penalty was applicable. It demonstrates how important the structure and reliability of the underlying records are.

PMS International Group plc TC2181

SEIS tax relief update – all you need to know (Lecture P747 – 13.03 minutes)

As we all get used to the staggering tax breaks available under this scheme, so we appreciate various technical issues which include the following, some good and some not so good:

<u>Possible approach</u>

The monetary limits are such that a "friends and family" approach may well be the way forward. There is however a maximum 30% shareholding and this applies to the investor *plus* associates.

Associates for this purpose include:

- Spouse
- Civil partner
- Children
- Grandchildren
- Parents
- Grandparents
- Trustees of a settlement of which investor is settlor or beneficiary

They exclude:

- Brother / Sisters
- Nephews / Nieces
- Uncles / Aunts

Ideally, to ensure that the investment is not entirely driven by the tax breaks there needs to be an added aspect such as:

- Wanting to help, say, a niece or nephew starting in business.
- Knowing the people behind the new business, and trusting their business acumen.
- A desire to support the particular activity the business is involved in.

Some important issues identified

1. Income tax relief is at a fixed rate of 50%, provided the amount of tax relief is covered by the income tax payable in the tax year of the investment (or in the preceding tax year as from 2013/14 any part of an SEIS investment can be carried back one year).

2. Any shares on which SEIS relief is to be claimed must not, warn HMRC, be allocated during the company registration process and then only issued at a later date when the company is able to receive payment for them – typically once it has opened a bank account. That means that off the shelf companies should not be used, as with such a company it will have been under the control of a corporate shareholder at some point before incorporation. That debars SEIS relief, even if the shares are transferred to individuals before the SEIS share issue takes place.

3. The trade must not have been in existence for 2 years or more. To reduce the risk element an investor may want to delay investing until after the first year's results are known, and with care this can be achieved provided of course the company has not already raised the maximum permissible under SEIS of £150,000.

4. The company has 3 years to use the funds raised. This covers spending the funds for the purposes of a qualifying business activity which includes preparatory work before the trade starts. It does not include paying dividends to shareholders. Any monies not spent, or spent for a non-qualifying business activity, are ignored if they are insignificant.

5. The company submits form SEIS1 to HMRC asking for a certificate allowing the company to send claim form SEIS3 to the investors so they can claim their tax relief. The submission of form SEIS1 has to wait until either (a) the company has been trading for at least 4 months or (b) it has spent at least 70% of the funds raised.

6. CGT exemption on gains made in 2012/13 reinvested in SEIS in the same tax year (or reinvested in 2013/14 and related back to 2012/13).

SEIS investment becomes worthless after 3 years - what is the bottom line?

This is what potential investors want to know, and they may be surprised by the answer. This is best illustrated by the following example:

SEIS investment of £10,000. Tax relief @ 50% = £5,000. Net cost £5,000.
In year 3 or later the shares become worthless. Income tax loss relief on £5,000 @ 45% = £2,250 so net cost becomes £2,750 (27.5%). That increases to £3,000 (30%) for a 40% taxpayer.

If CGT reinvestment relief is also claimed on a gain of £10,000 (annual exemption used elsewhere) the value thereof @ 28% is £2,800. That means that overall the investment, despite becoming worthless, basically "washes its face".

The fact that with CGT reinvestment relief a 45% taxpayer has nothing to lose is both reassuring and worrying! The latter feeling is with the prospect that some businesses will be set up to attract investors but will have little regard to running the business properly.

Using the CGT exemption, known as SEIS reinvestment relief – section 150G and schedule 5BB TCGA1992

One novel feature is that the CGT payable on the disposal of ANY chargeable asset in the tax year 2012/13 is eliminated if the individual buys shares under SEIS also in 2012/13 (or in 2013/14 and then carried back to 2012/13) via a subscription in cash fully paid at the time of issue and then held for the usual 3 years.

How this works is illustrated below:

- To obtain full SEIS reinvestment relief only requires reinvestment of an amount equal to the gain, not the proceeds.
- A gain of £50,000 in 2012/13 on a sale for £80,000 is fully exempt if the reinvestment is of at least £50,000.
- If reinvesting £30,000 the gain left to tax is £20,000.
- If the CGT annual exemption has not been used the optimum reinvestment in 2012/13 would be of £39,400 with the non-exempt gain of £10,600 being covered by the annual exemption.

SEIS possible schemes

1. *Combining tax reliefs as under:*

a. *on 1/12/12 Jan, a 40% taxpayer, invests £10,000 under SEIS*
b. *on 1/12/15 she contributes £10,000 gross into her pension plan*
c. *on 2/12/15 the pension plan buys the SEIS investment from Jan at market value (say £10,000, the same as the original cost)*

effective costs:

a. *£5,000 net of 50% tax relief*
b. *£6,000 net of 40% tax relief*
c. *return of £10,000*

Jan has therefore effectively paid £1,000 for a £10,000 SEIS investment, which means tax relief at 90%. It would be at 95% for a 45% taxpayer.

2. *SEIS plus new CGT reinvestment relief*

Chargeable gain in 2012/13 of £50,000 with £50,000 invested under SEIS in 2012/13. Value of CGT reinvestment relief @ 28% = £14,000. SEIS relief @ 50% = £25,000. Total tax relief = £14,000 + £25,000 = £39,000 = 78%.

If combined with 1. above the tax relief is 28% + 90% = 118% (123% if a 45% taxpayer).

3. SEIS investment worth the same after 3 years:

SEIS investment of £10,000. Tax relief @ 50% = £5,000. Net cost £5,000.
After year 3 or later the shares are still worth £10,000 and tax relief cannot be clawed-back. IHT BPR after year 2 @ 40% = £4,000, so net cost becomes £1,000 for an investment worth £10,000 although of course the value of BPR is not directly received by the investor.

Contributed by Gerry Hart

Benefits in kind 'made good' by directors – No NIC

A family company (M) owned a property which its directors occupied. M paid for repairs to the property. HMRC informed M that this amounted to a benefit in kind, giving rise to a charge to income tax under ITEPA 2003 s 203. M adjusted the directors' loan accounts in order to 'make good' the benefit in kind under s 203(2). HMRC accepted that this had the effect of removing the charge to income tax under s 203. However HMRC issued a ruling that M was still required to pay Class 1A National Insurance Contributions under SSCBA 1992 s 10.

Decision:

The First-tier Tribunal allowed M's appeal. Judge Short held that 'there can be no charge to Class 1A NICs in circumstances where there is no income tax charge' and that 'the "making good" provisions at s 203 result in any taxable benefit and therefore any income tax charge being extinguished and treated as never having arisen'.

Comments - This is an important decision, because Judge Short specifically disapproved of HMRC's interpretation of the interaction between ITEPA 2003 s 203 and SSCBA 1992 s 10. A benefit in kind gives rise to a charge to income tax under ITEPA 2003 s 203 and to a charge to National Insurance Contributions under SSCBA 1992 s 10. Where the benefit is subsequently 'made good', the effect of s 203(2) is to withdraw the charge to income tax. However, HMRC has taken the view that the charge to NICs remains. Judge Short disagreed, and her comments are self-explanatory. It is not yet known whether HMRC intend to appeal to the Upper Tribunal against this decision. If it is appealed HMRC will clearly be trying to apply the letter of the law rather than the spirit of the law.

Marcia Willett Ltd v HMRC TC2301

Appeal struck out as not valid grounds

The taxpayer received a large termination payment in 2007/08 which he declared on his self assessment tax return for that year. However, HMRC omitted to include this sum in their assessment until a further assessment was issued in November 2010.

The taxpayer appealed on the grounds that the assessment was time-barred under TMA 1970, s 9ZB as well as noting the decision in Michael Prince (TC1852) and the possible application of extra-statutory concession A19.

HMRC applied for the appeal to be struck out because the assessment was based on information contained in a return and had been made within the statutory time limit. Consequently, the appeal had no prospect of success.

Decision:

The First-tier Tribunal accepted HMRC's argument and struck out the appeal. Section 9ZB applied where there was a correction or an amendment to a return by HMRC. This was not the case here, where there was simply an error in “capturing” the information on the return. The judge added that the tribunal could not competently consider the application of ESC A19.

Comments – The time limits for assessment and the law are clear. This was not a circumstance which fell within either of the pieces of legislation being appealed under.

A Churchill TC2328

Claim is not dual-purpose

The taxpayer received a dividend of £25,000, grossed up to £31,250 to take account of corporation tax paid, from a company resident in Guernsey.

In the foreign pages of her 2003/04 self-assessment tax return, she included £31,250 as the amount chargeable in the box “foreign tax credit relief for foreign tax suffered”, with £6,250 shown as the tax paid, and ticked the box to claim foreign tax credit relief. After an enquiry, HMRC amended her return, increasing the tax payable and saying that no foreign tax credit relief was due in respect of the dividend, on the basis that the tax on the dividend represented tax paid by the company which it would have had to pay regardless of whether or not the dividend was issued (TA 1988, s 790 “unilateral relief ”).

The taxpayer appealed. She accepted that s 790 meant that she had no statutory entitlement to relief, but submitted that she had a claim to one-ninth tax relief under s 231 “tax credits for certain recipients of qualifying distributions”.

She argued that her original claim in her tax return could be read as being a s 231 claim and cited Gallic Leasing Ltd v Coburn [1991] STC 699 in support, on the basis that the taxpayer in that case had not specifically identified the nature of the relief claimed.

Decision:

The First-tier Tribunal said there was no analogy with Gallic Leasing. In that case, the claim was deemed by the judge to refer only to group relief claims. The tribunal judge said the taxpayer's original claim was for foreign tax credit relief and not one under s 231.

The original claim had not been amended and no valid s 231 claim had been made. He said:

"We find that in an appeal against the closure notice rejecting her foreign tax credit claim, [the appellant] cannot ask the tribunal to determine at first instance the merits of an entirely separate claim, the merits of which have not been the subject of any prior decision by HMRC."

The taxpayer's appeal was dismissed.

V Buxton TC2183

Investment bond tax traps (Lecture P746 – 23.32 minutes)

This article focuses on some of the particular tax problems that can arise when **an individual** makes a full or partial encashment of investment bonds. Unless otherwise stated, the tax rules discussed apply equally to both UK investment bonds and offshore bonds.

Segmentation of bonds

Bonds are usually written as a cluster of small, identical bonds, rather than as one single bond. For example, an investment of £100,000 in a particular life fund is likely to be written as, say, 100 identical bonds, each with £1,000 invested in the same underlying fund.

When a sizeable withdrawal is subsequently made, this gives a choice as to whether to make a partial surrender across all policies, or to do a full surrender of a certain number of the individual policies. Although there will be no apparent difference for the investor between these options (e.g. he will just feel that he is withdrawing, say, 40% of his original investment), the method chosen can have a very significant effect on the tax charges arising from the partial withdrawal. This is demonstrated in the example *Greta.*

Greta

Greta is aged 42 and has taxable income (after PA) of £34,000. On 6 January 2008 she invested £40,000 into a UK single premium bond, which is split into 50 segments. On 1 April 2011 she took a partial surrender of £3,500. In June 2012 she wishes to realise a further £15,000. The current value of the bond is £39,000.

Calculate the tax payable on this withdrawal if Greta

(i) surrenders an element of every segment; or

(ii) encashes whole segments to realise a minimum of £15,000.

Firstly, determine the extent of cumulative 5% allowance available in June 2012.

Policy year ended	Investment	5% Cumulative allowance	Withdrawals
5.1.09	40,000	2,000	
5.1.10		4,000	
5.1.11		6,000	
5.1.12		8,000	3,500
5.1.13		6,500*	

*8,000 – 3,500 + 2,000

(i) Treating withdrawal in June 2012 as a partial encashment of total policies

	£
Proceeds	15,000
Cumulative allowance	(6,500)
Gain	8,500

Any partial encashments are, for tax purposes, deemed to arise on the last day of the policy year. Any chargeable event gain is therefore taxed according to *the investor's position in the tax year in which the policy year ends.*

Top sliced gain is £8,500/5 = £1,700 (Note: no previous chargeable events.)

As taxable income for 2012/13 is £34,000, only £370 of this gain falls within the basic rate band, leaving £1,330 in the higher rate band. The higher rate tax charge is therefore £1,330 @ 20% x 5 = £1,330.

(ii) Treating the withdrawal in 2012/13 as the encashment of whole segments

Greta can take a further £6,500 now in order to use up her cumulative allowance. The remaining value of the bonds is £39,000 - £6,500 = £32,500.

Each segment is therefore worth £32,500 / 50 = £650 per segment.

To generate the extra cash, Greta needs to encash

$$\frac{15{,}000 - 6{,}500}{650}$$

= 13.08 policies, i.e. 14 whole policies.

	£
Cash in value 14 x £650	9,100
Withdrawals relevant to the encashment of the 14 bonds (including the 6,500 above) (£6,500 + £3,500) $\times \frac{14}{50}$	2,800
Original cost of 14 bonds $\frac{£40{,}000}{50} \times 14$	(11,200)
Chargeable event gain	£ 700

Full encashments of whole policies take place for tax purposes on the date on which the encashment takes place.

The top sliced gain is £700/ 4 years = £175. With £370 of basic rate band available, no higher rate tax charge arises.

As shown, the calculations can become relatively complex, but there are potentially big tax savings from encashing bonds in the optimum way.

When a partial encashment above the 5% threshold is made, the default position of the life company is normally that it is a partial withdrawal across all policies. The investor (or their IFA) should therefore specify before any withdrawal is made that, where appropriate, it is to be an encashment of a certain number of whole policies. Note that a 'chargeable event certificate', giving the details needed for tax purposes, will be provided to the investor by the life company once the withdrawal has been made.

