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Contents

Personal Tax **3**

Relevant emoluments and practice prevailing 3
Unfortunate omission costs dear in NIC contributions 4
Statutory residence test – Automatic residence tests ***(Lecture P756 – 12.25 minutes)*** 5

Capital Taxes **10**

Determination of main residence 10
IHT – Non-UK Domiciled Spouses and Civil Partners ***(Lecture P758 – 16.51 minutes)*** 10

Administration **13**

Prudential Decision goes against Accountants on LAP ***(Lecture P760 – 8.35 minutes)*** 13
Validity of assessment 16
Whether judicial review application should precede appeal against residence ruling 17
Application for costs: HMRC delay in settling case 17
Approval of third party notices 18
Whether appeal settled by agreement 18
Opportunity for participants in tax avoidance schemes ***(Lecture P759 – 7.11 minutes)*** 19
Promoter sued 24
Not so careless 24
Penalty imposed at 15% 25

Business Taxation **26**

AIA in the transitional periods ***(Lecture B756 – 11.51 minutes)*** 26
Simplifying small business accounts for tax ***(Lecture B757 – 10.43 minutes)*** 28
Dancer: whether an employee 30
Salesman: whether an employee 31
Wide discretion with withdrawal of gross payment status 31
Excavation support equipment: claim for first-year allowances 32
Assessments on undeclared profits 32
Correct dividend paperwork ***(Lecture B758 –12.15 minutes/Lecture B759 –9.33 minutes)*** 33
Utilising Property losses ***(Lecture P757 – 7.50 minutes)*** 39

VAT **43**

Penalty is proportionate 43
Mail order company: cash commission to agents 44
Construction of house to be used by employee 44
VAT: application for late appeal 45
Supply was in the UK 45
Date on which VAT assessment issued 46
Floor- based method is fair 46
Input tax reclaimed on supplies received by associated company 47
Invoices allegedly issued by deregistered supplier 48
Date from which voluntary registration effective 48
Removal of threshold for an overseas business ***(Lecture B760 – 14.04 minutes)*** 49

Personal Tax

Relevant emoluments and practice prevailing

The appellant company established an employee benefit trust ("the EBT") which made certain payments to beneficiaries in 2000, 2001 and 2002. In its corporation tax returns for those periods, the appellant deducted those payments in computing its trading profits under Sch D, Case 1. It subsequently transpired, and it was common ground, that those deductions were not due as a matter of law, as they were "potential emoluments" within FA 1989 s 43(11). HMRC issued discovery assessments under FA 1998 Sch 18, para 41. The appellant appealed. The sole issue for determination was whether the return for the 2000 period was in fact "made on the basis or in accordance with the practice generally prevailing at the time when it was made", within the meaning of FA 1998 Sch 18, para 45(b).

Decision:

On its proper construction, the expression "practice generally prevailing" in FA 1998 Sch 18, para 45(b) meant that the practice had to be capable of being readily ascertained; otherwise it could not be one that was capable of general acceptance. And in order to be readily ascertainable, the practice had to have substance (in the sense of not being inchoate), and be sufficiently precise and devoid of uncertainty as to its application. In particular, such a practice would not exist if it was equivocal or dependent on the ascertainment of facts, except where the criteria for its application by reference to the facts were themselves understood with a sufficient degree of precision so as to make the practice one that could be readily applied in any given case. A practice of that nature would be readily ascertainable by interested parties in a number of possible ways. There might be a published statement of practice, concession or otherwise by HMRC. That process might be more or less formal. However, publication was not a necessary ingredient. A practice, albeit unpublished, would be equally ascertainable if it could be readily discovered from enquiry by HMRC themselves or from advice sought from a practitioner in the field, particularly where the practice arose in a specialised area. The practice had to be relatively long-standing.

A published practice was likely to be capable of being regarded as "generally prevailing" over a shorter period than one that merely became established through practice. Furthermore, in order to be generally prevailing the practice had to be capable of being identified by taxpayers when making their returns, and had to have been adapted by HMRC and generally, if not universally, by the taxpayer community. An internal practice adopted by HMRC, however precise its terms, would not be generally prevailing until such time as it could be identified with sufficient precision by taxpayers and their advisers. Communication as such was not required. As custom could arise by usage, so too a practice could become generally prevailing merely by general adoption, irrespective of any actual communication. If it encompassed a number of aspects, or included exceptions or caveats, all aspects of that practice had to be so adopted and consistently applied. In addition, the practice had to be settled and the criteria could not be subject to change depending on the particular circumstances or the facts of a particular case. Mere inactivity could, in appropriate circumstances, also give rise to a practice, but such an omission had to be capable of articulation in the same way as a positive act.

What mattered was that there was a mutual understanding to proceed in a particular way in particular defined circumstances. In the present case the appellant's advisers and HMRC shared a common misunderstanding on the interpretation of s 43. However, a common misunderstanding was not capable, of itself, of giving rise to a practice that s 43 would not be applied in those circumstances. There was a difference between what simply happened in practice and the identification, or establishment, of a particular practice. There was no evidence of HMRC having determined to adopt a practice in relation to their view of the law. Nor was there any evidence that HMRC addressed the issue. It followed that the appellant's return was not made on the basis or in accordance with the practice generally prevailing at the time. The appeal would be dismissed with respect to FA 1998, Sch 18, para 43.

Appeal dismissed.

Comments – This case looks at the practical area of the practice prevailing as a defence. The report of the case is worth noting because of the length of the decision discussing the decision even in the event of the appeal being dismissed. The expression "practice generally prevailing" in FA 1998 Sch 18, para 45(b) is examined in detail in relation to each of the words forming the expression.

Boyer Allan Investment Services Limited (formerly Boyer Allan Investment Management Limited) v Revenue and Customs Comrs TC 2235

Unfortunate omission costs dear in NIC contributions

The taxpayer had been self-employed since 1989. The business was VAT registered and had a number of employees. She had no difficulties in relation to VAT or PAYE or other direct taxes.

When she turned 60, she discovered her state pension was less than she expected and found that this was because she had not paid any class 2 National Insurance contributions.

She applied to pay the contributions so that her pension would be increased, but HMRC refused to allow this. They accepted that her failure to pay the contributions was a result of error or ignorance on her part, but said this showed a lack of due care and diligence. The taxpayer appealed.

Decision:

The First-tier Tribunal felt that the taxpayer could not be regarded as ignorant about National Insurance because she used professional advisers to prepare her accounts and returns and that a "reasonably competent accountant would have been aware of the National Insurance scheme and the obligation on self-employed earners to pay class 2 contributions". She had registered as self-employed and must have known she was supposed to pay the contributions. She had made no subsequent enquiries, though, which led the tribunal to conclude that she had failed to exercise due care and diligence.

Expressing "some regret", the tribunal dismissed the taxpayer's appeal, but noted that payment of some voluntary class 3 contributions could help make up the shortfall in her state pension.

Comments – This case seems unusual in light of the failure of the individual to pay Class 2 NICs. Most self employed individuals are well aware of the different classes of NIC that are payable as the Class 2 even at its extremely low level (just over £2 per week in recent years). This was a business which was VAT registered and with employees. The tribunal's regret with the comment about Class 3 contributions does not emphasise the limited length of time that Class 3 contributions can be made and the fact they are currently nearly 5 times as expensive per week.

C Thacker TC2367

Statutory residence test – Automatic residence tests (Lecture P756 – 12.25 minutes)

The last elements of amendment have now been applied to the draft legislation, and this new test is "ready to go". After quite a number of iterations of draft legislation, this summary looks only at the current draft legislation, and assumes no prior knowledge of the previous versions.

<u>Application of the statutory residence test</u>

The new regime will determine residence for the following tax purposes:

- Income tax
- Capital gains tax, and

As far as the residence of an individual is relevant to them, inheritance tax and corporation tax.

<u>The basic rule</u>

An individual (P) is resident in the UK in a tax year (X) if:

(a) The automatic residence test is met for that year, or

(b) The "sufficient ties" test is met for that year.

If neither of these tests is met for a year, P is not UK resident for that year.

<u>The automatic residence test</u>

The automatic residence test is split into two divisions. To meet the automatic residence test, an individual must meet at least one of the automatic UK tests, and none of the automatic overseas tests for a year. If the result is inconclusive, then the automatic residence test is not met, and the question of residence will be met only by the sufficient ties test.

<u>Automatic overseas tests</u>

In order to be UK resident the taxpayer must meet NONE of the following in the tax year, in addition to meeting AT LEAST ONE of the automatic UK tests. If any one of the following is met, the individual is NOT UK resident for the year in question.

- P was resident in the UK for one or more of the three tax years preceding year X, but the number of days in year X spends in the UK is less than 16, and P does not die in year X.
- P was not resident in the UK for any of the 3 tax years preceding year X, and P spent less than 46 days in the UK in tax year X

- P works full time overseas for year X, with no significant break in overseas work (as above), and the number of days in which P does more than 3 hours work in the UK is less than 31, and the number of days spent in the UK (other than deemed days - see below) is less than 91. (This test does not apply to international transport workers)
- P dies in year X, and P was not UK resident for either of the two tax years preceding X or P was not resident for the preceding tax year before X and the pre-preceding year was a split year by virtue of Case 1, 2 or 3, and P spent less than 46 days in the UK in year X.

Automatic UK tests

There are 4 automatic UK tests. They are:

1. P spends at least 183 days in the UK in the tax year (X)
2. P has a home in the UK for more than 90 days at which he is present for at least 30 separate days (whether consecutive or intermittent, taking any part day as a day) in year X, and
   a. While P has that home there is at least one period of 91 consecutive days throughout which P either has no home overseas or although P has homes overseas, he is not present at any of them for at least 30 separate days in year X, and
   b. At least one day of at least one of those 91 days periods falls in year X.

   Where P has more than one home in the UK, this test must be applied separately to each home, and this test is met if it is met in relation to any one of the homes.
3. P works full time in the UK for a period of 365 days, and during that period there are no significant breaks from UK work (more than 31 days taken together when P does not work at least 3 hours in the UK), and all or part of the period falls within year X, and more than 75% of the total number of days in which P works at least 3 hours are days when P works for at least 3 hours in the UK. (Does not apply to international transport workers)
4. P dies in the year, and for each of the last 3 tax years, P was resident in the UK by virtue of meeting the automatic residence test, and even if P was not UK resident in year X, the preceding year would not have been a split year, and when P died either his only home was in the UK, or he had at least one home in the UK.

Days in the UK

This follows the established practice of counting days in the UK as days when the individual is in the UK at midnight.

A day is excluded from the day count if:

- The individual arrives in the UK as passenger, and
- leaves the UK the next day, and
- between his arrival and departure he only undertakes activities that are related to his passage through the UK.

This is commonly referred to as the transit rule.

Days would also be included if the stay in the UK was due to exceptional circumstances. Days spent in the UK may be disregarded if the individual's presence in the UK is due to exceptional circumstances beyond their control. This will usually only apply to events that occur while an individual is in the UK and which prevent them from leaving the UK. Exceptional circumstances will normally apply where an individual has no choice concerning the time they spend in the UK or in coming back to the UK. The situation must be beyond the individual's control. The maximum amount of time spent in the UK in any tax year that may be disregarded due to exceptional circumstances is 60 days. This limit applies if there is one event or several events in the same tax year. Days spent in the UK over the 60-day limit count for the purposes of the SRT.

There is also a deeming rule in relation to the number of days spent in the UK, but this is only relevant where the automatic residence tests are inconclusive and the taxpayer is looking at the sufficient ties tests. The deeming rule is not therefore dealt with here.

'Work' for the purposes of SRT

Work takes its everyday meaning. If you are an employee, work covers the activities you carry out in the performance of your duties. If you are self-employed it covers the activities you carry out in the course of your trade. A voluntary post for which you have no contract of service does not count as work for the purposes of the statutory residence test.

What else is counted as time spent working?

Your time spent working includes:

- instances where your employer instructs you to stay away from work, for example while serving a period of notice while you remain on the payroll;
- travelling time; where
  - the cost of the journey is met by your employer
  - if you are self-employed, the cost is a deductible expense for income tax purposes, or
  - to the extent that you work during the journey
- job-related training;
  - paid for by your employer, or,
  - if you are self-employed, where the cost is an allowable deduction against your profit for income tax purposes.

Being on-call or stand-by may count as time spent working depending on the conditions of your employment and the nature of your duties.

'Significant break' from work

You will have a significant break from either UK work or work overseas if at least 31 days go by and not one of those days is a day on which you:

- work for more than three hours, or
- would have worked for more than three hours, but you do not do so because you are on annual leave, sick leave or parenting leave.

A break of more than 30 days (other than for sick or annual or parenting leave) will mean that you cannot qualify for full-time work overseas under the third automatic overseas test neither can you qualify for full-time work in the UK under the third automatic UK residence test

Examples in the guidance

The draft guidance includes a number of scenarios illustrating the automatic residence tests. Although the guidance is not final, the examples are worth being aware of.

Example 1 - 91 days

Stan has lived in Australia all his life. In June 2012 he takes a holiday in London and likes it so much he decides to emigrate to the UK. He spends the next few months preparing for the move. He sells his Australian house (his only home) on 10 January 2014 and arrives in the UK on 25 January 2014. He finds a flat in London and moves in on 1 February 2014. The London flat is now his only home and he lives there for a year.

During tax year 2013-14 Stan is present in his Australian home on 250 days, and he is present in his London flat on 55 days.

There is a period of 91 consecutive days falling partly within tax year 2013-14 (the period starting on 1 February 2014) when Stan has a home in the UK and no home overseas (it does not matter that the period when these conditions are met is in fact longer than 91 days). During tax year 2013-14 Stan is present in that UK home on at least 30 days.

As Stan does not meet any of the automatic overseas tests, he is resident under the second automatic UK test for tax year 2013-14.

Example 2 – 91 days

Edith has had a home in Cheshire for many years. It is her only home. Edith retires towards the end of tax year 2014-15 and decides to use her retirement lump sum to see the world. During tax year 2015-16 she takes three long holidays, visiting 22 different countries. She moves around and does not establish a home overseas. Between trips she returns briefly to her Cheshire home, and is present there on 41 days in tax year 2015-16.

There is a period of 91 consecutive days, falling partly within tax year 2015-16 when Edith has a home in the UK and no home overseas (it does not matter that the period when these conditions are met is in fact longer than 91 days). Edith is present in her UK home on at least 30 days during tax year 2015-16.

As Edith does not meet any of the automatic overseas tests, she is resident under the second automatic UK test for tax year 2015-16.

Example 3 – 30 day rule

Fatima has had four UK homes for several years. In the tax year in question she spends 15 days at her home in Swansea, a further 20 in her in Loch Lomond cottage, 29 in her London flat and 29 in her Newcastle flat.

Although Fatima has spent more than 91 days in total in those UK homes, as she was not present in any individual home for at least 30 days, she will not meet this automatic residence test.

Example 4 – 30 and 91 day rules together

Jane has a home in the UK throughout tax year 2013-14 and tax year 2014-15. She is present in that home for 30 days during tax year 2013-14.

Jane acquires an overseas home on 1 March 2014 and is present there for 30 days in tax year 2013-14.

She meets the second automatic UK test for tax year 2013-14. Although there is a period of 91 consecutive days, falling partly within year 2013-14, when Jane had both a UK home and an overseas home, and the 30-day rule is met in relation to both, there is also a period of 91 consecutive days when she didn't have an overseas home; the period from 6 April 2013 to 28 February 2014.

Example 5 – UK working

Henri travels to the UK on 1 July 2013 to start a new job on the following day. His posting finishes on 1 July 2014 and he leaves the UK on 6 August 2014, 400 days after he arrived in the UK. Over the 365 day period to 30 June 2014 Henri met the full-time work criteria and has not taken a significant break from his UK work during this period.

Between 6 April 2014 and 1 July 2014 Henri works for over three hours on 65 days, but only 45 (69%) are days on which he works for over three hours in the UK. Henri is therefore resident under the third automatic residence test for tax year 2013-14 but not for 2014-15.

(Example 6 not used)

Example 7 – exceptional circumstances

Pete came from the USA on a temporary assignment to work for his employer at its UK base. He arrived on 3 June and planned to return to the USA on 9 November (139 days).

Unfortunately, he was involved in a serious car accident on 7 November, and was unable to fly home again until discharged from hospital. He returned home immediately he was discharged on 29 December.

Pete was in the UK for a total of 189 days, but the days he spent in the hospital would be considered as exceptional circumstances. Pete would only be considered to have spent 137 days in the UK for the purposes of applying the statutory residence test.

Contributed by Rebecca Benneyworth

Capital Taxes

Determination of main residence

A married couple purchased a property in 1999. They let it to tenants until August 2004. In October 2004 they submitted an election under TCGA 1992 s 222(5) that the property should be treated as their main residence. In March 2005 they sold the property at a profit. Subsequently HMRC issued assessments on the basis that the property had not qualified for relief under s 222. The couple appealed. At the hearing of the appeal, HMRC stated that they 'accepted that the property was a residence used by the taxpayers' but contended that 'the nature and extent of the use made of the property did not permit of the conclusion that it was their main residence'.

Decision:

The First-tier Tribunal (FTT) allowed the couple's appeal. Judge Geraint Jones held that 'the respondents can challenge the assertion made by a taxpayer that a particular property is a residence used/occupied by him, but once it is proved or accepted that a particular property is a residence used/ occupied by the taxpayer, the respondents cannot argue that as a matter of fact and degree that residence is not the taxpayer's main residence if an election has been made in favour of that property under section 222(5)'.

Comments - TCGA 1992 s 222(5) provides that where a taxpayer has more than one residence, he may nominate which one is his main residence for the purpose of claiming private residence relief from capital gains tax. In this case, HMRC raised the novel contention that, although the property in question had been a residence of the appellants, it could not be treated as their main residence. The FTT rejected HMRC's contention and reaffirmed the principle that even if a taxpayer spends more time in one of his two residences, he can still nominate the other residence for the purpose of the relief. Judge Geraint Jones' comments are self-explanatory. A detailed article and lecture on this case will follow in March.

Mrs PA Ellis v HMRC (and related appeal) TC2426

IHT – Non-UK Domiciled Spouses and Civil Partners (Lecture P758 – 16.51 minutes)

The current position
The inheritance tax (IHT) legislation provides an unlimited exemption for transfers between spouses (or civil partners) both of whom are domiciled in the UK (IHTA 1984, s 18(1).

However, there is a restriction on the exemption where the *recipient* spouse is not domiciled in the UK. IHTA 1984, s 18(2) states:

> “(2) If, immediately before the transfer, the transferor but not the transferor's spouse or civil partner is domiciled in the United Kingdom the value in respect of which the transfer is exempt (calculated as a value on which no tax is chargeable) shall not exceed £55,000 less any amount previously taken into account for the purposes of the exemption conferred by this section.”

The above limit of £55,000 has been in place since for transfers since 9 March 1982.

Points to note:

- Any lifetime gifts in excess of this exemption figure will normally constitute a potentially exempt transfer (PET). For transfers on death, any excess over the £55,000 limit potentially reduces the deceased's nil rate band, and can give rise to an IHT liability.

- The above restriction only applies if the *transferee* spouse is non-UK domiciled. Thus there is no limit in the spouse exemption if:

  - Both spouses are domiciled in the UK; or
  - Both spouses are domiciled abroad; or
  - The *transferor* spouse is domiciled abroad but the *transferee* spouse is domiciled in the UK.

- There is a widened definition of domicile for IHT purposes in IHTA 1984, s 267, which applies in the context of the spouse exemption. Thus if the transferee spouse is non-UK domiciled under general law but domiciled in the UK for IHT purposes, the unrestricted spouse exemption is generally available.

HMRC's guidance (at IHTM11033) includes two examples:

<u>Example 1 – Restricted exemption used during lifetime</u>

'In 1998, Mr Allsop, who was domiciled in the UK transferred £200,000 to Mrs Allsop, who was not domiciled in the UK. Of this transfer, £55,000 is exempt under IHTA1984/S18 (2), and £145,000 is a PET and assumed to be exempt. Mr Allsop dies in 2007 and leaves all his property to his wife, who remains domiciled outside the UK. Even though Mr Allsop has survived for 7 years after making the transfer, the limited exemption under IHTA1984/S18 (2) has all been used and is not available on his death.'