A recent case on this issue was *Shanthiratnam v HMRC TC01215,* where the taxpayer had invested £150k in a cluster of 50 overseas bonds (i.e. £3,000 per bond). One year later, he withdrew £50k, spread across all the bonds, when the total value of his investment had fallen to £140k. The Tribunal confirmed that he had a chargeable event gain of £42,500 (calculated as £50,000 – (£150,000 @ 5%). This was the case even though his investments had fallen in value! Had he instead surrendered a certain number of whole bonds, those would have shown a loss and there would have been no chargeable event gain.

This leads nicely onto talking about losses on investment bonds, where there is more bad news.

Deficiency relief

Many investors are unaware that if the bond is eventually surrendered for an overall loss (an increasingly common scenario over recent years, unfortunately), this loss cannot be set against capital gains or income to save tax at marginal rates. Indeed, if two investment bonds are surrendered, one showing a profit (i.e. chargeable event gain) and the other a loss, they cannot be matched off.

There is a very limited form of loss relief, known as *deficiency relief,* under ITTOIA 2003 s.539 . This is only available where:

- there has been an earlier chargeable event gain **on the same bond; and**
- the chargeable event gain calculation at final encashment produces a loss rather than a gain; **and**
- the investor is a higher or top rate taxpayer in that final year.

Examples of deficiency relief calculations can be found in the Insurance Policy Taxation Manual at IPTM3880. The effect of the rules is that the basic rate band is extended by the deficiency relief available, resulting in a saving of higher rate tax.

As most investors try to avoid making partial encashments that might trigger chargeable event gains, this relief will not be encountered too often in practice. Advisors should be aware of it (and its limitations) though: for the taxpayer in the *Shanthiratnam* case, it may produce a significant tax saving on eventual surrender of the policies, should the investment continue to perform poorly.

Unexpected higher rate tax charges

As readers will be aware, when someone's adjusted net income exceeds £100,000, the PA is abated by £1 for every £2 of excess income (ITA 2007 s.35(2)), until it fully disappears at income of £116,210

(for 2012/13). It is important to appreciate that, although a higher rate liability may be mitigated by top slicing relief, the *whole* of any chargeable event gain counts as part of adjusted net income for PA purposes: top slicing is irrelevant. If this point is not appreciated, very large and unexpected tax charges can arise on an encashment, as demonstrated in *Nigel.*

Nigel

Nigel has gross income of £38,105 in 2012/13; this would be £30,000 after PA. On 12 January 2013, he makes a profit of £80,000 on encashment of a UK investment bond that he has held for 20 years, having originally invested £100,000 on 1 July 1992. No previous withdrawals have been made from the bond.

At first sight, it appears that there will be no tax charge, as the top-sliced gain of £4,000 would fall within the basic rate band.

However, we first of all need to deal with the possible restriction on the PA resulting from the encashment, where top slicing is irrelevant. This will then determine what the taxable income is and therefore how much basic rate band is in fact available.

Solution

Adjusted net income for personal allowance abatement purposes includes the full gain on the investment bond, thus is £118,105 (£38,105 + 80,000) in this case. As this exceeds £116,210, the whole of the PA is lost. This leaves taxable income (before considering encashment of LA bond) of £38,105.

As the investor, due to the loss of PA, is already a higher rate taxpayer, the whole bond profit suffers a higher rate charge of £16,000 (i.e. (40% - 20%) of £80,000. In fact, the total extra tax due as a result of the encashment is calculated as follows:

Before the surrender, income tax was simply £30,000 @ 20% = £6,000.

Afterwards, the position is

		£
Tax on general income		
	34,370 @ 20%	6,874
	(38,105-34,370) @ 40%	1,494
Tax on bond		
	80,000 @ (40-20%)	16,000
		£24,368

Thus the extra tax charge for Nigel arising from the encashment is £18,368!

Staggering encashments to avoid this tax trap

One way of avoiding the loss of PA would be to make sufficient gift aid or personal pension contribution such that, after adding in the investment bond gain, adjusted net income does not exceed £100,000. Although this would make such a payment extremely tax-efficient, many clients may prefer to look to strategies that don't involve extra outlay for them.

Splitting an encashment over 2 or more tax years could potentially avoid the loss of PA, but there are two points which can easily be overlooked.

Firstly, in *Nigel*, supposing the investor had made a partial encashment triggering a gain of £60,000 in January 2012 and then a final surrender in Jan 2013, realising a further £20,000 of gain.

How this is dealt with is explained at IPTM7210. As both surrenders would be taxed in 2012/13 (the partial surrender in January 2012 being deemed to take place on 30 June 2012, the last day of the policy year), the total amount received is covered by one chargeable event certificate, dated on the day the policy finished (i.e. final surrender).

The total gain assessable in 2012/13 would therefore still wipe out the PA, with the same disastrous tax effects.

Secondly, such a strategy can have a big impact on top slicing relief where successive partial encashments are made. This is demonstrated by *Gaston.*

Gaston

Gaston invested £150,000 in a UK investment bond on 1 March 2002. In January 2012 he makes a partial encashment (for the first time), triggering a chargeable event gain of £40,000. In January 2013 he makes a further partial encashment, triggering a gain of £35,000. His other taxable income (after PA) in 2011/12 and 2012/13 leaves £5,000 of basic rate band available each year.

The partial encashment in January 2012 is deemed to take place on the last day of the policy year, which is 29 February 2012, so is dealt with in 2011/12. The full gain of £40,000 does not bring adjusted net income to anywhere near the £100,000 level, so he still has a full PA available.

The 'top sliced' gain is £4,000, being the gain of £40,000 divided by the 10 complete years for which the bond has been held. When added into the existing taxable income, the extra £4,000 does not make him a higher rate taxpayer. Therefore he has no income tax liability on the £40,000 profit. So far so good!

When we look at his position the next year though, another perhaps unexpected trap emerges. When determining the top sliced gain on a partial encashment of a UK bond, the calculation is:

Chargeable event gain

Number of complete policy years ***since the last chargeable event***

As the partial encashment the previous year produced a chargeable event, the denominator of this fraction is '1' when we are looking at the surrender in 2012/13. There is therefore no top slicing available on the £35,000 gain.

With only £5,000 of basic rate band available, there is a liability to higher rate tax on £30,000 of the gain, giving an additional tax bill of £6,000.

Offshore bonds and top slicing

One of the key distinctions between the legislation on UK and offshore bonds is in the calculation of a top sliced gain. As explained in IPTM 3860, for offshore bonds the denominator is always the number of complete policy years **since inception** (even if there have been earlier chargeable event gains). Thus, in *Gaston*, there would be no loss of top slicing relief when splitting the encashment of

the bond, so no higher rate tax charge on the second surrender gain of £35,000. Like any offshore bond though, there would be a *basic rate* tax charge on the full chargeable event gain arising in both years, as no corporation tax has been suffered in the fund.

Yet another tax trap!

Michelle is a 40 year-old mother of 5 school-age children, who was unfortunately widowed 3 years ago. She has recently gone back to work. Her total income from all sources (including a small pension from her husband's employer) is £35,205 in 2013/14, giving taxable income of £26,000 (as the personal allowance next year is rising to £9,205).

Her only significant investment is a UK life assurance bond, bought with an inheritance for £35,000 15 years ago. In May 2013, when it is worth £65,000, she decides to cash it in to pay off debts and help with her general outgoings. This produces a chargeable event gain of £30,000. She has never previously made withdrawals from the bond.

Her adjusted net income is £65,205 (being £35,205 + £30,000), thus her PA is preserved. Top slicing reduces the gain to £2,000, so there is no higher rate liability. So where's the problem? It is that the definition of 'adjusted net income' for HICBC purposes is the same as that for PA abatement purposes. As adjusted net income exceeds £60,000 for her in 2013/14, she will be liable for a full clawback of her child benefit via a tax charge. At current levels of child benefit, this would be £3,842!

Note that availability of child and working tax credit is affected in a similar way, as income for these purposes also includes the full investment bond gain

Conclusion

The tax rules on surrendering life assurance bonds are extremely complex for a non-specialist to deal with. As this article has shown, getting them wrong can lead to very significant additional tax charges for investors. Before advising on a surrender, or preparing the tax return for someone who has already done one, there are several key questions that should be considered, in particular:

- In which tax year will the surrender be dealt with? Final encashments take place, for tax purposes, on the date they happen, whereas partial surrenders occur on the last day of the policy year.
- Assuming the bond is in segmented form and is not being fully encashed, is it a part disposal of all policies or a full surrender of certain whole policies? The latter is normally more tax-efficient, but needs to be specified with the life company before the surrender takes place.
- Will the gain (before top slicing) make income sufficiently high to affect the availability of PA and, if it does, will this increase any tax charge on the bond itself?
- What is the number of years over which the gain will be top sliced? The rules are different for UK and offshore bonds.
- Do the investor or their spouse / civil partner /co-habitee receive child benefit and, if so, could the surrender trigger a tax charge?
- If the bond will trigger a loss, have there been previous chargeable event gains on the same bond that could allow a claim for deficiency relief to reduce this year's tax bill.

Contributed by Kevin Read

Capital Taxes

Principal private residence nominations? (Lecture P748 – 13.30 minutes)

When you sell your home any resultant gain is subject to the principal private residence exemption. If you have occupied the property as your home for all the years that you have owned the property then the gain is fully covered by the principal private residence exemption. If you have only occupied the property for part of the time then a proportion of the gain will be covered by the exemption – on a time apportioned basis.

If a property has been your principal private residence at any point you are always deemed to occupy the property as your main residence for the last three years of ownership – irrespective of the fact that you may live somewhere else in those last three years.

Apart from the last three year rule above, a taxpayer can only ever have one principal private residence at any one time. So if you have a main home and a holiday home you may have two residences but you will only get principal private residence exemption on one of them at any one time. The facts will decide which of the properties is your main residence and consequently covered by the main residence relief.

The taxpayer can however override the facts and nominate which of his residences is his main residence for the principal private residence exemption.

This nomination must be made by written notice to an HMRC officer within two years of acquiring the second residence. If the taxpayer were to acquire a third residence the two year clock would start again.

The taxpayer has the right to vary a nomination notice by a further written notice to an HMRC officer – the variation can backdated up to two years.

In the case of a man and his wife living with him or of civil partners, there can only be one residence or main residence for both, so long as 'living together' and, where a notice specifying the main residence affects either spouses or civil partners, it must be given by both. If when a couple marries they each have a residence and they continue to use both, the two-year period for jointly nominating the main residence begins on the date of marriage (HMRC Capital Gains Manual CG 64525).

It is worth noting that the choice is not between two or more properties but between two or more *residences*. A property never occupied by the taxpayer as a residence cannot enter the equation. A nomination given more than two years after the *acquisition* of a property will not be late if made within two years after the property is first occupied as a residence.

Example
John and Jane Smith live in London with their three children. Four years ago they acquired a derelict barn in Norfolk with a view to converting it to a holiday home for the family.

The barn conversion was completed in early May 2012 and on the 12 May 2012 the council approved it for residential occupation. The family's first visit to the barn was on 2 June 2012 for the start of the half term break.

The two year clock for nomination purposes starts from 2 June 2012 – when they first started using it as a residence.

VAT point:
Do not forget the VAT DIY claim on the barn conversion which must be submitted to HMRC within three months of completion (by 12 August 2012).

Form of notice (CG64520)

There is no statutory form for a notice under TCGA92/S222 (5) or for a variation of such a notice. However the following conditions must be fulfilled,

- A nomination by an individual must be made to an officer of the Board and must be signed by the individual.
- Spouses or civil partners who are living together can only have one main residence between them for the purpose of private residence relief. If a nomination affects both of them it must be made by notice in writing to an officer of the Board and must be signed by both of them.
- The signature of an agent is not sufficient.

Example wording of a nomination letter could be as follows:

"Dear Sir or Madam

Mr John Smith (UTR #) and Mrs Jane Smith (UTR #)

Capital gains – nomination of a main residence under s.222(5) TCGA 1992

On the 12 May 2012 the local authority approved our converted barn for residential occupation. On 2 June 2012 we started using the barn as a second residence.

The address of our two residences is now as follows:

Residence 1 – .....

Residence 2 – ....

We hereby nominate Residence 2 as our main residence under Section 222(5) TCGA 1992 with effect from the date of this letter.

Yours faithfully

Signed by Mr and Mrs Smith"

It is important that both the clients sign the nomination letter. I would also recommend including the date the second property became a residence of the family e.g. 2 June 2012. This is not necessarily the date of acquisition – it should be the date the property became a residence of the client which could be much later. Inclusion of this date just confirms that the nomination is being made within two years of acquiring the second residence.

Once Mr and Mrs Smith have nominated residence 2 they may switch to residence 1 at any time. This is effected by sending in a second letter confirming the variation of the original nomination. It would be perfectly reasonable to send in a second letter within a week or so of the above nomination. The objective of nominating residence 2 was to secure the last three years as Principal Private Residence relief – which the first letter has done. If you feel the larger gain is likely on residence 1 then it is best to shift the nomination back to residence 1 as soon as possible.

HMRC treatment of notice (CG64530)

If a notice or a variation of a notice is received, HMRC should acknowledge it but are unlikely to comment on its validity. They may ask further questions but they would only do so if there were obvious errors in the nomination letter.

It is only when a property is sold that detailed questions are asked concerning the validity of a nomination. This may be some years later so it is important that we retain evidence to support the validity of the nomination i.e. evidence of actual residence.

Whether house used as principal private residence

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

Decision:

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

Comments - TCGA 1992 s 222 provides relief from capital gains tax on the disposal of a private residence which has been the 'only or main residence' of the person making the disposal. The First-tier Tribunal upheld HMRC's view that this disposal failed to qualify for relief. Judge Staker's comments are self-explanatory. The importance of the property actually being a residence rather than just another property owned by the taxpayer is crucial as is demonstrated in yet another Tribunal decision.