<u>Example 2 – Transferor spouse 'deemed' domiciled in the UK</u>

'In 1998 Mr Costa transfers a UK property worth £500,000 to Mrs Costa. Both are domiciled outside the UK. Exemption under IHTA1984/S18 (1) is available in full. In 2006 Mr Costa is deemed to be domiciled in the UK and a year later gives £100,000 to his wife, who remains domiciled outside the UK. The limited exemption under IHTA1984/S18 (2) is not then available because the amount of exemption already given under IHTA1984/S18 as a whole exceeds £55,000.'

Doubts have previously been expressed as to whether the restricted spouse exemption was compatible with EU law, on the basis that it discriminated against non-UK domiciled spouses. This may have been a factor in the Finance Bill 2013 changes mentioned below. However, some concern will probably remain on this discrimination point even if the changes become law.

The new position (Draft Finance Bill 2013)

The government announced in Budget 2012 that it intended to increase the spouse exemption of £55,000 in respect of transfers to a non-UK domiciled spouse or civil partner. The government also stated its intention to allow individuals who are domiciled outside the UK and who have a UK-domiciled spouse or civil partner to elect to be treated as domiciled in the UK for IHT purposes. Those announced changes were subsequently included in the draft Finance Bill 2013 clauses published on 11 December 2012.

Increase in £55,000 exemption limit

The lifetime limit for exempt transfers is to be increased, from £55,000 to the IHT exemption limit at the time of the transfer. Thus, if no election is made to be treated as UK domiciled (see below), the overseas assets of the non-UK domiciled spouse will generally continue to be excluded property for IHT purposes, and transfers from their spouse or civil partner will be subject to the increased 'capped' limit.

Election to be treated as UK domiciled for IHT purposes

The effect of making the new election in writing to HMRC will broadly be to avoid a possible IHT charge on the first death. However, the worldwide estate of the surviving spouse will be liable to IHT on the second death.

An election made while both individuals are alive will take effect from the date the election is made. Elections following a death must be made within two years of the death, where it occurs on or after 6 April 2013.

Elections will be irrevocable, and will continue to apply while the electing individual continues to remain resident in the UK. However, an election will cease to have effect if the electing individual is resident outside the UK for more than three consecutive tax years. Thus overseas assets may cease to be liable to IHT once more, subject to the person not being actually or 'deemed' domiciled in the UK at that point.

The above election is to be ignored in determining a person's domicile within the deeming provisions of s 267, and s 267 is to be ignored in determining whether a person is eligible to make an election by reason of their domicile status. The election will not apply for the purposes of other taxes such as income tax, including the remittance basis.

The increased exemption limit is to have effect for transfers of value made on or after 6 April 2013. The first opportunity to make an election will be the date of Royal Assent of Finance Act 2013 (nb note the above comments regarding elections following a death).

Contributed by Mark McLaughlin

Administration

Prudential Decision goes against Accountants on LAP (Lecture P760 – 8.35 minutes)

In 2004, an international firm of chartered accountants (the firm) devised a marketed tax avoidance scheme (the scheme), which they disclosed to the Commissioners for Inland Revenue (HMRC). At about that time, a group of companies of which the claimant companies formed part (the group) instructed the firm to advise them in connection with overseas holdings and the firm identified that the scheme could be adapted for their benefit. Thereafter, the group implemented the scheme, which involved a series of transactions (the transactions). The inspector of taxes (the inspector) considered it necessary to look into the details of the transactions and served notices, pursuant to s 20(B)(1) of the Taxes Management Act 1970, on the claimant companies, giving them the opportunity to make available specified classes of documents in relation to the transactions. The claimants disclosed many of the documents requested, but refused to disclose certain documents (the disputed documents) on the ground that they were entitled to claim legal advice privilege (LAP) in respect of them. The inspector obtained authorisation from the first respondent to require the claimants to disclose the disputed documents and accordingly served notices pursuant to ss 20(1) and (3) of the Act on the second and first claimant companies respectively, requiring disclosure of the disputed documents. The claimants applied for judicial review, challenging the validity of the notices on the ground that they sought disclosure of documents which related to the seeking and giving of legal advice in connection with the transactions, which were therefore said to be excluded from the disclosure requirements of s 20 of the Act by virtue of LAP. That application was rejected on the ground that, although the disputed documents would have attracted LAP if the advice in question had been sought from, and provided by, a member of the legal profession, no such privilege extended to advice, even if identical in nature, provided by a professional person who was not a qualified lawyer (see[2009] All ER (D) 142 (Oct)). That decision was subsequently upheld by the Court of Appeal (see[2010] All ER (D) 132 (Oct)). The claimants appealed to the Supreme Court.

Issue:

The issue for determination was whether legal advice privilege (LAP) extended, or ought to be extended, so as to apply to legal advice given by someone other than a member of the legal profession and, if so, how far LAP thereby extended, or ought to be extended, and more specifically, whether LAP ought to attach to communications passing between chartered accountants and their client in connection with expert tax advice given by the accountants to their client, in circumstances where there was no doubt that LAP would attach to those communications if the same advice was being given to the same client by a member of the legal profession. The claimants submitted, amongst other things, that, based on the proposition that LAP was a common law right created by judges which should be applied and, if necessary, extended so as to accord with the principles which underlay and justified the right, LAP did attach to such communications. Given that LAP was justified by the rule of law, and that it existed for the benefit of a client who sought and received legal advice, there was no principled basis upon which it could be restricted to cases where the adviser happened to be a member of the legal professions, as opposed to a qualified accountant. Consideration was given, amongst other things, to ss 20, 20A 20B and 20BA of and para 5 of Sch 1AA to the Act.

Decision:

The appeal would be dismissed (Lord Sumption and Lord Clarke dissenting).

It was universally believed that LAP only applied to communications in connection with advice given by members of the legal profession. It ought not to be extended to communications in connection with advice given by professional people other than lawyers, even where that advice was legal advice which that professional person was qualified to give.

What the court was being asked to do was a matter for Parliament rather than for the judiciary.

First, the consequences of allowing the appeal were hard to assess and would be likely to lead to what was a clear and well understood principle becoming an unclear principle, involving uncertainty. It might be necessary for a court to delve into the qualifications or standing and maybe into the rules and disciplinary procedures of a particular group of people to decide whether the group constituted a profession for the purpose of LAP. There would accordingly be room for uncertainty, expenditure and inconsistency if the court had to decide such an issue.

Secondly, the question whether LAP should be extended to cases where legal advice was given from professional people who were not qualified lawyers raised questions of policy which ought to be left to Parliament. The general implications of extending the generally understood limits of LAP could have significant implications which would be very difficult to identify, let alone to assess and should be considered through the legislative process, with its wide powers of inquiry and consultation and its democratic accountability. Further, despite thinking it appropriate to extend LAP to certain other professions such as patent attorneys, trade mark agents and licensed conveyancers, Parliament had apparently chosen not to extend LAP to accountants giving tax advice.

Thirdly, Parliament had enacted legislation relating to LAP, which, at the very least, suggested that it would be inappropriate for the court to extend the law on LAP as proposed. Parliament had, on three occasions, thought it appropriate to extend LAP and had done so on the basis that LAP was limited to advice given by members of the legal profession.

On the facts, there was a strong case in terms of logic for allowing the appeal. LAP was conferred for the benefit of the client and could only be waived by the client; it did not serve to protect the legal profession. In the light of that, it was hard to see why, as a matter of pure logic, that privilege should be restricted to communications with legal advisers who happened to be qualified lawyers, as opposed to communications with other professional people with a qualification or experience which enabled them to give expert advice in a particular field. However, where a common law rule was valid in the modern world, but it had an aspect or limitation which appeared to be outmoded, it was by no means always right for the courts to modify the aspect or remove the limitation. In any such case, the court had to consider whether the implications of the proposed modification or removal were such that it would be more appropriate to leave the matter to Parliament. The court also had to consider whether the aspect or limitation in question had led to problems, and whether it had been assumed, approved or disapproved impliedly or expressly by Parliament. If Parliament had unequivocally endorsed the aspect or limitation then the courts should not alter it.

If the appeal were to have been allowed, the court would have been extending LAP beyond what had, for a long time, been understood to have been its limits. It would have been extending it considerably, as the issue could not simply have been treated as limited to the question as to whether tax advice given by expert accountants was covered by LAP. Whilst that was the specific question between the parties, it was just a subset of a much larger set. To have concentrated on tax advice given by accountants would have been wrong, because it would ineluctably have followed from accepting the claimants' argument that legal advice given by some other professional people would also have been covered.

R (on the application of Morgan Grenfell & Co Ltd) v Special Comr of Income Tax [2002] 3 All ER 1 considered; Three Rivers District Council v Governor and Company of the Bank of England [2005] 4 All ER 948 considered.

Decision of court of appeal [2010] All ER (D) 132 (Oct) Affirmed.

Comments- The Supreme Court has refused to extend legal professional privilege (LPP) to accountants in the long-running legal case between Prudential and HMRC.

A reminder of the background: Prudential originally sought a Judicial Review of HMRC information notices concerning documents from its tax advisers that the insurance company said should be subject to LPP. HMRC won the decision before the Special Commissioners in 2009, and again at the Court of Appeal the following year.

As currently defined, LPP only applies to clients of lawyers and includes any tax advice they provide, even though the majority of tax advice is provided by accountants, the ICAEW contended. Its position is that Parliament should amend the law to extend privilege to accountants. The lawyers, of course, were not so keen to erode their statutory advantage in this area.

Because of the importance of the case, both the ICAEW and the Law Society intervened in the proceedings to advance the claims of their members, with the accountants supporting a further appeal by Prudential to the Supreme Court.

The court's detailed judgment has not yet been published, but after hearing of the verdict, ICAEW chief executive Michael Izza commented, "The current position on LPP is unprincipled and anti-competitive for individuals and businesses who we believe should be able to seek the best professional advice upon the same terms whether from lawyers, accountants or indeed other appropriately qualified professionals."

With the Legal Services Act paving the way for multi-disciplinary practices, Izza added that it was "a matter of urgency" for Parliament to resolve how LPP would be addressed within firms offering combined accountancy and legal services.

"Though it's undeniably disappointing news, the Supreme Court's decision doesn't mean our fight is over," Izza blogged, adding that two of the seven Supreme Court judges favoured the accountants' arguments.

"The Supreme Court believes that issues of extending legal advice privilege are a question for Parliament. In other words, the way to resolve this issue is by statute. So for us, the work on getting equal treatment for our clients moves to the political field, rather than the legal courts."