MJ & Mrs BA Harte v HMRC (TC01951

Buy to let being sold with a PPR claim!

Jonah has owned a buy to let property for the last 8 years. He sold the property in 2012/13 and maintains that he resided in the property for his first year of ownership.

If true that will give him 4 years' worth of principal private residence exemption and up to the same in letting exemption. This could be a CGT free sale – if he can prove residence in the first year of ownership.
As their advisor we need to establish whether Jonah actually resided in the property for the first year of ownership. The penalties for an erroneous claim will be a minimum of 15% of the CGT avoided.

The first question I would ask is whether Jonah had another property at the same time. If the answer to that is yes then we have a problem. We need to prove on the facts that he occupied the "buy to let" property as his main home in that first year. Nominations are out of time so it will be all based on the facts.

Has Jonah retained any utility bills, bank statements, council tax records, telephone bills etc from that first year. We need to obtain whatever evidence we can that this was Jonah's main residence. It is not sufficient to prove Jonah stayed there – we must be able to prove that he (and his family) resided there with a degree of permanence. If this was his only property at that time we should be confident of establishing such a claim – when there are two properties then the need for evidence increases significantly.

It may be easier to establish residence on the other property e.g. locality of children's schools etc and this by default would mean that the "buy to let" property is unlikely to qualify on the facts as his main residence.

Contributed by Dean Wootten

Withdrawal of appeal results in higher figures being assessed

A partnership (OP) acquired a property in 1996 and sold it in 2002. In its tax return it declared a capital gain on the sale, and claimed business asset taper relief. Following an enquiry into the return, HMRC issued an amendment to OP's self-assessment, charging income tax on the basis that the sale was part of OP's trading activities. OP appealed. In HMRC's statement of case for the hearing of the appeal, they included an alternative contention that, if the tribunal should find that the transaction was an investment activity, the sale did not qualify for business asset taper relief. OP applied for this part of the case to be struck out, contending that this argument had not been referred to in HMRC's original closure notice. The First Tier Tribunal rejected this application at a hearing in 2010 (see Decision TC00614). Judge Berner held that 'the purchase and sale is the scope of the appeal over which the tribunal has jurisdiction ... Simply to restore the appellant's calculation, including the application of business asset taper relief, would not be consistent with the duty of the tribunal to determine the amount of tax payable.'

The result of HMRC's contention denying business asset taper relief was that each of the six partners would have made a capital gain of £110,099, rather than £35,903 as declared in the partnership

returns, and OP's total profit would be increased by £444,996 (i.e. an increase of £74,166 for each of the partners). In May 2011 HMRC issued an amended statement of case stating that they accepted OP's contention that it had not been trading and stating that 'the profit should be increased by £74,166'. In June 2011 OP's accountants sent an email to HMRC and the Tribunal Centre stating that OP 'wish to withdraw their appeal against the contention [by HMRC] that the partnership profit should be increased by £74,166'. In September 2011, HMRC issued amendments to the returns of each of the partners showing an increased profit of £74,166 for each partner. OP appealed against these amendments, contending that its original appeals had been determined by a binding agreement under TMA 1970 s 54, by which the total partnership profit, rather than the profit for each partner, had been increased by £74,166.

Decision:

The First-tier Tribunal rejected this contention. Judge Sinfield observed that the email sent by OP's accountants 'stated that the appeal that was being withdrawn was against the contention by HMRC that the partnership profit should be increased by £74,166. This was an odd statement as there was no previous decision to that effect and (OP) had never appealed against any such decision. (OP)'s notice of appeal referred to a primary claim for an increase in profit of £1,146,102 and a secondary claim for £444,996.' He observed that it was 'very unlikely' that the accountants, 'who had computed the overall tax liability of £444,996 in the notice of appeal by multiplying HMRC's figure for the increase in profit per partner of £74,166 by the number of partners, did not realise that the amount of £74,166 in the amended statement of case was a simple error rather than a proposal to settle'. It appeared that OP 'was deliberately trying to take advantage of an obvious error in the statement of case which understated the tax in dispute'. Applying the CA decision in Schuldenfrei v Hilton [1999] STC 821, there had been no agreement of the appeal under s 54(1). By virtue of TMA 1970 s 54(4), the consequence of OP's withdrawal of the appeal was 'that the decision under appeal should be upheld without variation'. The appeal had been against HMRC's contention that the partnership's profit should be increased by £444,996. Judge Sinfield concluded that 'as a consequence of withdrawing the appeal in the absence of an agreement, (OP) has made itself liable to pay the tax due on the basis of HMRC's alternative argument with no opportunity to appeal against that decision'.

Comments - This is a significant victory for HMRC. The partnership had attempted to take advantage of a clerical error by HMRC and to claim that its appeal had been settled by agreement within TMA 1970 s 54(1). The First-tier Tribunal rejected these contentions and gave judgment for HMRC, holding that there had been no agreement within s 54(1) and finding that the partnership had withdrawn its appeal, within s 54(4). Judge Sinfield's comments are self-explanatory.

Orchid Properties v HMRC (No. 2) TC2323

Gift of property to trust: whether reservation of benefit

A woman (K) held the lease of a flat in Knightsbridge. In 1997 she granted a rent-free underlease of the flat to a company (ON), to begin in 2007 and expire in 2094. The underlease contained several covenants which reflected those included in the main lease and included a requirement to pay an amount equal to the service charge which K was required to pay under the headlease. On the same day she transferred the underlease to a newly-created settlement, the trustee of which was a company (L) in the same group as ON, and the beneficiaries of which were K's two sons. K died in 2008. HMRC issued a determination on the basis that the creation of the underlease had been a gift

subject to reservation, so that the underlease of the flat was 'property to which she was beneficially entitled immediately before her death'. K's executor, L, and K's two sons, appealed to the First-Tier Tribunal, contending that there had been no reservation of benefit. The Tribunal reviewed the evidence in detail, rejected this contention, and dismissed the appeals, distinguishing the 1998 decision in Ingram & Palmer-Tomkinson (Lady Ingram's Executors) v CIR, on the grounds that K 'did not merely grant a limited interest in land: she granted a limited property interest in land conditional upon fulfilment of covenants in favour of herself'. Judge Mosedale observed that the appellants were contending that 'a future underlease would seem to be effective at reducing inheritance tax while allowing the donor to live in the property', and held that this would be an 'absurd result'. The fact that ON had covenanted to pay an amount equal to the service charges (£9000pa at the time of K's death), and to decorate and repair the property, meant that there had been a reservation of benefit.

Decision:

The Upper Tribunal upheld this decision. Proudman J held that there had been a benefit to K 'by transferring to the trustee of her settlement a liability which she would otherwise have borne'.

Comments - FA 1986 s 102 was enacted with the intention of ensuring that taxpayers cannot benefit from property and at the same time give it away. In the tax planning of lifetime dispositions, the gift with reservation rules are very often the part of IHT that is the main focus of attention. In the well-known 1998 case of Lady Ingram's Executors v CIR, the House of Lords held that the section did not apply. However, the Tribunal had little difficulty in distinguishing the Ingram decision on the facts here. See also now FA 1986 s 102A, which was introduced by FA 1999 with effect for disposals on or after 27 July 1999 and was intended to close the scope for avoidance which had been revealed by the Ingram case.

M Buzzoni (Kamhi's Executor) v HMRC (and related appeals) (Upper Tribunal)

Administration

Business records checks relaunch (Lecture B746 – 6.13 minutes)

The review

In a pragmatic admission that they need us as tax agents to keep the tax system under control, some time ago HMRC announced a review of BRCs under the pilot project, and that was closely followed by a suspension of the scheme.

The main points to take on board were:

1. Whilst the need to keep proper records in order to comply with tax obligations is widely acknowledged, HMRC's random enquiry programme indicates that poor record keeping is a problem in around 40% of the total of about 5 million SME cases. Research by the OECD indicates that poor business record keeping generally leads to an underassessment of tax even where there is an audit-type check into a return for the period covered by such records. On this basis, say HMRC, poor business record keeping is responsible for a loss of tax in up to 2 million SME cases annually.
2. According to HMRC, tax agents tell them that whilst they advise clients on what records to keep and how to keep them, many do not follow the advice given. This causes additional unnecessary work for those agents who have no way of enforcing the standards that they think necessary.
3. The pilot programme of BRCs began in April 2011 and involved checks by HMRC on the standard of small and medium-sized enterprises' statutory business records. Up to 4 January 2012, 2,437 BRC's had been carried out. These found that 28% of them had some issue with their record-keeping, and an additional 11% had issues serious enough to warrant a follow-up visit. This accords with the view of the OECD that 40% of small businesses have poor records – coincidence, or does this show how accurate the OECD were in their assessment of the situation?
4. HMRC said that they recognised that the launch of the BRC pilots caused considerable concern to the tax profession and that the project would have benefited from more detailed consultation with tax professionals at an earlier stage. In the light of these concerns, HMRC undertook a strategic review of the project in consultation with the professional and representative bodies. The purpose of the review was to consider the overall aims of BRCs, examine whether the current approach is the best way of achieving the policy objectives, and identify what changes are needed to ensure that the objectives are achieved.
5. As a result of the review the scheme was suspended, but a relaunch was planned early in the 2012/13 tax year with a fresh approach. That relaunch was delayed. It would, we were told, partly involve the following:

    - The aim to collect a revised amount of £124 million over 4 years, instead of the originally projected £600 million.
    - No unannounced visits.
    - Refocus on businesses considered to be at a higher risk of keeping poor records.
    - No penalties unless poor records lead to an incorrect tax return.

6. HMRC reiterated that they and the tax profession share the overriding policy objective, namely to ensure that businesses' record-keeping meets the necessary statutory requirements and that their records are sufficient to enable a correct and complete tax return to be submitted within the time limits.

The relaunch

HMRC will now be sending out letters to SMEs that it believes may be at risk of keeping inadequate records, advising them that it will be in touch by phone. Presumably the emphasis will be on cash businesses.

The call will take the business representative through a set of questions designed to assess their record keeping affairs. It is at that stage that the client should really refer the caller to their accountant, as giving HMRC information that is wrong or is capable of a different interpretation will not help the taxpayer's cause.

Depending on the outcome of the phone call, HMRC will decide whether the business would benefit from "tailored educational support" and whether a visit is necessary.

If businesses are keeping inadequate records they will receive guidance on what to do. HMRC will then set up another visit after three months to check that the necessary improvements have been made. Businesses that then fail to comply will be liable to a penalty.

The BRC programme will be rolled-out, region-by-region, over the following 14-week period:

- London & East Anglia – 26 November 2012
- South East England – 14 January 2013
- Scotland – 14 January 2013
- Northern Ireland – 14 January 2013
- Central England – 21 January 2013
- East of England – 28 January 2013
- North Wales & North West England – 28 January 2013
- South Wales & South West England – 4 February 2013

Issues

If a BRC visit is arranged, take care to ensure that HMRC's checklist approach does provide them with a proper understanding of the records kept. This should be determined at the time of the visit, thus avoiding the risk that HMRC officers will come to the wrong conclusions when back at their own offices and having the checklist as their source of information. Any failure on HMRC's part to fully understand the way the business operates could result in inappropriate further action by them.

The CIOT is concerned about the relaunch and makes the following points:

"HMRC has listened to some of our concerns and recast how Business Record Checks will be carried out, but the fundamental issue of in-year penalties remains. HMRC has still not provided a satisfactorily clear reasoning to justify their belief that they can charge penalties in-year before the return goes in for keeping records below the standard they consider is adequate. In our view it is questionable whether HMRC have the power to do this.

HMRC has consulted representative bodies to define more clearly what constitutes 'adequate' records and we understand that this is to be included in guidance for HMRC staff. It is important that the approach taken with different kinds of businesses is appropriate. It is unrealistic to expect smaller businesses to have perfect records written up every day.

Tax agents, and the businesses they advise, need to work closely with HMRC and ensure that, following any BRC visit, any conditions set by HMRC and accepted by the business are fully achievable. They must also check before any revisit that the conditions have been complied with, otherwise a penalty may be charged.

Unrepresented small businesses need to follow the same recommendation, but may want to take some advice before they sign up to HMRC conditions. Many advisers offer a free initial meeting or pro bono help to those on very low incomes, so it may not be costly to get some help.

Since the selection process for BRCs is based on risk assessment it is more likely that cash businesses will be chosen for BRCs. Such businesses in particular will need to ensure they are keeping adequate records going forward.

Tax advisers are strongly supportive of efforts to improve record keeping by business, but up until now HMRC has been going about it the wrong way, increasing burdens disproportionately. A good programme to improve business record keeping will involve HMRC and tax advisers working together to educate business about good practice and support them in improving their systems, as well as warning about the risks of poor record-keeping."

Contributed by Gerry Hart

Penalties reinstated in Hok

The Upper Tribunal has overturned the First-tier Tribunal's decision in Hok Ltd (TC1286).

In brief, the facts were that the taxpayer business received a £400 late-filing penalty notice for failing to submit its employer's end-of-year return for 2009/10 on time. The taxpayer believed it did not need to submit a return because its only employee had ceased employment part-way through the year. It later agreed that this was a mistake and that a penalty was due.

However, the taxpayer argued that, had the notification of late filing been sent before the end of September, it could have rectified the situation sooner. This would have resulted in a smaller penalty, rather than the five months' worth imposed.

The First-tier Tribunal allowed the appeal. HMRC appealed to the Upper Tribunal.

Decision:

The Upper Tribunal judge, Mr Justice Warren, gave a considered and detailed decision, beginning with a look at how the First-tier Tribunal was set up. The point of this was largely to decide whether it had the power of judicial review.