HMRC welcomed the Supreme Court decision as the latest in a series of important legal rulings which make it very clear that the principle of Legal Professional Privilege applies purely to advice given by qualified lawyers.

A spokesman commented: "The right to see tax advice provided by accountants plays an important role in our work against tax avoidance, helping to establish the right tax position. Today's decision is a good one for the majority of taxpayers who follow the letter and spirit of the law. Tax avoiders should not be able to conceal their true intentions or arrangements from us."

Validity of assessment

An individual (C) had entered into an avoidance scheme in 2006/07. The scheme was broadly similar to that which was subsequently held to be ineffective in Drummond v HMRC, [2009] STC 2206. In July 2009 HMRC issued a discovery assessment under TMA 1970 s 29. C appealed, contending that the assessment had been issued outside the statutory time limit. The First-tier Tribunal accepted this contention and allowed the appeal. Judge Nowlan held that there had been a discovery within TMA 1970 s 29(1), but that the information provided with C's return was sufficient to show that 'no officer could have missed the point that an artificial tax avoidance scheme had been implemented'. Any officer reviewing the return 'should then have proceeded to seek some guidance from colleagues' and an enquiry should have begun before the closure of the 'enquiry window' on 31 January 2009.

Decision:

The Upper Tribunal upheld this decision. Norris J held that 'on the basis of the information made available to him before the closure of the enquiry window, an officer would have been reasonably expected to have been aware of the insufficiency of tax such as to justify an assessment'. Accordingly, the assessment was not authorised by TMA 1970 s 29(5).

Comments - TMA 1970 s 29(1) provides that an HMRC officer make an assessment where he discovers that any income has not been assessed, subject to certain conditions. TMA 1970 s 29(5) provides that where an enquiry has not been opened within the statutory time limit, such an assessment may only be issued where the officer 'could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation'. The First-tier Tribunal held that HMRC had made a 'discovery' within s 29(1), but that the conditions imposed by s 29(5) were not satisfied, so that the assessment was invalid. The Upper Tribunal upheld this decision.

HMRC v Dr M Charlton (and related appeals) Upper Tribunal

Whether judicial review application should precede appeal against residence ruling

HMRC issued a discovery assessment charging tax of more than £10,000,000 on an individual (D) who had declared that he had not been resident in the UK in 1999/2000. D appealed against the assessment, and applied for judicial review, contending that Revenue pamphlet IR20 had led him to believe that he would not be treated as resident in the UK. Judge Bishopp directed that the statutory appeal should be heard before the application for judicial review. D appealed to the CA, contending that the application for judicial review should be heard first.

Decision:

The CA unanimously rejected this contention. Tomlinson LJ observed that 'there is an underlying factual dispute between the taxpayer and HMRC which can only be conclusively resolved by the First-tier Tribunal. Proceeding first with the judicial review claim risks delay and the ultimately fruitless expenditure of costs. The statutory appeal has the potential finally to resolve the dispute concerning the taxpayer's residence status for the relevant year, and thus his liability to pay further tax.' Accordingly, 'the judicial review claim should be stayed whilst the statutory appeal proceeds to a determination'.

Comments - The CA upheld HMRC's contention that it would be more convenient to hear the statutory appeal before the application for judicial review.

P Daniel v HMRC EWCA

Application for costs: HMRC delay in settling case

A company (S) claimed a deduction for sponsorship payments to a major rugby club. In May 2008 HMRC began an enquiry into S's return, and in March 2010 they issued a notice of amendment rejecting the claim on the grounds that the expenditure was not wholly and exclusively for the purpose of S's business. S appealed. In January 2012 HMRC decided not to contest the appeal. S applied for costs, contending that HMRC had acted unreasonably in not settling the case sooner.

Decision:

The First-tier Tribunal accepted this contention. Judge Raghavan observed that HMRC had received S's witness statements in June 2011, and held that HMRC should have settled the case within 28 days of receiving the witness statements. Accordingly he directed that HMRC should pay S's costs from 20 July 2011.

Comments - The substantive issue in this case concerned sponsorship payments which the company had made to a large and successful rugby club, which was promoted to the Premiership shortly after the year to which the appeal related. HMRC frequently rejects claims for a corporation tax deduction for sponsorship payments made by family companies to small sports clubs, on the basis that there is a dual purpose to the expenditure, as the company's shareholders are directly involved in the club.

It is, however, unusual for HMRC to reject a claim to deduct sponsorship payments made to a large professional club, as they did here. It is therefore not surprising that HMRC eventually conceded the case rather than take it to a Tribunal hearing. The First-tier Tribunal held that HMRC should have settled the case within 28 days of receiving the company's witness statements, and awarded costs accordingly.

Southwest Communications Group Ltd v HMRC TC2370

Approval of third party notices

The Australian Taxation Office made a request to HMRC for assistance in accordance with the exchange of information procedure under Article 27 of the Double Taxation Agreement between the UK and Australia. HMRC applied to the First-tier Tribunal, under FA 2008 Sch 36 para 3, for approval of the issue of certain third party notices under FA 2008 Sch 36 para 2.

Decision:

The First-tier Tribunal approved the notices. Judge Berner held that the effect of FA 2006 s 173(8) was that Australian tax was 'relevant foreign tax' within FA 2008 Sch 36 para 63. Furthermore, the issue of the notices did not contravene the European Convention on Human Rights, since a taxpayer who was aggrieved by a notice under Sch 36 could apply for judicial review.

Comments - FA 2008 Sch 36 para 2 provides HMRC officers with the power to obtain information and documents from third parties. FA 2008 Sch 36 para 3 provides for the approval of such notices by the First-tier Tribunal. Solicitors acting for some of the taxpayers potentially affected by these notices had contended that the issue of the notices would contravene the European Convention on Human Rights. The First-tier Tribunal rejected this contention and upheld the issue of the notices.

Application by HMRC (re Certain Taxpayers) TC2424

Whether appeal settled by agreement

HMRC began an enquiry into the 2004/05 tax return of a sole trader (E). A meeting took place between E and an HMRC officer in February 2007. The officer considered that £19,400 which E had claimed as expenses should be included in his profits, and subsequently issued a closure notice to this effect. E appealed, contending that the £19,400 had been paid to subcontractors who had carried out work on his computers. E attended a further meeting, with a different HMRC officer (D), in January 2009. D formed the opinion that, at this meeting, E had agreed that the £19,400 should be included in his profits. E disagreed, and wrote to HMRC in February 2009 confirming his disagreement. E subsequently applied to the First-tier Tribunal to have his appeal set down for hearing. HMRC opposed the application, contending that the appeal had already been agreed under TMA 1970 s 54.

Decision:

The First-tier Tribunal rejected HMRC's contention, granted E's application, and allowed his appeal. Judge Radford found that E had never signed any agreement under s 54, and that E had paid the £19,400 for work on his computers. She also found that E 'was misled to a degree by (D) and was of the belief that the invoices had been accepted'.

Comments - This case appears to show HMRC in an unusually poor light. On the facts as found by Judge Radford, the appellant here had paid £19,400 for work to his computers, which was a legitimate business expense. However HMRC were not satisfied with the appellant's evidence, and sought to treat the £19,400 as undeclared profits. An HMRC officer tried to persuade the appellant to agree to this, and issued a letter purporting to be an agreement under TMA 1970 s 54. The appellant replied confirming that he did not agree that the £19,400 should be treated as additional profits. Despite the appellant's letter, HMRC attempted to treat the appeal as settled, and opposed the appellant's request to have the case set down for hearing by the Tribunal. Judge Radford found that the appellant had never reached an agreement within section 54. Furthermore, even if there had been a verbal agreement at the disputed meeting, the effect of TMA 1970 s 54(2) was that the appellant's subsequent letter would have prevented the agreement from taking effect. Judge Radford's decision is notable for her criticism of the HMRC officer who held a meeting with the appellant, and for her finding that the officer had misled the appellant.

J Edoh v HMRC TC2438

Opportunity for participants in tax avoidance schemes (Lecture P759 – 7.11 minutes)

On 3 December 2012, the Government announced additional investment in HM Revenue & Customs (HMRC) to clamp down on tax avoidance and evasion. Following this announcement, HMRC are inviting some participants in certain schemes to settle their tax liabilities by agreement, without the need for litigation. HMRC believe that this settlement opportunity offers both the taxpayers and HMRC the best opportunity to resolve these disputes in a way which is cost-effective and consistent with the law. Where people decline the settlement opportunity, HMRC will increase the pace of their investigations and accelerate disputes into litigation.

HMRC aim to contact all those who are eligible for the offer by the end of January 2013.

Terms of the settlement opportunity are now available for:

- UK GAAP Partnerships
- Other Partnership Reliefs and Allowances
- Film Production Partnerships
- Sole Traders

UK GAAP partnerships settlement opportunity

As part of the phased roll out of the settlement opportunity HMRC has written to individuals who have taken part in UK GAAP Partnership schemes. If you have received a letter this page sets out the broad terms under which HMRC is proposing to allow settlement.

GAAP partnerships are those which have sought to create a loss through the write-off of expenditure or the value of rights or assets through Generally Accepted Accounting Practice.

Terms of Settlement

- Loss relief against other income will be allowed in an amount equivalent to your contribution to the partnership personally contributed by you as the cash contribution, less any element expended on unallowable fees.
  - Unallowable fees are those spent on tax advice or circular funding arrangements. We will tell you if we believe a disallowance for fees is needed.
- The balance of the loss claim will not be allowable.
- Loan interest will only be allowable to the extent that it represents the allowable expenditure paid out of the initial cash contribution.
- Any share of income attributable to the cash element of expenditure will be taxable in full.
- Any share of income attributable to the loan financed element will only be taxable in so far as it represents investment income over and above the return of the initial capital.

Example

- Partner A invests £1m into a partnership
  - £200,000 is cash from his own resources.
  - £800,000 is by way of loan finance as part of the scheme.
- The objective is to claim loss relief of £1m.
  - At a tax rate of 40% this equates to £400,000 cash tax.
- Relief allowed under the opportunity is limited to £200,000 (less any disallowance for fees)
  - At a tax rate of 40% this equates to £80,000 cash tax.

What to do now

Whilst not of general applicability to partnerships, within the specific terms of this settlement opportunity HMRC is prepared to settle with individual partners, irrespective of whether or not the partnership itself continues to disagree with HMRC's view.