Mr Justice Warren reasoned that, on the basis that the company accepted the penalty was lawfully imposed but that the delay in sending a reminder should relieve it of at least some of the penalty, the only avenue to the company was to seek judicial review, per Lord Justice Nicholls' decision in Asplin v Estill [1987] STC 723. In essence, Nicholls LJ said that the administrative practices could only be challenged by way of judicial review and, in the Upper Tribunal's judgment, there was “no room for doubt that the First-tier Tribunal does not have any judicial review jurisdiction”.

On this alone, the taxpayer's case was lost. However, Mr Justice Warren also mentioned the issue of fairness. He said that the fact that HMRC's practice in waiting four months before issuing penalty notices had since been changed (see “P35 pledge”, Taxation, 22 March 2012, page 6) did “not carry with it any necessary implication that before the improvement the practice was unfair”. He did add that there was “insufficient before us from which we could properly say any more”.

Finally, criticised the reasoning of the First-tier Tribunal judge Geraint Jones QC that HMRC's practice was deliberate and intended to ensure that a defaulting employer paid a minimum of £500 in penalties. Mr Justice Warren said:

> “There was no evidence before the tribunal from which they could draw such a conclusion; it was based entirely upon the judge's perception … that because, as he assumed … a penalty notice could have been sent out within a month, the fact that it was sent later meant that HMRC deliberately delayed. He appears to have made no enquiry of HMRC about the justification or reasons for the practice and simply dismissed the explanation (which we acknowledge was somewhat opaque) given in the statement of case.”

HMRC's appeal was allowed and the penalties reinstated in full.

Comments - An HMRC spokesman said: “We are pleased with the decision, which confirms HMRC's interpretation of the law. There are no plans to revisit cases that had been finalised. We expect that cases stood behind Hok will be resolved in line with the decision, following normal procedures.”

“The thing that has always bothered me about Hok is that HMRC took the case in the first place”, said Paul Aplin of AC Mole. “The new P35 process — a product of the joint service standards initiative with the professional bodies — is based on the core objective of getting the returns in, not generating penalties. That change of approach was important and very welcome. What I would now like to see is a rethink of the approach to charging penalties generally, to ensure that they are used proportionately and sensibly and not simply 'because they are there'.”

CRC v Hok Ltd, Upper Tribunal

Incomplete instructions on tax return partially reduce penalties

The taxpayer appealed against two £100 penalties imposed for the late submission of his tax returns for 2008/09 and 2009/10. They were both due by the end of July 2011, this being three months from the date of issue. They were submitted to HMRC on 23 August.

The returns were sent because the taxpayer's employer had subjected the taxpayer's income to tax at 20% instead of 40%.

HMRC acknowledged the 2008/09 return did not include in its guidance the correct information about the deadline for submission, although the 2009/10 return did refer to the three-month period.

The taxpayer said he had reasonable excuse for the delay in sending the returns. He thought the forms were a formality because he believed he had paid the correct tax under PAYE for the years in question.

Decision:

The First-tier Tribunal judge found it "significant" that the instructions on the 2008/09 return failed to specify the three-month period. He noted that the returns were only about three weeks late and said it would be "manifestly unfair" to disregard the lack of instruction. Where guidance was provided though, it was reasonable to assume that a responsible taxpayer would have taken note of it.

On that basis, the tribunal allowed the taxpayer's appeal in respect of the 2008/09 penalty, but confirmed the penalty for 2009/10.

Comments – The case demonstrates the importance of ensuring that the returns are made by the appropriate deadline. This case is unusual in that the deadline was not the normal one but one imposed when the returns are issued later

R W Eadie TC2221

RTI: Extension to reporting time limits (Lecture P748 – 10.38 minutes)

HMRC has published information explaining the circumstances where employers will be allowed extra time to send real time PAYE information to HMRC.

Under RTI, employers who have to operate PAYE for at least one employee will have to report PAYE information in real time. The information must be reported on or before payments are made to employees unless one of the following scenarios applies:

1. Ad hoc payments made outside of the regular payroll.

These would include:
- A new starter is notified late to the person running the payroll.
- An overtime payment is missed off the payroll run by mistake, despite the employer taking reasonable care to ensure these are reported.
- An ad hoc payment on account of earnings.

Ad hoc payments need to be reported the next time the regular payroll is run.

Payments on account of earnings are **not** considered to be ad hoc where it is established practice for some earnings to be paid outside the normal payroll cycle – e.g. where overtime is always paid more frequently than the basic salary or wage payments. Such payments must be reported on or before the time they are made.

It should be noted that a loan from the employer to the employee is not subject to PAYE and does not need to be reported to HMRC. A loan is an amount of money given by an employer to an employee with the expectation that this amount is repaid to the employer.

EIM42270 states that earnings are treated as received when a payment is made on account of earnings. A payment on account of earnings is not the same thing as a loan. The terms used to describe a payment do not decide its treatment. You have to look at the substance of the matter. Something described as an advance may be a loan (not RTI reportable) or a payment on account (RTI reportable).

Directors very often draw money from the company during the year, which is debited to their loan account and repaid at the end of the year by crediting fees, or a dividend, voted or declared after the end of the year. Until that time, and in the absence of specific evidence to the contrary, the amounts drawn do not actually belong to the director. The in-year drawings are not payments on account of earnings.

2. <u>Payments to employees for whom employers do not have to maintain a Deductions Working Sheet (P11).</u>

This would include payments to:
- Casual employees who work for less than a week and do not provide a P45.
- Permanent employees who do not present a P45 to the employer and who are paid below the Lower Earnings Limit (£107 per week in 2012/13).

These must be reported by the earliest of:

- the next 'regular' return the employer is required to send; or
- seven days following the day on which the payment is made.

3. <u>Payments which vary according to the work done on the day, where it is impractical to report on or before.</u>

Payments which meet **all** of the following conditions:
- made to employees for work done on the day of payment; **and**
- made non-electronically (e.g. cash or cheque); **and**
- made at a time or place where it would be impractical for it to be reported 'on or before' the time of payment; **and**
- where the employer cannot know how much the payment will be in time to report the information in advance of the payment being made.

This includes, for example, where someone is employed to pick crops in a field and they are paid in cash based on the amount that they have picked. It also includes catering staff paid by the hour at the end of their shift.

These payments must be reported by the earliest of:
- the next 'regular' return the employer is required to send; or
- seven days following the day on which the payment is made.

4. Benefits and expenses that are not subject to tax under PAYE, but are subject to Class 1 National Insurance Contributions.

For example, where an employee claims expenses from their employer for the employee's private phone bill.

These payments must be reported by the earliest of:

- the time that the employer calculates the NICs that are due on the payment, or otherwise runs their payroll; or
- 14 days after the end of the tax month in which the payment was made – e.g. for a payment made between 6 July and 5 August, this would be 19 August.

5. Notional payments

This covers certain types of payment where there is no transfer of money from the employer to the employee. These include certain payments by an intermediary of an employer, certain payments by non UK employers, or payment made using special types of income.

For example, when an employer awards shares to an employee for less than their market value, this may be a notional payment.

These payments must be reported by the earliest of:
- the time that the employer operates PAYE on the payment; or
- 14 days after the end of the of the tax month in which the payment was made.

6. Earnings and notional payments delivered by overseas employers and third parties to employees for duties performed on assignment in the UK or overseas AND employment income paid in respect of employment-related securities (for example, on the exercise of share options).

This will include payments where an employer is operating reasonable and currently accepted payroll/administrative practices and it is not possible to operate PAYE and/or calculate NICs to be deducted by the PAYE deadline.

HMRC will apply a common sense approach in-year where employers in these situations have a reasonable excuse for not reporting the information by the end of the pay period or 19th of the following month.

HMRC expect that the late reporting would normally be no later than the next regular payroll date.

HMRC Enquiries – Reopening Earlier Years (Lecture P750 – 12.02 minutes)

HMRC enquiries into the tax returns of self-employed individuals in particular will often result in additions to income (i.e. business profits) for the tax year of enquiry. Profit additions for other years may follow as well.

HMRC refers to this practice of spreading additions into other years as the 'presumption of continuity'.

Presumption of continuity

HMRC uses case law as authority for spreading additions into other years, based on the 'presumption of continuity'. HMRC officers are instructed in the enquiry manual as follows (EM3309):

> "…if you have proven omissions for which there is no ready explanation and the business and way of life of the taxpayer have not changed you will be in a much stronger position to argue for addition to other years.
>
> Taken together, then, the tax cases [below] demonstrate that, in the absence of evidence to the contrary, a `presumption of continuity' can be made and the Inspector can be entitled to conclude that under-declarations in some years can be taken as a pointer to under-declaration in others and make discovery assessments accordingly."

The tax cases referred to by HMRC are:

- *Jonas v Bamford* [1973] STC 519 (see EM3311);
- *Rosette Franks* (King Street) Limited v Dick, Ch D 1955, 36 TC 100 (see EM3312);
- *Nicholson v Morris* [1977] STC 162 (see EM3313); and
- *Bi-Flex Caribbean Ltd v The Board of Inland Revenue* [1990] 63 TC 515 (see EM3314).

Probably the most well-known of the above cases is *Jonas v Bamford*, in which Judge Walton J expressed the presumption of continuity as follows:

> *"once the inspector comes to the conclusion that, on the facts which he has discovered, the taxpayer has additional income beyond that which he has so far declared to the inspector, then the usual presumption of continuity will apply. The situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer."*

Jonas v Bamford was mentioned in a more recent case (below), which suggests that the presumption of continuity is more limited in its scope than HMRC have applied it.

Barkham v Revenue & Customs

In *Barkham v Revenue & Customs* [2012] UKFTT 499 (TC), HMRC enquired into the taxpayer's 2004-05 tax return. HMRC raised assessments for 2004-05, and also for 2001-02, 2002-03 and 2003-04, increasing the taxpayer's profits from his car sales and maintenance business. The taxpayer appealed. The issues were whether the taxpayer's accounts for the year ended 31 December 2004 were understated, and whether discovery assessments were competent for earlier years.

During the enquiry, HMRC alleged that turnover for the above year was understated in respect of cash receipts. Following correspondence with the taxpayer's accountant and a meeting, HMRC made an adjustment for 2004-05 to increase the taxpayer's gross profit. This represented a 58% increase in gross receipts. The same percentage was used to increase gross receipts for 2001-02, 2002-03 and 2003-04 as well.

It was argued for the taxpayer that the accounts presented for tax purposes were correct. HMRC contended that the figures for the year of enquiry were based on bankings, which did not include all cash receipts. Furthermore, HMRC considered that under the 'presumption of continuity', where there is evidence of omissions from one or more returns, they could infer that omissions would have occurred in other years. HMRC relied on this principle to make assessments for earlier years.

The tribunal considered the evidence and the submission of both sides, and concluded that there was no evidence that the sales figure based on the bankings included the total amount of cash which should have been banked. The taxpayer's appeal against the 2004-05 assessment was therefore dismissed.

However, with regard to the discovery assessments for 2001-02, 2002-03 and 2003-04, the tribunal found the 58% rate of increase to turnover be "unfair and unreasonable" and "unrealistic" in the circumstances. The tribunal added: "a simple projection of profits on a fixed percentage basis does not strike the tribunal as accurate or fair." The discovery assessments were not upheld, and the parties were invited to submit alternate increases based on sufficient evidence.

Conclusion

The tribunal in *Barkham* pointed out that once HMRC has raised an assessment, the onus of proof is on the taxpayer to show, on a balance of probabilities, that the assessment is excessive.

Thus it is possible for taxpayers to disprove the presumption of continuity by providing evidence to show that the amounts assessed should be reduced.

In particular, HMRC's method of calculating additions to income for other tax years on the basis of spreading is open to challenge where a more reasonable and accurate method is appropriate.

Contributed by Mark McLaughlin

Company accounts without directors' report: penalty

A company (G) submitted accounts without including a directors' report. HMRC imposed penalties under FA 1998 Sch 18 paras 17(3) and 18, on the basis that G had failed to comply with the Companies Act. G appealed, contending firstly that no penalty was due, and alternatively that it had a reasonable excuse for not having realised that its returns were insufficient.

Decision:

The First-tier Tribunal rejected these contentions and dismissed the appeals. Judge Raghavan observed that Sch 18 para 11 permitted HMRC to require that accounts should be accompanied by 'such documents as are required to be prepared under the Companies Act'. This included a directors' report, the preparation of which was required by the Companies Act even for small companies which were not required to file such reports with the Registrar of Companies.

Comments - The First-tier Tribunal upheld HMRC's view that a company is required to submit a directors' report with its annual corporation tax return, and is liable to penalties under FA 1998 Sch 18 if it fails to do so.

Goodtime Print & Design Ltd v HMRC TC2286

HMRC'S Single Compliance Process Developments (Lecture P749 – 10.32 minutes)

The process

As yet another attempt to change the enquiry regime in terms of working an enquiry, HMRC announced trials of a single compliance process for enquiries across a range of different taxes, aimed at local compliance enquiries on SMEs. This is clearly resource driven, and a further briefing paper for tax agents was published on 8 October 2012 to announce changes to the original plan as well as reiterating points made previously.

By simplifying and standardising the process for compliance checks HMRC will they claim improve customer experience and reduce costs as the check will only take as long as the risks and behaviours encountered dictate.

The trials of the new process will now run up to an undetermined date. HMRC's latest comments are:

"This is so we can understand more about how customers will benefit from an SCP approach. It will also allow the department to gather additional information to establish that indicative benefits will be seen across the broader range of cases - particularly those that lasted longer than the initial trial period.

The decision to further test the process should not been seen as an indication that any assumptions have been made on the future of the SCP. The process is still being tested and while there are many positive indications, lessons continue to be learnt on the best design of the process and its impact".

The following 16 locations are involved:

GROUP 1	GROUP 2	GROUP 3
Belfast	Newcastle	Worcester
Cardiff	Reading/Slough	Lincoln
Edinburgh/Dundee	Southampton	Ipswich
Euston Tower	Warrington	Tolworth
Exeter	York	

SCP will focus solely on the risks and behaviours identified in cases and throughout the life of the compliance check, irrespective of the head of duty (VAT, Income Tax, Corporation Tax and PAYE) involved. The process will be capable of addressing lower risk cases at an appropriate level, but HMRC rather spoil the message by adding that the process will also increase in intensity should the approach be warranted.

How will the SCP be tested?

HMRC wants to ensure that the SCP is fit for purpose and accomplishes the aims that they have set out to achieve. In order to do this, HMRC has extended the original trial phase for further testing in some of the more technically complex areas, to better understand how they will benefit from an SCP approach. The extended trial will run until sufficient conclusive data is available to ensure a convincing business case for roll out, which is robust and fully supports proposed implementation plans.

The purpose of this trial phase (called Phase 3) is to test the following:

- use of the SCP
- mechanics of the SCP
- content and usability of a standard framework for enquiries
- business and agent reaction
- timings
- communications
- quality assurance process

There is a commitment to listen to feedback from agent representative bodies through the Compliance Reform Forum.

Examples of data to be collected during the trial are:

- cycle times
- yield and average yield
- elapsed times
- number of cases opened and settled
- case quality
- number of cases changing level, appealed and reviewed
- learning requirements
- business feedback

Driving the enquiry (with HMRC behind the wheel)

The claim is that the SCP will allow for the enquiry to be driven by the risks or behaviours identified and that, according to HMRC, includes:

- Building on the principles of the openness and early dialogue by informing the taxpayer and agent at the first opportunity of the particular risks to be addressed to give time savings and clarity for both parties about the risks being addressed.
- Developing a relationship with the agent/business for mutual understanding of the benefits of particular approaches and how these maintain the pace or speed up the process at every stage in the enquiry.
- Collaboration beteen HMRC and agent/business at every stage in the enquiry and communicating any findings directly so that there should be “no surprises”.
- Swifter record reviews carried out “on site”.
- Only seeking the facts and evidence to address the particular risks identified and not using the enquiry to undertake a general “fishing expedition”, meaning that discussions are more focussed.

- Sample record reviews as opposed to a full review when appropriate.
- Working to Litigation and Settlement Strategy principles, importantly that HMRC will not generally enter into a dispute unless the revenue flows potentially involved justify doing so.

The 4 levels of enquiry under SCP

LEVEL 1

This is where there is no need for a face to face meeting. Maximum time estimated to work the enquiry is 1.5 days.

LEVEL 2

A simplified and faster route for those cases where a lower intensity face to face intervention is required. 2 days estimated.

LEVEL 3

Cases requiring a greater amount of time because the depth and breadth of the enquiry is more involved. 4 days estimated.

LEVEL 4

The most demanding cases such as those indicating tax evasion characteristics or those highly complex in nature. 8 days estimated.

5 stages of the SCP

These are:

STAGE 1 - PLANNING
STAGE 2 - CONTACT
STAGE 3 - PROCESS
STAGE 4 - RESOLVE
STAGE 5 - CLOSE

SCP feedback

In the extended trial period HMRC will continue to seek completion by agents of evaluation sheets, so HMRC can assess the impact of SCP and whether there are any areas they need to improve or change.

Your role to ensure all is fair for your client

Clearly this is a resource driven initiative, being sold to us on the basis that it will reduce the time, costs and hassle experienced by agents and clients. You must ensure that in adopting the SCP approach none of the following happens:

1. HMRC unfairly seeks to obtain agreement to additional taxable profits arising, by encouraging your client to settle if he wants them to make a speedy exit. Do not allow HMRC to rush things along if you consider that will be detrimental to the client.

2. HMRC use SCP but wrongly identify what they consider to be risk areas – perhaps as a result of only a superficial consideration of what they regard as facts but which in reality are nothing of

the sort. That may well be derived from a check-list review which you feel shows a basic lack of understanding of how the business operates. If so, you need to be ready to make the point firmly and at an early stage of the enquiry.

3. HMRC attempts to apply a higher level to the enquiry than you consider justified.

4. HMRC use the new 4 levels approach to insist on a meeting with the client when you consider that all can be settled without that.

5. A tax enquiry becomes drawn-out and HMRC seemingly refuses to apply this initiative when it is adopted nationwide. Even at this stage you could refer to the SCP procedures to try and get the enquiry settled.

Contributed by Gerry Hart

Time to pay arrangement confusion in taxpayer's favour

The taxpayer employee appealed against surcharges for 2008/09 and 2009/10, contending that he had requested a deferred payment agreement. HMRC argued that "no time-to-pay arrangement was ever formally concluded" and that, if there had been a payment arrangement under the PAYE system, it had been cancelled when his agent submitted details of his expenses.

Decision:

The First-tier Tribunal found that there had been a verbal agreement for a time-to-pay arrangement and this would not have been automatically cancelled just because the taxpayer had been brought within the self-assessment system. A time-to-pay arrangement is a contractual arrangement for the payment of tax concluded with HMRC under their broad powers of collection and management and, unless the arrangement included a term providing for termination on the transfer to self assessment, the arrangement would remain valid and continue.

The taxpayer's appeal was allowed.

Comments – The time to pay facility was introduced because of the harsh economic times. Although they have conditions that must be adhered to there was clearly an understanding that had been agreed to and therefore both parties had to adhere to that agreement and not renege therefrom as HMRC had attempted to do.

D Wilmot TC2325

Judicial review application: refusal of hardship application

A company (T) had appealed against two assessments to recover input tax, and applied under VATA 1984 s 84(3B) for the appeals to be entertained without paying or depositing the tax. The First-tier Tribunal rejected the applications, finding that T had not submitted sufficient evidence to show that payment of the tax would cause hardship. T applied for judicial review, contending that it had been unfairly denied the right of appeal against the First-tier Tribunal decision. The QB dismissed the application.

Decision:

The CA unanimously allowed T's appeal, holding that VATA 1994 s 84(3C), which had been inserted by the Transfer of Tribunal Functions and Revenue & Customs Appeals Order 2009 (SI 2009/56) and had removed the right of appeal against a First-tier Tribunal decision on a hardship application, was ultra vires and unlawful. Applying dicta of Lord Cooke of Thorndon in R (oao Spath Holme Ltd) v Secretary of State for Transport, the Environment and Regions, HL, [2001] 1 All ER 195, 'Parliament does not lightly take the exceptional course of delegating to the executive the power to amend primary legislation. When it does so the enabling power should be scrutinised, should not receive anything but a narrow and strict construction and any doubts about its scope should be resolved by a restrictive approach.' Moses LJ held that FA 2008 s 124 'does not clearly confer the power to revoke the right of appeal from First-tier Tribunal to Upper Tribunal in relation to hardship applications'. Arden LJ held that 'to bring to an end a right of appeal in existing proceedings has been held to constitute retrospective legislation even where the decision sought to be appealed has not yet been made and the right has not in that sense crystallised'.

Comments - The Upper Tribunal held that VATA 1994 s 84(3C), which was added by statutory instrument rather than by primary legislation, was unlawful and ultra vires, so that the company should have a right of appeal to the Upper Tribunal against the rejection of its 'hardship application'.

R (oao Totel Ltd) v First-Tier Tribunal (and related application) (CA)

Penalty for late trust return

HMRC issued a trust and estate tax return to the trustees of a settlement in April 2011. HMRC received the completed return on 1 November 2011, one day after the deadline for paper returns. HMRC imposed a penalty of £100. The trustees appealed, contending that they had posted the return on Friday 28 October.

Decision:

The First-tier Tribunal dismissed the appeal, holding that this was not a reasonable excuse. Judge McKenna observed that it was not 'the action of a reasonable and prudent taxpayer to post a return on the very last day before a deadline, especially with an intervening weekend'.

Comments - The First-tier Tribunal upheld the penalty on the trustees, whose return had been received one day late. Judge McKenna's comments are self-explanatory.

Derek Evans Settlement v HMRC TC2230

Documents stay under wraps

The taxpayers were the shareholders of SJG, a Gibraltar telebetting company, and SJA, a UK company. SJA was bought by SJG in February 2000 and HMRC raised assessments under TA 1988, s 739 “Prevention of avoidance of income tax” on the basis that there had been a transfer of assets abroad.

The taxpayers appealed, saying that tax avoidance was not a motive of the transfer of the business from SJA to SJG. It was a genuine commercial transaction: the 9% gaming duty on bets placed in the UK made the telebetting business untenable after the High Court ruled in Victor Chandler International v CCE [2000] 2 All ER 315 that it was effectively within the law to use teletext to promote telebetting outside the UK.

In support of their appeal, they applied for the disclosure of certain documents held by HMRC.

Decision:

The First-tier Tribunal ruled that the documents should not be disclosed. The items in question were unlikely to be relevant to the hearing. The judge said the tribunal would consider the issues raised based on information held by the appellants at the time. He described the application as “a fishing exercise to catch fish that are most unlikely to be any interest to the tribunal hearing the substantive appeal”.

He refused this application and also one from HMRC for the tribunal to order the taxpayers to disclose a note of a conference held with between them and a QC. The judge said this was privileged information.

P Fisher; S Fisher; A Fisher TC2021

Reason for surcharge

In April 2009, the taxpayer was made redundant. He received a redundancy payment from his former employer and was told that HMRC would inform him if any higher rate tax was due.

He contacted HMRC in February 2011 and told them about the payment. In May, the department sent him a tax return for 2009/10 and this the taxpayer completed and submitted in July.

HMRC calculated the additional tax and sent the bill to the taxpayer in August. He did not pay the tax, so HMRC sent him a reminder on 27 October and also issued a surcharge notice on the grounds that the tax had not been paid within 28 days of the due date.

The taxpayer paid the tax in October, but appealed against the surcharge saying he had not been able to pay the tax earlier because he did not have sufficient funds and had not been aware of the due date.

Decision:

The First-tier Tribunal said that a reasonable taxpayer would have tried to sort out his tax liability sooner, either by contacting HMRC or appointing a professional adviser. This was not, however, the cause of the surcharge. This was imposed because he paid the tax late. The fact that he could not afford to pay the tax by the due date was not a reasonable excuse. The taxpayer's appeal was dismissed.

Coales v HMRC TC2154

Business Taxation

Short life assets? (Lecture B747 – 12.09 minutes)

Relevance?

From April 2011 the short life asset treatment was extended to assets with an expected economic life of 8 years (previously 4 years). This is economic life to the purchaser – so if they have a five year capital replacement policy they now have access to the advantages of a short life asset election.

Treating an asset as a short life asset will enable the business to claim a balancing allowance on disposal – assuming proceeds are less than tax WDV. The balancing allowance is achieved by showing the asset in its own column in the tax computation – a short life asset election keeps assets out of the 18% pool and as such a disposal within the 8 years (previously 4 years) will trigger a balancing adjustment.

Balancing allowances are not available on the 18% pool until the business ceases. So short life asset elections accelerate tax relief and for some this is a very valuable relief.

Consider a partnership with a corporate partner. The Annual Investment Allowance is not available to them (because of the corporate partner) and an 18% WDA is the best they can hope for. At least a short life asset election would secure balancing allowances on asset disposals.

So what assets qualify as a short life asset and how do we make a short life asset election?

Meaning of short life asset

As long as the asset is not an excluded asset then it qualifies for a short life asset election. The actual or expected life of the asset is irrelevant in deciding whether or not it qualifies for short life asset treatment. All that matters is that an election is made and that it is not specifically excluded.

Technically a business with a five year capital replacement policy could have made a short life asset election when the limit was four years but they would never have received the advantage of a balancing allowance on sale as the asset had to be transferred to the 18% (previously 20%) pool at the end of year four i.e. before it was sold.

The key assets that are excluded from short life asset treatment are as follows:

- cars;
- long life assets;
- special rate expenditure assets (integral fixtures)

There are other exclusions – mainly related to leasing – but the above are the most common assets that clients are likely to have.

It should be noted that businesses will claim the annual investment allowance (AIA) before considering short life asset elections. It is only spend above the AIA that we need to consider short life asset elections. It would be advisable to use the AIA against assets that would ordinarily go into the 8% pool – integral fixtures for example. Assuming the AIA covers all the integral fixtures acquired in the year, any spend above the AIA would qualify for 18% WDA and we can make a short life asset election to accelerate the balancing allowance on eventual sale of these assets.

Timing of the election

An election to have an asset treated as a short life asset:

- must be made in writing to HMRC;
- must specify the short life asset together with its cost and the date on which it was acquired;
- must be made:
  - within two years of the end of the chargeable period (corporation tax);
  - by the first anniversary of 31 January after the end of the tax year (income tax);

in which the expenditure was incurred on the asset;

- is irrevocable (so do not elect if a balancing charge is likely!).

Consider Barrack who buys a computer in his accounting period ended 31 July 2012. If he wants to make a short life asset election he must do it by 31 January 2015. In the majority of cases you would make the election when submitting the 2012/13 self assessment return so well before the required time.

Expenditure incurred before 1 April 2011 (CT), 6 April 2011 (IT)

Expenditure on a short life asset goes into a single asset pool. No other expenditure goes in that pool so the term “pool” is a little misleading. If there has not been a final chargeable period by the four year cut off the expenditure in the short life asset pool is transferred to the main pool. The four-year cut off is the fourth anniversary of the end of the chargeable period in which the qualifying expenditure on the asset was incurred.

Consider Mitt who buys a computer in his accounting period ended 31 July 2010 and makes a short life asset election. If Mitt still owns the computer on 31 July 2014 the expenditure in the short life asset pool is transferred to the main pool on 1 August 2014.