This new handling strategy will not apply to cases already adopted for criminal investigation. Any cases which are, during the course of an enquiry, identified as falling within HMRC's criminal investigation policy, or civil investigation of fraud procedures, will no longer be dealt with under this handling strategy.

Other Partnership Reliefs and Allowances and sideways loss relief settlement opportunity

As part of the phased roll out of the settlement opportunity HM Revenue & Customs (HMRC) has written to individuals who have taken part in other partnership reliefs and allowances schemes. If you have received a letter this page sets out the broad terms under which HMRC is proposing to allow settlement.

Other partnership reliefs and allowances schemes include those which have sought to create losses in partnerships through reliefs such as first year allowance, payments made for restrictive covenants, specific capital allowances.

Terms of Settlement

- Loss relief against other income will be allowed in an amount equivalent to your contribution to the partnership personally contributed by you as the cash contribution, less any element expended on unallowable fees.
  - Unallowable fees are those spent on tax advice or circular funding arrangements. We will tell you if we believe a disallowance for fees is needed.
- The balance of the loss claim will not be allowable.
- Loan interest will only be allowable to the extent that it represents the allowable expenditure paid out of the initial cash contribution.
- Any share of income attributable to the cash element of expenditure will be taxable in full.
- Any share of income attributable to the loan financed element will only be taxable in so far as it represents investment income over and above the return of the initial capital.

Example

- Partner A invests £1m into a partnership
  - £200,000 is cash from his own resources.
  - £800,000 is by way of loan finance as part of the scheme.
- The objective is to claim loss relief of £1m.
  - At a tax rate of 40 per cent this equates to £400,000 cash tax.
- Relief allowed under the opportunity is limited to £200,000 (less any disallowance for fees)
  - At a tax rate of 40 per cent this equates to £80,000 cash tax.

What to do now

Whilst not of general applicability to partnerships, within the specific terms of this settlement opportunity HMRC is prepared to settle with individual partners, irrespective of whether or not the partnership itself continues to disagree with HMRC's view.

This new handling strategy will not apply to cases already adopted for criminal investigation. Any cases which are, during the course of an enquiry, identified as falling within HMRC's criminal investigation policy, or civil investigation of fraud procedures, will no longer be dealt with under this handling strategy.

Film Production and sideways loss relief settlement opportunity

As part of the phased roll out of the settlement opportunity HM Revenue & Customs (HMRC) has written to individuals who have taken part in Film Production Partnership schemes. If you have received a letter this page sets out the broad terms under which HMRC is proposing to allow settlement.

Film Production partnerships are those which seek to claim relief for expenditure incurred on the production of a qualifying British film under S.42 and 48 Finance Act (no.2) 1992.

Terms of Settlement

- Loss relief against other income will be allowed in an amount equivalent to the contribution to the partnership personally contributed by you as the cash contribution, less any element expended on unallowable fees.
    - Unallowable fees are those spent on tax advice, or payments to Independent financial advisers or circular funding arrangements. We will tell you if we believe a disallowance for fees is needed.
- The balance of the loss claim will not be allowable.
- Loan interest will only be allowable to the extent that it represents the allowable expenditure paid out of the initial cash contribution.
- Any share of income attributable to the cash element of expenditure will be taxable in full.
- Any share of income attributable to the loan financed element will only be taxable in so far as it represents investment income over and above the return of the initial capital.

Example

- Partner A invests £1 million into a partnership
    - £200,000 is cash from his own resources.
    - £800,000 is by way of loan finance as part of the scheme.
- The objective is to claim loss relief of £1 million.
    - At a tax rate of 40 per cent this equates to £400,000 cash tax.
- Relief allowed under the opportunity is limited to £200,000 (less any disallowance for fees)
    - At a tax rate of 40 per cent this equates to £80,000 cash tax.

What to do now

Whilst not of general applicability to partnerships, within the specific terms of this settlement opportunity HMRC is prepared to settle with individual partners, irrespective of whether or not the partnership itself continues to disagree with HMRC's view.

This new handling strategy will not apply to cases already adopted for criminal investigation. Any cases which are, during the course of an enquiry, identified as falling within HMRC's criminal investigation policy, or civil investigation of fraud procedures, will no longer be dealt with under this handling strategy.

Sole Traders and sideways loss relief settlement opportunity

As part of the phased roll out of the settlement opportunity HM Revenue & Customs (HMRC) has written to individuals who have taken part in sole trader schemes. If you have received a letter this page sets out the broad terms under which HMRC is proposing to allow settlement.

Sole trader schemes are those which have sought to create a loss through a self-employed trade that would involve substantial expenditure said to be incurred in the trade, or a write-off of expenditure or the value of rights or assets through Generally Accepted Accounting Practice.

Terms of settlement

- Loss relief against other income will be allowed in an amount equivalent to your contribution to the sole trader scheme personally contributed by you as the cash contribution, less any element expended on unallowable fees.
  - Unallowable fees are those spent on tax advice or circular funding arrangements. HMRC will tell you if HMRC believe a disallowance for fees is needed.
- The balance of the loss claim will not be allowable.
- Loan interest will only be allowable to the extent that it represents the allowable expenditure paid out of the initial cash contribution.

Any share of income attributable to the cash element of expenditure will be taxable in full.

Any share of income attributable to the loan financed element will only be taxable in so far as it represents investment income over and above the return of the initial capital.

Example

- Sole trader invests £1 million into a scheme
  - £200,000 is cash from his own resources.
  - £800,000 is by way of loan finance as part of the scheme.
- The objective is to claim loss relief of £1 million.
  - At a tax rate of 40 per cent this equates to £400,000 cash tax.
- Relief allowed under the opportunity is limited to £200,000 (less any disallowance for fees)
  - At a tax rate of 40 per cent this equates to £80,000 cash tax.

What to do now

Whilst not of general applicability to sole trader schemes, within the specific terms of this settlement opportunity HMRC is prepared to settle with individual sole traders, irrespective of whether or not the promoter or the other participants in the scheme continue to disagree with HMRC's view.

This new handling strategy will not apply to cases already adopted for criminal investigation. Any cases which are, during the course of an enquiry, identified as falling within HMRC's criminal investigation policy, or civil investigation of fraud procedures, will no longer be dealt with under this handling strategy.

Promoter sued

The claimant, a chartered accountant, was a managing director at KPMG Consulting Ltd. After seeing a presentation by the defendants about an investment opportunity involving a film tax relief, he decided to join the scheme.

The claimant said he was told he could claim a refund on income tax already paid, invest the proceeds in films and recover a guaranteed return of 20% of the amount of the investment. This happened as planned, but HMRC subsequently ruled that he was not entitled to a refund and demanded repayment with interest and penalties. He brought a claim for damages against the defendants in respect of alleged fraudulent misrepresentation.

Decision:

The High Court judge was satisfied that the first defendant had described an arrangement in such a way that the claimant understood that the scheme being promoted had been approved by the Revenue, and that this was the promoter's intention.

The judge accepted that the claimant would not have taken part in a tax avoidance scheme where the outcome was not guaranteed.

He ruled that the first defendant was fully aware that the representations were untrue and false and was therefore liable to the claimant in deceit. The second defendant had not acted dishonestly. The claimant was entitled to recover damages from the first defendant in the sum of the amount of which he had to repay to HMRC.

Comments – It is highly unlikely that HMRC would approve tax avoidance schemes and accordingly the judge accepted that the claimant would not have taken part in a tax avoidance scheme where the outcome was not guaranteed. This demonstrates to be very careful in describing a result which involves the interaction of tax and investment.

Horner v Allison and another, Queen's Bench Division

Not so careless

The taxpayer's employment with the Royal Bank of Scotland was terminated in November 2009. His form P45 showed earnings of £44,844 for 2009/10. Holiday pay of £6,400 was not included, although it appeared on his P14. He received a bonus from the bank of £1,611 in March 2010.

After discovering the figures in the taxpayer's return were incorrect, HMRC imposed penalties for carelessness in completing the return.

The taxpayer said the mistakes were caused by the error on his P45, of which he had been unaware. He had not included his bonus because he did not believe he was entitled to it and had expected the bank to ask for it to be repaid.

Decision:

The First-tier Tribunal said the taxpayer was honest and sincere, but he should have checked with the bank as to whether or not he was entitled to the bonus. However, the error on the P45 had been made by the bank and there was no reason why the taxpayer should have questioned it or checked it was correct.

The penalty in respect of the undeclared bonus was confirmed but that for the holiday pay was cancelled.

The taxpayer's appeal was allowed in part.

Comments – The onus of ensuring that the correct figures are declared rest with the taxpayer. The judge quite correctly dealt with the bonus as the taxpayer should have checked the treatment that the bonus would receive rather than rely on it being taken back and hence he excluded it. If he had checked he would probably have treated it correctly.

G Hunt TC2411

Penalty imposed at 15%

An employee (H) was made redundant in 2008. He received a redundancy payment of £329,415, which he failed to disclose on his tax return. When HMRC discovered this, they imposed a penalty at the rate of 15% of the potential lost revenue.

Decision:

The FTT upheld the penalty and dismissed H's appeal. Judge Geraint Jones observed that 'we do not accept that somebody as intelligent and accomplished in financial affairs as the appellant, could have failed to observe that his P45 demonstrated that only basic rate tax had been deducted from his compensation payment any more than we accept that he was unaware that he would have to account for tax at his higher marginal rates by disclosing the sum received in his tax return. We are entirely satisfied that the appellant chose not to disclose it. He took a gamble; he lost'.

Comments - The FTT upheld HMRC's view that there was no reasonable excuse for failing to declare such a large redundancy payment on the appellant's tax return, and that there were no grounds for any further mitigation of the penalty. Judge Geraint Jones' comments are self-explanatory.

M Hearn v HMRC TC2433

Business Taxation

AIA in the transitional periods (Lecture B756 – 11.51 minutes)

The AIA is fast becoming a political football. It was £50,000 on its introduction from 1 April 2008 and doubled to £100,000 from 1 April 2010. From 1 April 2012 it reduced to £25,000 and now it has dramatically increased to £250,000 for each of the calendar years 2013 and 2014. The draft Finance Bill 2013 clauses make it clear that the AIA will revert to £25,000 from 1 January 2015 – unless of course there is another change introduced nearer that time.

The amount claimable is subject to time-apportionment where the accounting period spans 31 March (5 April for sole traders and partnerships) or 31 December, but that is not the only aspect, as careful consideration is required of the timing of incurring the expenditure.