FA 2011 changes for expenditure incurred on or after 1April 2011 (CT), 6 April 2011 (IT)

FA 2011 increased the short life cut-off period for qualifying expenditure on plant or machinery incurred on or after 1 April 2011 (CT), 6 April 2011 (IT). The increased cut-off period is eight years from the end of the chargeable period in which the expenditure is incurred.

Any remaining balance of qualifying expenditure will, in future, be transferred to the main capital allowances pool at the end of eight years from the end of the chargeable period in which the expenditure was incurred, rather than four years as previously.

The exceptions to short life asset treatment continue to apply.

The election itself

The format of the election is not specified by HMRC.

As long as the required information is communicated to HMRC by the required date then the election will be made.

It is probably easiest to include the details as a note to the capital allowances computation. In the computation we follow the short life asset treatment for the computer (say). We then make a note in the computation that XYZ computer was acquired on 6 November 2011 for £3,000 and it is subject to a short life asset election. There is no need to obtain HMRC approval so as long as we make the details clear the election is made.

Some firms prefer to submit a separate letter to HMRC – it is entirely up to you how you make the election.

Strictly, an election for short life asset treatment should specify each asset it covers together with its cost. This is easily done via the tax computation where only the occasional asset is subject to a short life asset election.

If separate identification of the short life assets acquired in a chargeable period is impossible or impracticable, then HMRC will accept an election that gives information about the assets by reference to batches of acquisitions, with their costs aggregated and shown in one amount provided you can satisfy HMRC that:

- the assets are not specifically excluded, and
- the election gives enough information for it to be clear what is and what is not covered by it.

Strictly, each short life asset should go into its own separate pool so that the allowances on it are calculated separately. This may not be practicable where assets are held in large numbers. In cases like that capital allowance computations that give the correct statutory result, and do not abuse the short life asset provisions, should be accepted even if there is not a separate computation for each asset.

HMRC Example (CA23640)

Alice runs a restaurant and, every year, buys glasses to use in the business. She agrees with HMRC that the glasses have an actual life of three years and that nothing is received for the remains.

She has used her AIA annual amount on other expenditure. She spends £1,200 on wine glasses in the year ended 30 June 2010 and makes a short life asset election. She can make a single capital allowance calculation for that expenditure of £1,200 and claim a balancing allowance for the year ended 30 June 2013 based on a disposal value of nil. None of the glasses bought in the year ended 30 June 2010 should still exist by then because they have an actual life of 3 years and Alice will not have received anything for the remains.

If Alice spends £1,500 on glasses in the year ended 30 June 2011 and makes another short life election, that expenditure is put into a separate pool.

The HMRC example does not explain how Alice should make the election. In this instance I would recommend a separate letter to HMRC as you are seeking their agreement to a short life asset write off policy. At the end of year three Alice intends to claim a balancing allowance on the 2010 glass additions so that should be agreed with HMRC.

Something along the lines:

Client reference

Short life asset election

Every year our client buys glasses for use in her restaurant business. It is not practical to keep records of each individual glass but the glasses bought are unlikely to last more than three years in the business due to breakages and deteriorating quality

Our client wishes to make an aggregated short life asset election on the glasses bought in each calendar year. In the year to 30 June 2010 glass additions totalled £1,200. These will be subject to a short life asset election and shown in one single column as "2010 glasses".

In the year to 30 June 2013 the tax written down value of the "2010 glasses" will be claimed as a balancing allowance.

This letter is notice of our client's election for short life asset treatment and we request that you confirm that the treatment detailed above is acceptable to HMRC.

The tax computations should be prepared on this basis with a note along the same lines. Whilst this may seem excessive for such small sums it is more the principle that we are trying to establish. The amounts involved can be much larger.

I have had experience of HMRC accepting the above treatment when the aggregated annual additions were in excess of £300,000 (metal milk crates in a dairy).

Contributed by Dean Wootten

Consultancy fee: whether capital expenditure

A trader (B) operated a cleaning business. He claimed a deduction for £11,000, described as a consultancy fee, which he had paid to an American who had helped him win a major contract. HMRC rejected the claim on the grounds that the payment was capital expenditure.

Decision:

The First-tier Tribunal dismissed B's appeal. Judge Tildesley observed that the projected turnover under the contract exceeded B's current annual turnover, and was intended to secure 'an enduring benefit for the appellant's business'.

Comments - The First-tier Tribunal upheld HMRC's view that, in view of the size of the projected contract, the payment here was capital expenditure rather than revenue expenditure. It is clear also that an asset of enduring benefit was potentially being brought into existence.

G Bowman (t/a the Janitor Cleaning Co) v HMRC TC2284

Loan relationships – Avoidance scheme failure

A company (P) held a large shareholding in another company (W). It wished to sell half of these shares. In an attempt to avoid the corporation tax which would become due on the sale, P sold the shares in March 2001 to a newly-acquired subsidiary (E). In April 2001 E sold those shares in the open market, realising a chargeable gain of £8,595,731. In November 2001 E incorporated three subsidiary companies. E and its subsidiaries then undertook a number of derivative transactions in an attempt to reduce or avoid the corporation tax due on the gain. As part of the scheme (which was devised by an accountancy firm), E sold one of the subsidiaries (Q) to an unconnected third party in 2002, and claimed a capital loss of £8,864,992 on the disposal. HMRC subsequently began enquiries into the transactions and issued closure notices to the effect that the gain on the shares in W was chargeable to corporation tax; that E was not entitled to the capital losses which it had claimed; and that two of E's subsidiaries were not entitled to the capital losses which they had claimed. The First-tier Tribunal allowed the companies' appeals in part, and both sides appealed to the Upper Tribunal (UT)

Decision:

The Upper Tribunal dismissed the companies' appeals and allowed HMRC's cross-appeal. The UT held that 'even if (E) can be said to have gained and lost on the 2001 derivative transactions, the 'gains' and 'losses' did not have the character of income'. Furthermore, the transactions were 'designed to achieve a 'loss' or 'gain' of fiscal significance without there ever being any prospect of a loss or gain having a commercial reality'.

Comments - CTA 2009 s 441 provides that where a company's loan relationship has an 'unallowable purpose', the company may not include any credits or debits in respect of that relationship which are 'attributable to the unallowable purpose'. The Upper Tribunal upheld HMRC's view that the loan relationship in question had an 'unallowable purpose'.

Explainaway Ltd v HMRC (and related appeals) (Upper Tribunal)

Guidance on tax treatment of dividends

HMRC has issued two guidance notes on:

- Guidance on tax treatment of payments to UK companies registered in an overseas territory ("foreign companies")
- Guidance on tax treatment of payments to individuals and other non-corporates following share capital reduction

GUIDANCE ON TAX TREATMENT OF PAYMENTS TO UK COMPANIES FROM COMPANIES REGISTERED IN AN OVERSEAS TERRITORY ("FOREIGN COMPANIES")

HMRC has been asked for its view on aspects of the tax treatment of payments received by companies in the UK in respect of shares held in foreign companies.

Background

Part 9A of the Corporation Tax Act (CTA) 2009 contains the rules for the corporation tax treatment of distributions received by UK resident companies from both UK and foreign companies.

Section 931A CTA 2009 provides that a charge to corporation tax (CT) arises in respect of "dividends and other distributions", though the effect of Part 9A is to ensure that in most cases, distributions received by UK companies are exempt from CT.

The definition of distribution is taken from section 1000(1) CTA 2010 and includes:

- any dividend, including a capital dividend (one paid out of capital profits): section 1000(1)A, and
- any other distribution out of the assets of the company made in respect of shares, except to the extent that the distribution represents a repayment of capital on the shares or is equal to any new consideration received by the company: section 1000(1) B.

Dividends (section 1000(1)A)

Following the judgment of the Court of Appeal in the case of *HMRC v First Nationwide* [2012] EWCA 278, HMRC's view is that if a dividend payment is a distribution permitted in accordance with the law that governs the foreign company then in the absence of any evidence calling into question the legal form of the payment it will be treated as a dividend for the purposes of section 1000(1)A CTA 2010.

Other distributions (section 1000(1)B)

Any other distribution out of assets made in respect of shares will be treated as a distribution under section 1000(1) B, other than on a winding up, unless (or to the extent that) it represents a repayment of capital on the shares, or is equal to any new consideration received by the company. Such distributions are likely to comprise redemptions at premium or repurchases of capital.

What is the capital on the shares?

For companies incorporated in the UK under the Companies Act 2006 or its predecessors, this will usually comprise nominal share capital. In addition,

where shares are issued at a premium Part 23 CTA 2010 (see section 1025), consistently with section 610(4) Companies Act 2006, makes it clear that share premium is treated as part of the share capital for this purpose. Amounts subscribed for share capital or paid as share premium will be treated as "capital on the shares".

For companies that do not have share capital, for example, companies limited by guarantee, Part 23 CTA 2010 extends the definition of share to include stock or any other interest of a member of the company.

For foreign companies, it may be less clear what capital on the shares consists of. The facts may vary between cases, but HMRC would normally expect to treat as a distribution an amount that:

- is distributable in accordance with the relevant company law, and
- is not made on winding up or as part of a procedure under the relevant company law for reducing share capital.

This is subject to section 1027A CTA 2010 which for the purposes of determining whether an amount is a repayment of capital on the shares, treats a distribution out of a reserve arising from a reduction of share capital as if it were made out of profits available for distribution otherwise than by virtue of the reduction. This will depend on whether section 1027A(4) applies or not to the reduction of share capital.

With regard to application of section 1025 CTA 2010, which treats a repayment of share premium as forming part of the share capital where the premium account was created in respect of new consideration received on the issue of the share capital, HMRC will normally, depending on application of the foreign company law, not treat a payment of out of a share premium account as a repayment of share capital in circumstances where under the foreign company law share premium is fully distributable and is not treated as forming part of the share capital.

Fiscal and Administrative consolidation (Organschaft)

Some jurisdictions provide for individual entities to enter into arrangements enabling those entities to consolidate their results for tax or administrative purposes. Such arrangements often involve the transfer or payment of amounts between the parties to consolidate results. HMRC takes the view that payments or transfers made as part of such arrangements and under the terms of a contract can be distributions provided that the:

- arrangement is dependent on the existing shareholder relationship for its existence, and
- payments / transfers between the members of the consolidated unit are made in respect of shareholdings (such that transfers or payments are in proportion to shareholdings).

GUIDANCE ON TAX TREATMENT OF PAYMENTS TO INDIVIDUALS AND OTHER NON-CORPORATES FOLLOWING SHARE CAPITAL REDUCTION

HMRC has been asked for its view on the tax treatment of payments received by individuals and other non-corporates from reserves created following a share capital or share premium reduction.

This guidance applies to payments from UK incorporated companies undertaking such reductions in accordance with UK company law. It also applies to payments from other UK resident companies that are incorporated outside the UK who have undertaken capital reductions in accordance with the company law of the company's territory of incorporation.

It does not apply to payments from non-UK resident companies. Guidance on distributions received by individuals from non-UK resident companies can be found at SAIM 5210

Tax treatment of UK distributions

Individuals and other non-corporates are charged to income tax on dividends and other distributions they receive from UK resident companies by section 383 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA). The charge to income tax applies even if the dividends and other

distributions are capital in nature, for instance certain bonus issues of shares or securities (section 383(3) ITTOIA).

Definition of distribution

The definition of distribution for income tax purposes is the same as that for corporation tax purposes and can be found in Part 23 of the Corporation Tax Act (CTA) 2010 (except section 1027A does not apply for income tax purposes): section 989 of the Income Tax Act 2007.

The definition of distribution at section 1000(1) CTA 2010 includes:

- any dividend, including a capital dividend (one paid out of capital profits): section 1000(1)A, and
- any other distribution out of the assets of the company made in respect of shares, unless the distribution represents a repayment of capital on the shares or is equal to any new consideration received: section 1000(1)B.

Payments following reduction in share capital or share premium

It follows that a payment which is a repayment of share capital (including premium) following such a reduction is not a distribution and so will not be chargeable to income tax. There may, however, be a charge to capital gains tax under section 122 Taxation of Chargeable Gains Act 1992, as a capital distribution (which should be distinguished from the 'capital dividend' mentioned above).

If, however, share capital (including premium) is reduced and a reserve is created and treated as a realised profit, for example in accordance with The Companies (Reduction of Share Capital) Order 2008 SI 2008/1915, made under section 654(2) of the Companies Act 2006, that treatment will be applied for tax purposes also. This means that:

- a dividend payment which is a distribution permitted under company law will be a dividend for the purposes of section 1000(1)A, and
- any other payment out of a reserve of this type will be a distribution under section 1000(1)B, and as it is treated as made out distributable profits no, part of it will be treated as representing a repayment of capital on the shares.

The distribution will therefore be chargeable to income tax.

HMRC Guidance Notes, 21/11/2012

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The post ESC C16 regime? (Lecture B749 – 8.43 minutes)

Informal winding up

Formal liquidations of solvent companies is something practitioners have been able to avoid for many years. Our recently departed friend ESC C16 was a great help for clients who wished to have access to a 10% CGT rate when winding up their trading company. The Companies Act 2006 allows

an 'informal' liquidation, or 'winding up', and this is done by the company applying to Companies House to strike the company off the register The process was simple and clients received great benefit with minimal expense with regard to professional fees.

Tax considerations on winding up

When the company ceases to trade all the normal rules would apply in respect of the final corporation tax computation. So an accounting period comes to an end and we bring in all trading income and deduct all allowable costs. Capital allowances will be subject to balancing allowances or balancing charges rather than the AIA or WDAs.

Wherever assets are distributed in specie to shareholders they are treated as a distribution at market value. Where these assets were included in the capital allowance computations the market value of these distributed assets is brought in as consideration in the final capital allowances computation.

Loans to participators can also form part of the distribution ie part of the participators distribution entitlement is settled by way of the company not collecting the overdrawn loan account. When this occurs the s,455 tax should be repaid by HMRC to the company.

So the final computation is fairly standard from a trading cessation perspective. The key to the informal winding up of a company is the treatment of the cash and asset distributions in the hands of the shareholders.

As long as the winding up of the company was done for genuine commercial reasons eg retirement then there were no specific anti avoidance rules that could jeopardise the ESC C16 capital route

Company law

A company is prohibited from making distributions out of anything but profits, with four exceptions:

- a distribution of bonus shares
- the redemption or purchase of the company's own shares
- the reduction of the company's share capital, and
- the distribution of assets to members on its formal liquidation

It could therefore be claimed that any share capital and share premium left in the company should pass to the Crown as *bona vacantia* when the company is struck off. As practitioners we would have been aware of the bona vacantia rules but that there was a £4,000 limit under which the Treasury Solicitor would not enforce their bona vacantia rights. This meant that we could follow ESC C16 where non-distributable reserves (share capital and share premium in the main) were no more than £4,000.

However, in October 2011, the Treasury Solicitor's Office announced that they would not seek to recover any unauthorised distributions made prior to dissolution. So if the issued share capital was £20,000 an informal winding up under ESC C16 procedure would not have any bona vacantia exposure. Technically there was a bona vacantia issue but the Treasury Solicitor was not going to enforce it.

When pursuing an informal winding up it is important to fulfil the requirements of Companies Act 2006, s 1003 and s,1004 - in particular the application for striking off cannot be made until at least three months after the cessation of the trade.

Taxation of distributions to shareholders

Ordinarily, a distribution by a company from distributable reserves is an income distribution. This will not be attractive to many shareholders as income distributions can be taxed at a higher rate than capital distributions. Capital distributions from trading companies tend to be taxed at the 10% entrepreneurs' rate.

Prior to 1 March 2012 however, a company that made a distribution followed by an application to be struck off under CA 2006, s 1003, could request that the distribution was treated as capital under ESC C16.

On 1 March 2012, ESC C16 was replaced by a new legislative provision at CTA 2010 s.1030A which allows an exception to the income distribution rule when distributing from distributable reserves.

The new provision introduces a £25,000 cap on the amount of distribution that can be treated as capital when paying distributions from distributable reserves as part of an informal winding up. If distributions from distributable reserves exceed the £25,000 then the whole of the distribution is treated as income – you do not get the first £25,000 as capital. Distributions from non-distributable reserves need not be considered against the £25,000 limit – they will always be regarded as capital distributions.

So a company with £10,000 of issued share capital and £20,000 of retained profits can be wound up under an informal winding up and any distributions are treated as capital without any formal clearance needed – it is a legislative provision. If the share capital was £10,000 and the retained reserves £30,000 – the distribution in respect of the shares would be capital (£10,000) and the distribution in respect of the retained reserves would be income (£30,000).

It should be noted that the capital treatment will be retrospectively withdrawn if any creditors remain outstanding after two years from the date of the distribution or if the company is not struck off within the same timeframe.

For companies with distributable reserves in excess of £25,000 a formal winding up might be the preferred option if the shareholders wanted the distributions treated as capital.

Whilst it is assumed that the capital treatment is best this is not always the case. The capital gains tax rate should be 10% when you consider the entrepreneurs rate but income distributions come with a 0% tax rate for basic rate taxpayers.

The new provisions do not appear to have a "get out" clause if you do not want the £25,000 rule to apply. So if you have a small husband and wife company with share capital of £100 and retained reserves of £24,000 you do not want to commence informal winding up proceedings before taking the retained reserves out as income distributions. If you take them out when informal winding up proceedings commence then HMRC may well expect you to report a capital distribution.

If the retained reserves were higher – say £50,000 – the basic rate taxpayer may want to leave the company in place and draw income distributions over a few years. The aim would be to keep income below the high rate bands.

Where the client is a high rate taxpayer the capital route will be more beneficial. If the retained reserves are less than £25,000 we can follow the informal winding up route and submit Form DS01 to Companies House with the £10 filing fee. There are some conditions to meet when submitting the DS01 e.g. not traded for three months, not changes its name.

Full guidance as to the company law procedures that need to be followed in an informal winding up can be found on www.companieshouse.gov.uk/about/pdf/gp4.pdf .

If a company has assets in excess of £25,000 then the company will have to be formally wound up by a liquidator to secure the capital treatment. The average cost of a formal liquidation is believed to be in the region of £4,000.

Distributions in anticipation of dissolution

Consider a situation where share capital is £10,000 and retained reserves £30,000. The informal winding up route would not secure capital treatment on the £30,000.

What if the company paid a dividend of £5,000 (income) and then followed the informal winding up procedure? Would capital treatment be secured on the £25,000 distribution from retained reserves?

Unfortunately distributions paid in anticipation of dissolution will count towards the £25,000 test - CTA 2010, s 1030A(2)(b). Consequently the capital treatment would not be secured on the second tranche of £25,000.

The key is how you distinguish between a 'normal' dividend and one which is in preparation to dissolve the company. Whilst there is no clear guidance in this area I would expect any dividend post cessation of trade to fall within this category – unless you have strong evidence to the contrary.

Contributed by Dean Wootten

VAT

Selling goods.......VAT and cross border trading (Lecture B750 – 10.31 minutes)

Beware of distance selling limits

Example 1
Steve buys teapots from a range of UK suppliers and sells them to customers throughout the world. He has queried the VAT treatment of the following sales:

- 1,000 teapots will be sold to a company in America (outside the EU)
- 100 teapots will be sold to private individuals in America
- 1,000 teapots will be sold to a VAT registered company in France (inside EU)
- 100 teapots will be sold to private individuals in France

What are the VAT issues?

Example 1 (solution)

In the first three situations, it is important that Steve obtains documentation to confirm that the goods have left the UK. This is because the sales are all zero-rated. For the goods supplied to America, the status of the customer is irrelevant – it does not matter whether he is a private individual or business customer. All exports of goods to a country outside of the EU are zero-rated.

In the case of the 1,000 teapots supplied to the French company, the procedure is as follows:

- The French company will provide Steve with its French VAT number, and Steve will show this number on his sales invoice.
- Steve can now zero-rate the sale of the goods…as long as he acquires and retains proof that the goods have left the UK

An important point to remember is that the sale of the goods to the French company is not escaping a charge of VAT. The reality is that the French company will account for output tax (or acquisition tax to be precise) by making an entry in Box 2 (equivalent) of its VAT return. This is calculated by multiplying the value of the goods by the French rate of VAT (which I understand is 19.6%). The French company will then reclaim the same amount as input tax in Box 4 of the same return (assuming it is not partly exempt etc).

In the case of the teapots sold to private individuals in France, UK VAT (standard rate) must be charged on these goods. Steve should also record the total value of sales made to all such non-registered customers in France to ensure he does not exceed the distance selling levels i.e. 35,000 or 100,000 Euros on a calendar year basis (each country chooses one limit). If he exceeds the distance selling limits, he will cease to charge UK VAT on his sales and obtain a VAT number in France and charge French VAT on his sales.

Note – don't forget that 'non-registered' customers not only include private individuals but many charities and also businesses that trade below the VAT registration threshold or are not VAT registered because they only make exempt sales.

A cross border sale of goods can be made to yourself

Imagine the following situation: Fizzy Drinks Ltd ships 1,000 litres of fizzy drinks from its warehouse in Skegness to its warehouse in Madrid. The goods will then be sold to private individuals who visit the warehouse in Spain. What is the VAT position?

In this situation, Fizzy Drinks Ltd will almost certainly have a VAT number in both UK and Spain and is deemed to be making a supply of goods, even though the goods are not being sold to a different legal entity (UK branch is selling to Spanish branch).

The sale by the UK branch to the Spanish branch is zero-rated because the goods are leaving the UK and being transferred to an EU business that is registered in that country (albeit a branch of the same legal entity). The Spanish branch will account for acquisition tax in Box 2 of its VAT return for the period in question (value of goods multiplied by Spanish rate of VAT) and claim input tax in Box 4. The onward supply from Madrid will be subject to Spanish VAT.

Note – there is no supply if goods are temporarily removed to another EU country for repair and return or for temporary use to provide a service.

Simplification process.........'triangulation'

Triangulation is an important issue in the VAT world because, once identified, it can avoid the need for an overseas business to register for VAT in another EU country. It only relates to supplies of goods, and not services. To highlight the principles of triangulation, consider the following example:

Example 2

A Polish manufacturer makes goods for a UK business – the latter has an order with a business customer in Germany – it makes sense for the Polish factory to produce the goods and deliver them directly to the German retailer.

The good news is that the VAT issues on the deal can be sorted out by the 'triangulation' procedures, which are fully explained in HMRC Notice 725, section 13. This outcome is possible because the three businesses involved in the deal are all based in different EU countries and are all VAT registered in their country.

The end result of the triangulation procedure is that the Polish business makes a zero-rated sale to the UK business, which in turn makes a sale without charging UK VAT to the final customer in Germany. The VAT is then sorted out by the German customer on its own VAT return, with acquisition tax accounted for on the purchase (value of goods multiplied by the German rate of VAT appropriate to those goods) and the same amount is then reclaimed as input tax to produce a nil liability overall. The good news is that the UK company does not need to register for VAT in Germany although there is a requirement to complete an EU Sales List (don't forget to enter indicator 2 in the end column i.e. for 'triangulation') and to also issue a tax invoice to the German customer with the usual details for an intra-EU supply of goods.

Contributed by Neil Warren

Removal of VAT registration threshold for businesses not established in the UK

From 1 December 2012, non-established taxable persons (NETPs) will no longer be able to benefit from the UK VAT registration threshold. They will be required to register for UK VAT when they make their first supply of goods or services here regardless of the value.

NETPs who are already making supplies here will be required to register for UK VAT with effect from 1 December 2012.

The UK has always allowed its domestic VAT registration threshold (currently £77,000) to apply to NETPs who make taxable supplies in the UK, as well as to UK businesses. NETPs include, for example, non-UK traders at farmers' markets or Irish service suppliers working across the land border. However, a decision (Schmelz C-97/09) in the CJEU (the European Court of Justice) has confirmed that only businesses established in a Member State can benefit from its domestic VAT registration threshold.

Therefore, a new Schedule 1A to the VAT Act 1994 and other consequential changes were made in Finance Act 2012 and come into force on 1 December 2012.

From 1 December 2012, any non-established business which makes or intends to make taxable supplies in the next 30 days has 30 days from the date it formed that intention to notify HM Revenue & Customs (HMRC) that it is required to register for VAT. Businesses which become required to register in the UK on 1 December 2012 will have to notify HMRC of that fact by 30 December 2012.

A business not established in the UK will be required to register from the earliest of the date that it made or expected to make taxable supplies in the UK (but no earlier than 1 December 2012). Non-established businesses which are aware that they will need to be registered from 1 December 2012 (for example, because they are already making supplies in the UK under the current threshold) can provide advance notice to HMRC, and they will be registered for VAT from 1 December 2012.

Existing UK place of supply rules have not been changed. Overseas businesses making only reverse charge supplies of services to the UK will not normally be affected by the removal of the threshold. However, there are some exceptions that are taxable supplies in the UK where they are supplied to a private customer rather than to a business, for example, services in connection with land which is located in the UK or entertainment services when the performance takes place in the UK.

Overseas businesses only involved in distance sales or acquisitions are not affected by the removal of the VAT registration threshold.

Any NETP business which is required or entitled to register for VAT can apply for VAT registration either online or by completing form VAT 1.

More information on UK VAT registration can be found in Notice 700/1 Should I be registered for VAT? on the website.

Revenue and Customs Brief, 15/11/2012

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Insufficient evidence

The taxpayer, a UK company, sold goods to a Spanish company E which arranged for the transport of the goods to Spain mostly using an independent haulier based in the Republic of Ireland. The taxpayer treated the supplies as zero rated, under VATA 1994, s 30(8) and VAT Regulations SI 1995/2518, reg 134, on the basis that the goods were supplied by a taxable person in one member state to another taxable person in another member state and transported from the seller's member state to that of the purchaser.

HMRC said the conditions for zero rating were not satisfied and issued an assessment to collect the underpaid tax.

The First-tier Tribunal found that E did not account for VAT in Spain, that the documents relating to the removal of the goods were forgeries, that the taxpayer had not carried out sufficient checks on E, and that there was no evidence to show the goods had left the UK. The transactions formed part of a tax avoidance scheme and zero rating should not apply.

The taxpayer appealed to the Upper Tribunal.

Decision:

The judges said that it would have been enough for the taxpayer to show that the goods had reached Ireland and were acquired there, but the First-tier Tribunal had found that the taxpayer had not done this. The taxpayer had not provided evidence to show that the goods had left the UK, nor had it taken steps to ensure that it did not become involved in tax evasion by another trader.

The Upper Tribunal decided the First-tier Tribunal had reached the correct conclusion and dismissed the taxpayer's appeal.

Comments - The Upper Tribunal began by looking at whether the FTT had applied the law correctly. The taxpayer had argued that whilst the goods may not have reached Spain the goods actually left Northern Ireland and ended up in Ireland. The Upper Tribunal noted that the FTT had made an error in this respect, in that it would have been sufficient to prove the goods were subject to acquisition in Ireland. However, the taxpayer had failed to do this and therefore the law was ultimately applied correctly. Turning to the FTT's conclusion that the goods did not reach Spain the Judge was of the opinion that the taxpayer had not discharged the burden of proof. The taxpayer's argument that the burden of proof had been wrongly imposed on him was also dismissed. Turning to Teleos the Upper Tribunal was satisfied the FTT understood the Teleos tests, made relevant findings of fact and came to the right conclusion. Despite some minor differences in opinion from the earlier Tribunal the Upper Tribunal conclude it had reached the correct conclusion.