The maximum AIA is tabulated below:

Year end	AIA
31/1/13	£56,250
28/2/13	£68,750
31/3/13	£81,250
30/4/13	£100,000
31/5/13	£118,750
30/6/13	£137,500
31/7/13	£156,250
31/8/13	£175,000
30/9/13	£193,750
31/10/13	£212,500
30/11/13	£231,250
31/12/13	£250,000

In the above table the calculation is by reference to whole months whereas a day count will give a slightly different result.

With a year end of 28 February 2013 there are 3 separate levels of AIA to consider – 1/3/12 to 31/3/12 = 1/12 x £100,000 = £8,333; 1/4/12 to 31/12/12 = 9/12 x £25,000 = £18,750; 1/1/13 to 28/2/13 = 2/12 x £250,000 = £41,667, giving the total of £68,750 as in the table above.

The relevant AIA limit has to be looked at not just by reference to the apportioned amount over the whole year end as in the table above, but also to the amount applying for the portion of a year falling on or after the date of the rate change.

The maximum AIA for the period is the sum of the maximum AIA found if the periods to and from the date of the rate change and the end of the chargeable period were separate chargeable periods, but for a chargeable period beginning before 1 April 2012 / 6 April 2012 the rules were less restrictive.

However, there is a further restriction where the chargeable period spans both 1 April 2012 / 6 April 2012 and 1 January 2013 (this essentially covers annual accounts prepared to between 1 January 2013 and 30 March / 5 April 2013) and the calculations are not exactly logical. Essentially the transitional rules operate differently at the rate change dates of April 2012, January 2013 and April 2015.

Illustration – period straddling both 1/4/12 and 1/1/13

Maximum AIA for the year to 28/2/13 is £68,750.

Within that over-riding limit, the following separate restrictions apply in this period:

- 1/3/12 to 31/3/12 = £8,333, being 1/12 x £100,000.
- 1/4/12 to 31/12/12 = £22,917. This is £25,000 x 11/12 rather than 9/12 as the rules ensure that the increase to £250,000 is ignored in this calculation and instead they reflect the transitional rules applying to the AIA reduction from £100,000 to £25,000 whereby the period 1/4/12 to 28/2/13 would have previously been subject to a maximum of 11/12 x £25,000.
- 1/1/13 to 28/2/13 = £41,667, being 2/12 x £250,000.

There are other aspects to consider as well before the complete picture is known:

- The maximum AIA before April 2012 is £8,333 + £22,917 = £31,250 as calculated above. If that level of expenditure had been incurred there would be no further AIA due before 1/1/13.
- If no expenditure had been incurred before April 2012 the maximum AIA for the period 1/4/12 to 31/12/12 would be £22,917.

Illustration – period straddling 1/1/13 only

Maximum AIA for the year to 31/3/13 is £81,250.

The following separate restrictions apply in this period, as if the increase to £250,000 had not been made:

- 1/4/12 to 31/12/12 = £25,000.
- 1/1/13 to 31/3/13 = minimum £56,250 (£81,250 less £25,000) with the limit being £81,250 less the AIA claimed for the period 1/4/12 to 31/12/12
- If all of the expenditure is incurred from 1/1/13 to 31/3/13 the AIA for that period is £81,250.

Illustration – period straddling 1/1/15

Here the rules are the same as when the AIA reduced from £100,000 to £25,000.

Maximum AIA for the year to 31/3/15 is £193,750.The following separate restrictions apply in this period:

1/4/14 to 31/12/14 = £187,500, being £250,000 x 9/12.

1/1/15 to 31/3/15 = £6,250, being £25,000 x 3/12.

If no expenditure incurred to 31/12/14 the AIA for the period 1/1/15 to 31/3/15 would be £6,250

Contributed by Gerry Hart

Simplifying small business accounts for tax (Lecture B757 – 10.43 minutes)

We now have the rules, which in isolation are straightforward but which are complex by reference to what is required to be able to take advantage of a simpler system.

It may be the case that overall the business will get the optimum tax deal by not going for the cash basis but nevertheless electing to claim the flat rate expenses. That election, where the cash basis is not opted for or is unavailable because of the turnover level, can apply to any or all of the flat rate expenses. Under the cash basis they are mandatory.

The cash basis will be mandatory for income assessment under the forthcoming Universal Credit.

The main aspects

1. Voluntary cash basis for annual receipts of less than the VAT registration level of £77,000, with entitlement to continue until annual receipts exceed twice the VAT registration level (= currently £154,000). It is reported that there are around 3.5 million traders, with more than 3 million of them having a turnover below £77,000.
2. If the individual carries on more than one business it is the combined receipts which need to be considered. An election for the cash basis then applies to all of the businesses.
3. Capital allowances replaced by a 100% expenses claim on plant and machinery. A few categories of assets will still qualify for capital allowances. There is no entitlement to capital allowances for integral features to a building, which in any event are unlikely to be relevant to a business within the turnover limit.
4. Simplified expenses claims – see details below.
5. Flat rate claim for business use of the home and flat rate adjustment for personal use of business premises – see details below.
6. Estimates acceptable for stationery and related items, based on unit costs such as per letter. Details awaited.
7. Claim allowed for costs of borrowing, including interest and any arrangement fees, limited to £500 per annum – new Section 57B ITTOIA2005. No requirement that the loan is wholly and exclusively for the business.
8. Any loss (= negative cash flow) can only be carried forward.

Excluded persons

These are fewer than originally proposed:

- Limited companies
- Partnerships in which any partner is not an individual
- LLPs
- Farmers or authors with a profits averaging claim in place
- Farmers using the herd basis
- Lloyd's underwriters

Motor expenses

1. The fixed deduction is 45p per business mile, reducing to 25p beyond 10,000 business miles in the year.
2. Deduction of 24p per mile for a motorcycle.
3. No deduction if capital allowances have been claimed in respect of the vehicle.
4. Goods vehicles are included, unless a capital allowances claim has been made or a deduction claimed for the cost under the cash basis.
5. The fixed deduction is mandatory for cars and motorcycles if the business is using or has used the cash basis when the vehicle was owned.
6. Any business can use this basis for claiming tax relief on motoring costs, whether or not the cash basis is opted for, but it has to be used throughout the period of use in the business.
7. If the car is leased there is no tax relief on rental payments – Section 51A ITTOIA2005.

Use of home for business

1. A fixed deduction can be claimed where there is business use of the home, and that is the case whether or not the cash basis is opted for.

2. The deduction is on a monthly basis according to the number of hours spent wholly and exclusively on work done by the individual or any employee:

hours worked	**deduction**
25+	£10
51+	£18
101+	£26

3. This gives a maximum claim of £312 per annum (£6 per week).

Use mainly for business but also as home

As an alternative to claiming the deduction above, the person can elect to claim the actual business costs *less* a flat rate to cover private use. Again this option is available whether or not the cash basis is opted for. It will only be better where business use is substantial, as the private use restriction is significant as shown below, but there is an alternative of claiming the allowable portion of the actual expenses.

number of relevant occupants	**reduction in claim per month or part month**
1	£350
2	£500
3+	£650

Accounting date and basis periods

A new Section 220A ITTOIA2005 covers the rules as under:

1. An election for the cash basis applies for a tax year.
2. The accounting period starts on the day after the end of the period for the preceding tax year. It ends on the chosen date which can be any date from 31 March to 30 April in the following tax year. It is not necessary to use the same date each year.
3. If no date is chosen there is a default date of 5 April, which given the size of the firm on the cash basis must be recognised as the simplest date to use (or 31 March in some cases).
4. Where a new business starts after 31 March the profits of the year of commencement are NIL, and any receipts and payments in that short period are included in the next tax year.
5. In the first year of not using the cash basis, the end of the basis period is 5 April – unless there is an accounting date of between 31 March and 4 April, in which case that is used instead. In the next tax year the basis period is 12 months following the end of the basis period for the year of the switch. That results in a business stopping the cash basis having to remain on fiscal accounting for a further two periods.

Contributed by Gerry Hart

Dancer: whether an employee

A company (S) operated two 'gentlemen's entertainment clubs' in London. It arranged for young women to dance at the clubs, and treated them as self-employed. The dancers received payments from customers at the clubs, in the form of vouchers which S distributed. A dancer (Q), who had worked at one of the clubs from June 2007 to December 2008, took proceedings against S in the Employment Tribunal, contending that she had been an employee of S and had been unfairly dismissed. The Employment Appeal Tribunal held that Q had been an employe.

Decision:

The CA unanimously allowed S's appeal, holding that Q had been self-employed. Elias LJ held that 'the club did not employ the dancers to dance', and that the dancers paid the club 'to be provided with an opportunity to earn money by dancing for the clients'.

Comments - The CA held that the dancer was self-employed and was not an employee of the club. This is not strictly a tax case, but it has tax implications and has attracted considerable publicity in the accountancy press over the time that it has been going through the Court system.

Stringfellows Restaurants Ltd v Quashie EWCA

Salesman: whether an employee

HMRC issued assessments on a salesman (Y), who had received commission from a company (S) which supplied windows and conservatories. Y appealed, contending that he had been an employee of S.

Decision:

The FTT accepted this contention and allowed his appeal.

Comments - In most cases where employment status is in dispute, HMRC contend that the worker is an employee. In this case, however, HMRC had accepted the view of the company for which the appellant worked and had treated him as self-employed. The FTT accepted the appellant's evidence that he had in fact been an employee.

Y Yetis v HMRC TC2410

Wide discretion with withdrawal of gross payment status

A family company was in business as water well engineers. It was registered for gross payments under the construction industry scheme, but was often late paying its PAYE tax and National Insurance due to cashflow problems. HMRC reviewed the company's construction industry scheme status three times. They agreed not to withdraw gross payment status in 2009 and 2010 but, after the third review, HMRC said they would proceed with cancellation.

The company appealed, saying this action was disproportionate and that the loss would have a detrimental effect on its business.

Decision:

The First-tier Tribunal noted that the taxpayer did not dispute that there had been compliance failures in the relevant period, ie July 2010 to June 2011. The judge said that, based on the evidence, there was no reasonable excuse for these failures, and that HMRC were entitled to take into account that there had been failed compliance reviews previously.

The judge decided, however, that HMRC should also have considered the financial effect on the company of cancelling its gross payment status. He said that the "provisions for cancellation of an existing registration under FA 2004 are quite different to the provisions for the grant of a certificate under TA 1988".

HMRC had discretion as to cancelling a certificate, even if there was no reasonable excuse for the company failing a compliance test. In this respect "reasonableness, including proportionality-type arguments, might be expected to be at the very heart of such discretion".

The taxpayer's appeal was allowed.

Comments – The Construction Industry Tax Deduction Scheme has been operating some time now since April 2007. Despite this length of time HMRC had not applied the discretion that the Tribunal perceived that they should have in the circumstances. Having said that the taxpayer’s history was one of failure and therefore the Tribunal have decided upon the decision based on fairness rather than based on the taxpayer’s history.

J P Whitter (Waterwell Engineers) Ltd (TC2316)

Excavation support equipment: claim for first-year allowances

A company (M) claimed first-year allowances on excavation support equipment, which it hired out. HMRC rejected the claim on the basis that the expenditure was 'on the provision of plant or machinery for leasing', so that the effect of CAA 2001 s 46(2) (general exclusion 6) was that first-year allowances were not due. M appealed, contending that the equipment had not been acquired for leasing, since it provided design services (through a subcontractor) as well as equipment.

Decision:

The First-tier Tribunal accepted this contention and allowed the appeal. Judge Cannan held that 'there can be circumstances where plant is supplied without labour but with other services and benefits such that the expenditure on such plant falls outside general exclusion 6'. On the evidence, M was 'providing an overall service beyond the leasing of assets referred to in general exclusion 6. It is analogous to a scaffolding firm hiring scaffolding but also providing something more, namely the labour to erect and dismantle the scaffolding'.

Comments - CAA 2001 s 46(2) provides that expenditure on the provision of plant or machinery for leasing does not qualify for first-year allowances. HMRC took the view that the company was leasing its excavation support equipment to its customers, so that its expenditure did not qualify for first-year allowances. The First-tier Tribunal allowed the company's appeal, holding that its provision of its equipment fell outside the definition of 'leasing'.

MGF (Trench Construction Systems) Ltd v HMRC TC2399

Assessments on undeclared profits

HMRC issued assessments under what is now CTA 2010 s 455 on a company which operated a lap-dancing club.

Decision:

The First-tier Tribunal upheld the assessments. Judge Mure observed that treating the additional takings as having been loaned to the directors, rather than as fees or dividends, produced 'a more favourable practical result' for the directors.

Comments - CTA 2010 s 455 provides that there is a tax liability where a close company loans or advances money to a participator. The First-tier Tribunal upheld HMRC's view that the appellant company had failed to declare all its takings, and that the undeclared takings should be treated as having been loaned or advanced to the directors.

Risky Business Ltd v HMRC TC2408

Correct dividend paperwork (Lecture B758 – 12.15 minutes/Lecture B759 – 9.33 minutes)

Dividends

There are essentially two types of dividend:

- final dividends, and
- interim dividends

Whilst the procedures are different for final v interim dividends there is a common principle that the dividends must be authorised by the directors after they have considered whether there are sufficient distributable profits to cover the dividend.

This is more problematic for interim dividends as management accounts may not be available. Distributable profits include retained profits from previous years so a company paying interim dividends with a good level of retained profits is less of a concern. Start ups or clients that draw all they earn are where careful attention is required – there must be sufficient profits to cover the interim dividend.

Final dividends are approved at the company's annual general meeting and as such the distributable profits will always be considered as the annual accounts will be approved at this meeting.

<u>Interim dividends</u>

The procedure for payment of an interim dividend can be summarised as follows:

- establish the distributable reserves
- determine the total amount to be distributed
- calculate the dividend per share
- hold a board meeting and prepare minutes approving payment
- make payment to the shareholders and prepare dividend vouchers

If only it were as simple as this!

Clients have a habit of complicating matters by drawing funds before thinking of the proper procedure. As practitioners we are quite often playing "catch up" to a clients draw – but we must still follow proper procedures to formalise the clients drawings.

The key issue is quantifying distributable profits at the time of the interim dividend…..

Final dividends

The procedure for payment of a final dividend is:

- establish the distributable reserves
- determine the total amount to be distributed
- calculate the dividend per share
- either:

  - prepare Annual General Meeting or Extraordinary General Meeting documents recommending a dividend for the members to approve at the meeting, or

  - prepare and circulate an elective resolution to the members approving the final dividend

- make payment to the shareholders and prepare dividend vouchers

Ultra vires dividends

If a dividend is declared without sufficient distributable reserves being available, the dividend may be considered illegal. This is also referred to as being *ultra vires*. *Ultra vires* literally means 'beyond the powers'. This term is used because the dividend was 'beyond the powers' of the directors to declare.

A dividend may be illegal from the point that it was declared, or become illegal subsequently. For example, an interim dividend declared by a company is shown to be in excess of available profits at the annual accounts due to subsequent expenditure. If the directors were aware of the expenditure at the time of the dividend, the dividend would have been illegal at the point it was declared. If not, the dividend would become 'retrospectively' illegal.

This can be an important distinction as an interim dividend which is retrospectively shown to be illegal does not need to be repaid *if* it can be shown that the directors had reasonable grounds to assume there were distributable reserves *at that time*.

A dividend that is illegal at the time of the declaration must be repaid. This is the case regardless whether the dividend was illegal due to negligence or deliberate act.

Payment of dividends

For all the purposes of the Taxes Acts dividends shall be treated as paid on the date they become due and payable. Consequently the payment date for interim and final dividends are different.

Final dividends are “paid” on the date of the Board resolution as this is when the debt becomes “due and payable” from a shareholder perspective. Sometimes the resolution may state a later date in which case the dividend is not “paid” until that later date.

Interim dividends are technically revocable so the payment date is when they are actually paid – it is only then that they can be said to be “due and payable”.

An interim dividend is not paid unless and until the shareholder receives the money or the distribution is otherwise unreservedly put at their disposal, perhaps by being credited to a loan account on which the shareholder has the power to draw.

In CTM 20095 HMRC state that small companies might not make such entries until the annual accounts are prepared – presumably because they may have limited accounting systems. This will create issues where the interim dividend is to clear loan accounts – when has the loan account been cleared?

An electronic payment or physical cheque being issued and cashed would leave no room for doubt.

Where it appears that a dividend may not have been declared, but a payment has been made, HMRC may argue that these payments should be considered as loans. They may extend this argument further and state that the payments are, in fact, earnings.

Example

Audra has been trading as a management consultant for many years and is very organised when preparing her books and records on QuickBooks. She likes to do everything "by the book" and will follow your advice to the letter! She produces monthly management accounts and in those accounts provides for 20% corporation tax.

Over the years she has never drawn all that she earns and her retained profits are at a reasonable level.

This would be very close to your perfect client! But sadly not your typical client!!

Audra is convinced by your arguments that low salary, high dividends is the optimum means of extraction but is keen that this is done completely "by the book".

She draws a small monthly salary – enough get credit for a state pension but not enough to pay national insurance. This is put through the payroll and she makes a separate electronic transfer each month to pay the net amount into her personal bank account.

In addition to this she wants to draw another £2,000 per month as an interim dividend – normally around the end of the month.

Your firm have agreed with Audra that an interim dividend of £6,000 will be minuted at the start of each quarter (rather than the more labour intensive monthly minutes). Minutes are sent to Audra each quarter and she simply signs and dates the minute supporting the £6,000 interim dividend. The minutes refer to the fact that the company has sufficient profits to cover the interim dividend and that a dividend voucher will be prepared at the end of the tax year.

The payment date for Audra's interim dividends depends on a number of factors:

- If Audra credits the £6,000 to her loan account via a Quick Books journal entry on the date she signs the minute then that will be the date of payment for her £6,000 dividend. This will be important for income tax purposes and making sure dividends are declared in the correct tax year.

- If Audra does not make any entry in her Quick Books program then the payment dates will be when she draws the £2,000 monthly amounts. Again important for income tax purposes.

- If the minute states that the £6,000 dividend is to be credited immediately to Audra's loan account and is available for draw without restriction then arguably the date of the minute is the payment date.

The key to all "payment" options is that at no stage is her directors loan account overdrawn. Overdrawn loan accounts have exposure to beneficial loan interest rules (when the loan exceeds £5,000) and s.455 CTA 2012 tax if overdrawn for too long.

As Audra has a reasonable level of retained profits brought forward it does not really matter that she has monthly management accounts for the current year. In the absence of monthly management accounts we could adopt the same quarterly minute approach, safe in the knowledge that the retained profits are sufficient to cover the current dividend. We should always use our judgement here but if we are concerned with current trading activity a quick bank + debtors – creditors calculation should give us an idea of the current year position i.e. profit or loss.

If Audra did not have a reasonable level of retained profits brought forward then we would need to change our approach somewhat.

Example

Kylie has been trading as an IT consultant for many years and is very organised when preparing her books and records on QuickBooks. She likes to do everything "by the book" and will follow your advice to the letter! She produces monthly management accounts and in those accounts provides for 20% corporation tax.

Over the years she has always drawn all that she earns and her retained profits are minimal.

Kylie is convinced by your arguments that low salary, high dividends is the optimum means of extraction but is keen that this is done completely "by the book".

She draws a small monthly salary – enough get credit for a state pension but not enough to pay national insurance. This is put through the payroll and she makes a separate electronic transfer each month to pay the net amount into her personal bank account.

In addition to her monthly salary she wants to draw most of her monthly post tax profit by way of an interim dividend.

Your firm have agreed that Kylie will e-mail you her management accounts when available. Your firm will have a cursory look over the accounts and as long as there are no obvious errors you will prepare a minute for an interim dividend of 90% of her post tax management profit. The minutes state that the monthly management accounts have been considered and an interim dividend of £x does not exceed the retained profits as at the date of the interim dividend.

The minute is e-mailed to Kylie which she then signs. Kylie then transfers the interim dividend amount to her personal bank account. The payment date for Kylie's dividend will be the date of the electronic transfer.

If we assume Kylie has a calendar year end and the management accounts to January 2013 show post tax profits of £5,000 the interim minute for the dividend payment in February 2013 should have the following narrative (or similar):

The directors noted that the company was continuing to trade profitably and that there were no reasons to assume that this would not continue for the foreseeable future. This was evidenced by management accounts prepared up to 31 January 2013 showing distributable reserves of £5,000.

It was therefore resolved that an interim dividend of £x per share per ordinary share in respect of the year ending 31 December 2013 be paid on 10 February 2013 to those shareholders registered at the close of business on 10 February 2013.