MacMahon (trading as Irish Cottage Trading Co) v CRC, Upper Tribunal

Supplies are not exempt

The taxpayer, a qualified dental nurse, established an employment business in 1976. Her principal activity was the supply to dentists of temporary dental nurses. This comprised about 97% of her turnover; the balance consisted of commission on the recruitment of permanent staff.

Between 1 January 1985 and 31 December 1996, the taxpayer added VAT to the amount charged to the dentists. She subsequently determined that the supplies were exempt, under VATA 1994, Sch 9 group 7 item 2 'the supply of any services consisting in the provision of medical care …' and made a late claim for overpaid output tax. HMRC refused the repayment on the grounds that the supplies were standard rated, and therefore no repayment was due. The First-tier Tribunal agreed with the Revenue, so the taxpayer appealed.

Decision:

The Upper Tribunal said that the taxpayer supplied staff to dentists who then assumed responsibility for directing the nurses as to what they should do. The dentists, not the taxpayer, supplied medical care to the patients. The taxpayer had no relationship with the patients. The First-tier Tribunal's conclusion that the supply was not exempt was correct.

The taxpayer's appeal was dismissed.

Comments - The Upper tribunal agreed with HMRC finding it was not rational to conclude that the taxpayer made supplies of medical care when it is accepted the nurses and auxiliaries were under the control of the dentist especially as the taxpayer did not control or even know what duties they were undertaking. Accordingly the taxpayer's appeal was dismissed. An interesting footnote at the end of the decision refers to the taxpayer's attempts to amend the grounds of appeal. This request was to argue (should they lose on the liability point) that VAT was only due on the commission element as based upon the recent Reed Employment Tribunal case. However permission for this was refused on the basis the argument is not an added ground of appeal but a completely different claim.

Moher v CRC, Upper Tribunal

Storage facilities

A company (U) provided storage facilities in the form of steel units in a secure compound at a site in Somerset. HMRC issued a ruling that U was required to account for VAT on its receipts. U appealed, contending that it was supplying a licence to occupy land.

Decision:

The Upper Tribunal rejected this contention and upheld HMRC's ruling, declining to follow the First-tier Tribunal decision in D Finnamore (t/a Hanbridge Storage Services) v HMRC, [2011] UKFTT 216 (TC); [2011] SFTD 551, TC01081 (which the company had cited as an authority). Judge Sinfield held that U was making a single supply of storage services, rather than a licence to occupy land.

Comments - The Upper Tribunal has reversed the First-tier decision, and has upheld HMRC's view that the company was making a single supply of taxable storage services, and was not supplying a

licence to occupy land. The similar case of Finnamore is currently awaiting hearing by the Upper Tribunal: it is not yet clear whether this will still proceed to a separate hearing, or whether it will be settled by agreement. There seems to be very little difference in the facts of the two cases.

Note: With effect from 1 October 2012 the grant of facilities for the self-storage of goods is, subject to some exceptions, excluded from the exemption for supplies of land by para.(ka) of Group 1. VAT Information Sheet 14/12 provides further guidance.

HMRC v UK Storage Company (SW) Ltd (Upper Tribunal)

Partial exemption special method

A company (L) supplied taxable self-storage services from several buildings, and also made some exempt supplies of insurance. It formed the opinion that the standard method of apportioning its input tax based on turnover did not attribute a sufficient proportion of the input tax incurred on its overheads to its taxable supplies. It applied for permission to use a special method of attributing its input tax, which would be based on floor space, and under which 99.98% of the input tax relating to its buildings would be attributed to its taxable supplies (rather than 94% under the standard method). HMRC rejected the application.

Decision:

The tribunal allowed L's appeal. Judge Sinfield observed that L 'uses the goods and services supplied to it in connection with the construction, maintenance and operation of its stores almost exclusively for the purpose of making supplies of storage'.

Comments - HMRC rejected the company's application for permission to use a special method, based on floor space, for attributing its input tax. However, the First-tier Tribunal allowed the company's appeal. Judge Sinfield's decision is worth reading in full and citing in similar disputes with HMRC.

Lok'nstore Group PLC v HMRC TC2266

Disregard for the facts

After being made redundant from the NHS, the taxpayer set up a management services company. She registered for VAT and applied to join the flat rate scheme in the management consultancy sector which attracted VAT at 12.5%. As time went on she found that this was the wrong sector and she should have opted for “business services not listed elsewhere”, which had a rate of 11%. She informed HMRC and sent a voluntary disclosure form to claim repayment of overpaid VAT for the periods where VAT had been paid at the management consultancy rate.

A VAT officer agreed to the revised rate but said that no claims could be accepted for past overpayments because the flat rate scheme was self assessing. It was therefore the taxpayer's responsibility to get it right.

The taxpayer appealed.

Decision:

The First-tier Tribunal said the taxpayer's original choice of sector for the flat rate scheme was reasonable at the time it was made. Furthermore, "a decision which is reasonable when it is made cannot be rendered unreasonable in the light of subsequent events", even if those future events turned out to be wrong.

The tribunal said that the VAT officer's assertion that it was not HMRC policy to backdate percentage changes had been made without taking into account whether the taxpayer's original choice was reasonable. This was a misapplication of the policy.

The tribunal could not know what conclusion the officer would have reached had she considered the facts. For this reason, the taxpayer's appeal was allowed.

Comments - Explaining the tribunal's decision, Neil Warren, independent VAT consultant, said it was how HMRC dealt with the taxpayer's request to reduce her flat rate sector retrospectively that had led to the appeal being allowed. They had not considered whether her initial choice was reasonable but just rejected it without thought. "Had HMRC considered the issues properly," he said, "but reached the same decision to reject the taxpayer's claim for a rebate, the taxpayer would almost certainly have lost the case because her original choice was reasonable."

AML Consulting TC2151

Polycarbonate panels for conservatory roofs

A company (P) supplied polycarbonate panels and radiation strips for conservatory roofs. HMRC issued a ruling that these supplies were standard rated. P appealed, contending that they qualified for the reduced rate under VATA 1994 Sch 7A Group 2.

Decision:

The tribunal accepted this contention and allowed the appeal, finding that the products achieved 'a demonstrable reduction in heat loss', and holding that they qualified as insulation for roofs, within Note 1(a). Sir Stephen Oliver held that Note 1(a) was not restricted to 'panels to be attached to existing roofs', but included 'all types of roofing insulation including those designed for use as a roof or as component parts of a roof'.

Comments - VATA 1994 Sch 7A Group 2 provides that the installation of 'energy-saving materials' may qualify for the reduced rate of 5%. Group 2 Note 1(a) provides that 'insulation for walls, floors, ceilings, roofs or lofts' falls within the definition of 'energy-saving materials'. The First-tier Tribunal upheld the company's contention that the polycarbonate panels and radiation strips which it supplied were within this definition and qualified for the reduced rate.

Pinevale Ltd v HMRC TC2283

Transferring VAT registration

K ran a takeaway food business as a sole trader until, in 2005 he set up a company, KT, of which he was sole director, to take over the enterprise. Following a visit to the premises, HMRC concluded that takings had been underdeclared and determined that K should have been VAT-registered from December 2002. HMRC assessed K to VAT for the period from December 2002 to November 2005, and the company to VAT for the period from December 2005 to September 2008.

K and the company appealed. The First-tier Tribunal decided that the assessments were valid, so the taxpayers appealed. They claimed that the First-tier Tribunal had made errors in law by not explaining why the assessments were within the time limits and also in deciding that the company was liable for VAT when its turnover was below the registration threshold.

Decision:

The Upper Tribunal said that HMRC had clearly notified the taxpayer of the tax due from him and that the assessments were made in time. With regard to the company's VAT status, it took over K's business as a going concern; VATA 1994, s 49 provided that the transferee is treated as having carried on the business before as well as after the transfer. This meant that taxable supplies made by the transferor were treated as made by the transferee when calculating whether or not the transferee should register for VAT. At the time of the transfer, K was liable to be VAT-registered, therefore so was the company.

The taxpayers' appeal was dismissed.

Comments - VAT assessments should be made within the time limits set out in VATA 1994 s 73(6) (now, broadly, not more than two years after the end of the prescribed accounting period, or one year after the evidence of facts sufficient to justify the making of the issued within the statutory time assessment comes to the knowledge of HMRC). Here, the Upper Tribunal decided that the assessment had been issued within the statutory time limit.

Khan (trading as Khan Tandoori II) and another v CRC, Upper Tribunal

Change in treatment of transfers of a going concern

When the assets of a business (or part of a business) are transferred as a going concern, subject to certain conditions no supply of those assets takes place for VAT purposes. For this to happen, the purchaser must have the intention of using those assets to carry on the same kind of business as the seller. This is equally the case where the business is that of property development or property rental, and the asset sold is the property, but it can sometimes be less clear when a business is being transferred in these situations.

HMRC has interpreted the law as meaning that, for there to be the transfer of a property rental or property development business as a going concern ('TOGC'), the interest in land being transferred must be the same interest as that used by the transferor in his business. It followed from this interpretation that, if what was transferred was less than the transferor's full interest in the land, then the retained interest would prevent there having been the transfer of a property business as a going concern. For example, HMRC's guidance says that where a freeholder grants a 999 year lease the freeholder's business is not transferred as a going concern because of the interest retained.

In its decision in the case of Robinson Family Limited, the Tax Tribunal disagreed with this interpretation of the law in the facts of that case. HMRC will not be appealing this decision.

Robinson Family Limited ('RFL')

RFL is a property development company which purchased a 125 year interest in a site owned by Belfast Harbour Commissioners, which it intended to develop into six units and grant sub-leases of these to third parties. The dispute between RFL and HMRC in the end concerned one unit which RFL had been negotiating to let. There was a restriction imposed by Belfast Harbour Commissioners against any sub-division of the site other than by way of the creation of sub-leases, so rather than sell its interest, RFL granted an interest of 125 years less three days to a purchaser subject to and with the benefit of the proposed letting.

HMRC relied solely on the argument that RFL could not have transferred all or part of its business as a going concern, because it did not assign the full term of its lease to the purchaser. HMRC's approach in the case reflected the guidance set out in the second bullet point in paragraph 6.3 of Notice 700/9 (April 2008): Transfer of business as a going concern:

"If you own the freehold of a property and grant a lease, even a 999-year lease, you are not transferring a business as a going concern. You are creating a new asset (the lease) and selling it while retaining your original asset (the freehold). This is true regardless of the length of the lease. Similarly, if you own a headlease and grant a sub-lease you are not transferring your business as a going concern."

The Tribunal found that, although RFL retained the headlease, that distant interest in a three day reversion and the small economic interest which it represented in no way altered the substance of the transaction. The substance of the transaction was to put the transferee business in a position where it was able to continue the previous lettings business of RFL. On this basis, the Tribunal found against HMRC.

What this means

In the light of the Tribunal's decision in the Robinson Family case, HMRC accepts that the fact that the transferor of a property rental business retains a small reversionary interest in the property transferred does not prevent the transaction from being treated as a TOGC for VAT purposes. Provided the interest retained is small enough not to disturb the substance of the transaction, the transaction will be a TOGC if the usual conditions are satisfied. In this context, the Tribunal's decision does not as such alter any other areas of HMRC's policy on TOGCs, but we are reviewing the policy on whether the surrender of an interest in land can sometimes result in a TOGC. HMRC is also reviewing whether properties which are used in a business other than property letting are affected by this change of policy.

The second bullet point in paragraph 6.3 of Notice 700/9 should be ignored, as HMRC now accept that the creation of a new asset (a lease or sub-lease) and the retention of the original asset (the freehold or a superior lease) is not automatically incompatible with TOGC treatment. The Notice will be updated in due course.

HMRC will accept that a reversion retained by the transferor is sufficiently small for TOGC treatment to be capable of applying if the value of the interest retained is no more than 1 per cent of the value of the property immediately before the transfer (disregarding any mortgage or charge).

Where more than one property is transferred at one time, this test should be applied on a property by property basis rather than for the entire portfolio.

If the interest retained by the transferor represents more than 1 per cent of the value of the property, HMRC will regard that as strongly indicative that the transaction is too complex to be a TOGC.

Example

A Ltd owns the freehold of a building valued at £1m which A Ltd rents out commercially. A Ltd sells that property rental business by granting to B Ltd a 999 year lease under which A Ltd is entitled to receive a ground rent of £100 each year. The value of that right, together with any and all other rights retained by A Ltd, is £2,000. Provided all the normal conditions are satisfied, the transaction will be a TOGC, because HMRC will regard the 0.2 per cent interest retained as too small to disturb the substance of the transaction.

The impact of the decision

HMRC accept there are situations where in the past customers did not regard a transaction as constituting a TOGC because of the guidance referred to. In some cases a building would have been sold where an option to tax had been exercised, and the relevant VAT charged and accounted for. SDLT would then have been payable on the VAT-inclusive amount. There are two questions to address where customers wish to retrospectively claim TOGC treatment on account of the Tribunal's decision in the Robinson Family.

Firstly, there is the difficulty that the relevant notification that an option to tax will not be rendered ineffective, will not have been given by the buyer to the seller. This is a legal requirement in articles 5(2A) and 5(2B) of the VAT (Special Provisions) Order 1995, and it is referred to in paragraph 11.2 of Notice 742A: Opting to tax land and buildings.

Provided the parties can satisfactorily evidence that Article 5(2B) did not apply at the time of the transaction and thus the requisite notification could have been given, HMRC will accept that the legal requirement has been complied with.

Secondly, there is the question of whether an adjustment can be made to the SDLT already paid. HMRC are considering this point and will provide further guidance on it soon.

Retrospective claims

Details of how to make any adjustments relating to previous VAT Return periods can be found in VAT Notice 700/45 How to correct VAT errors and make adjustments or claims.

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