There may be occasions when Kylie draws an amount prior to receiving the minute. Maybe her average interim dividend is £4,000 per month. She may take £2,000 at the end of the month and then the remaining £2,000 when she receives the £4,000 minute a week or so later. In these instances we would advise Kylie to post any advances to directors loan in her Quick Books program.

The minute would then state that the £4,000 dividend is going to be posted immediately to her loan account. Kylie then posts the £4,000 to the loan account and draws the remaining £2,000.

There should be no beneficial loan interest to report here as the loan account is always below £5,000. We should also have no problems with Real-time information reporting for PAYE purposes when that comes in from April 2013 as we are posting the advance payments to directors loan.

If only all our clients were like Audra and Kylie!

Let's consider another client – George – often referred to in the office as "a complete nightmare"!

Example

George has been trading as a car leasing broker for many years. He is very busy and has little time for bookkeeping. His wife does the bookkeeping but does just enough to enable the company VAT returns to be prepared on a timely basis. The VAT return stagger is aligned with the company's year end. He always looks forward to our annual accounts meeting as it is only then that he knows how much his company has made that year!

George sees the company bank account as an extension of his personal account and regularly draws large sums to cover personal bills. The company is profitable but does not have any retained profits of note. Any profits earned normally find their way into George's pocket – we just try and ensure that is done as cheaply as possible i.e. low salary, high dividends.

We run the payroll and George receives a fixed monthly amount around the personal allowance. This is processed with the staff payroll and his net pay amount is on the BACS runs. Any further payments are either taken by cheque or electronic transfer without any reference to ourselves.

So how do we deal with George!

Firstly we need to ensure that a minute is in place that authorises George to have a directors' loan account in excess of £10,000. We then need to explain to George that all that all the company payments which relate to his personal affairs must all be treated as directors' loan in the books and records of the company. If they just have a cash book then make sure the narrative for the payment is "directors loan". If they have a computer system, then ensure all personal payments are classified as directors' loan. This is important with RTI just around the corner – we do not want HMRC regarding any "personal payment" as remuneration. So if we post to a loan account we know at the time of draw exactly what it is – and the company has authorised this draw by way of a minute.

Our aim is then to clear the loan account by way of an interim dividend or even a final dividend. If we never really know what the profits are until the accounts are prepared a final dividend might be the best route. We have an outstanding loan account through the year and an interest benefit must be declared on the P11d. We try and ensure the accounts are prepared and signed off within nine months of the year so as to avoid an s.455 CTA 2010 tax for the company.

Alternatively we may feel more comfortable clearing his loan account on a quarterly basis. The main problem with this is that we do not really know what the profits are and these must be addressed when paying an interim dividend.

We may have to go down the interim dividend route if there is no realistic chance of preparing accounts within nine months of the year end or indeed if we need the dividends in a particular year for self-assessment purposes.

So how do we address the profit issue if we want to follow the interim dividend route? It is tricky but we should take comfort from the fact that the company has a record of profitability and George's current level of "personal payments" would seem to support the fact that the company is still generating cash which ultimately equates to profit.

We could prepare an informal balance sheet calculation each VAT quarter to ensure we have a basis for the interim dividend that George is about to sign up to.

An excel spreadsheet along the following lines would do the trick:

Quarter one	**£**
Fixed assets (per last accounts)	10,000
Current assets (at quarter end):	
Bank account	6,000
Trade debtors (per George)	12,000
Overdrawn loan account (personal drawings in quarter)	17,000
Current liabilities (at quarter end):	
Trade creditors (per George)	(7,000)
PAYE (per payroll)	(2,000)
VAT (per VAT return)	(5,000)
Issued share capital	(1,000)
Total	30,000
Corporation tax (1/6)	(5,000)
Profit (after corporation tax)	25,000

This "back of the envelope" calculation shows that an interim dividend of £17,000 is possible as profits earned to date amount to £25,000 (post corporation tax). It is not 100% accurate but it gives a good idea that George is well within acceptable profit parameters and that will be acceptable.

The interim minute should have the following narrative (or similar):

The directors noted that the company was continuing to trade profitably and that there were no reasons to assume that this would not continue for the foreseeable future. This was evidenced by the fact that post tax profits to 30 June 2013 were in the region of £25,000 (per the attached management information).

It was therefore resolved that an interim dividend of £170 per ordinary share in respect of the year ending 31 March 2014 be paid on 10 August 2013 to those shareholders registered at the close of business on 10 August 2013. These amounts are to be credited to the shareholders loan accounts with the company immediately.

Ideally an entry should be made in the accounting records in August 2013 to reflect the £17,000 interim dividend being posted to directors loan account. Some would argue that a statement to that fact in the minute would suffice but that is not free from doubt.

The same calculation can be used for quarter 2 as an estimate of profit for that quarter – not forgetting that we have £8,000 of retained profit available for distribution from quarter 1.

Utilising Property losses **(Lecture P757 – 7.50 minutes)**

Income tax losses
When a person has rental income from a property business they should record their rental profits on the supplementary property pages of the self-assessment return.

The properties need to be divided into four separate property businesses when recording them on the self-assessment return:

- UK Property business – UK commercial, UK furnished residential, UK residential
- UK FHL business – UK furnished holiday lets
- EEA FHL business – EU furnished holiday lets
- Overseas property business – Other overseas properties

The UK Property business is recorded in Boxes 20 to 43 on the supplementary UK property page. The UK FHL is recorded in Boxes 5 to 19 on the same supplementary page. If you also have an EEA FHL business you must complete an additional UK property page and complete Boxes 5 to 19 for the EEA FHL – remembering to put an X in Box 18 to denote EEA FHL. If you have an overseas property business then you must complete the Foreign income supplementary pages.

The reason they must be split into four separate property businesses is primarily due to the offset of losses. Essentially profits and losses within each property business are automatically offset within that property business. If there is an overall loss for the year in a particular property business that loss cannot be set off against against the profits in any other property business. The loss is automatically carried forward against profits from the same property business.

The deduction must be made from the first available profits (and then, if those profits are insufficient, from the next available, and so on until the loss is exhausted). The deduction is made in priority to deducting any other reliefs from available profits.

Limited set-off against general income

Where a person carrying on a UK property business or an overseas property business makes a loss in that business for a tax year by reason of capital allowances a claim may be made under ITA 2007, s 120 to set the available loss relief against his general income for the year of loss or the following tax year. The sideways loss offset for the year of loss for UK property is claimed by completing Box 42 on the UK Property supplementary page.

When claiming sideways offset in the following year you must remember to reduce the brought forward losses (Box 39) for that year and then claim the sideways offset on Box 42 in that year.

This sideways loss offset is not available on the UK FHL or the EEA FHL businesses

The available loss relief is the lower of the loss itself and the capital allowances in the year. The significant capital allowance claims will be on commercial property which would qualify for the annual investment allowance. For residential properties any assets which are made available for the tenants use are precluded from a capital allowances claim.

Relief cannot normally be claimed for both the year of loss and the following year in respect of the same loss, but where the whole of the available loss relief cannot be given in one year (i.e. due to an insufficiency of income), the balance may be separately claimed for the other year.

A claim must be made no later than the first anniversary of 31 January following the year to which the claim relates (i.e. the year for which relief is to be given).

FHL losses

If you make a loss in your FHL business you can set it against FHL profits of a later year. A loss in a UK FHL business can only be carried forward against a profit of the same UK FHL business. Likewise a loss in an EEA FHL business can only be carried forward against the profits of the same EEA FHL business. You cannot set the losses of an FHL business against the profits of any other property business.

Losses made on an individual FHL property may be set against the profits of other FHL profits in the same FHL business. However losses of an FHL business cannot be set against the profits of a non FHL rental business.

When a property ceases to qualify as an FHL, future income and expenditure from that property becomes UK or overseas property income. It will be added together with any other non FHL property income. Any losses up to the point it ceased to qualify stay in the FHL business.

If an FHL business has only ceased temporarily, the losses can be carried forward against any future FHL profits providing, for example, that the gap is not usually more than three years and that there have been no, for example, substantial alterations to the property. The losses can only go forward over a gap if it can be shown that the same let/business is being carried on.

Corporation tax losses

Where a company carrying on a UK property business makes a loss in that business then it may be set off against the company's total profits for the same accounting period. Any unrelieved part of the loss may be treated as a UK property business loss of succeeding periods, for set-off against total profits of such periods, provided that the company continues to carry on the property business in the period concerned.

Where the company is a company with investment business, and the UK property business ceases, unrelieved losses can be carried forward and treated as excess management expenses in the subsequent and later periods, provided that the company continues to be a company with investment business. These reliefs are available only where the UK property business is carried on on a commercial basis or in the exercise of statutory functions.

It should however be noted that mortgage interest would not be a qualifying deduction when calculating the property business profits. Interest is treated separately for corporates under the loan relationship rules. Quite often you have a property business profit and a non-trading loan relationship deficit.

Where a claim is made to set off a non-trade loan relationship deficit against the gross profits for the deficit period, that deficit is set off before relief for UK property business losses.

<u>Losses from an overseas property business</u>

Losses from overseas property businesses are available for carry forward against future profits from the same business.

<u>Losses from an FHL property business</u>

Losses from an FHL property businesses are available for carry forward against future profits from the same business.

<u>Non-trading loan relationship deficits</u>

A non-trading deficit of an accounting period (the '*deficit period*') may be claimed either:

(a) by set-off against profits of the deficit period; or

(b) by carry-back and set-off against profits of earlier accounting periods arising from non-trading loan relationships.

Any non-trading deficit for which relief is not claimed under (a) or (b) above, is carried forward and set against non-trading profits for succeeding accounting periods.

Claims under (a) and (b) above must be made within two years of the end of the deficit period or within such further period as HMRC may allow. A claim for a part or the whole of the deficit to be treated as a non-trading deficit of the first later period, to be carried forward for offset against non-trading profits of succeeding accounting periods, must be made within two years of the end of that first later period.

VAT

Penalty is proportionate

The taxpayer company ran an employment agency. It had been trading since 1973 and had an excellent tax compliance record. Following the introduction of a new accounting system, small adjustments to the total VAT due from the company had been paid after the due dates in respect of the returns for the periods ending May and November 2008. They were recorded as late payments by HMRC but because the VAT default surcharge was less than £400, HMRC did not collect it. The company was one day late paying its VAT for the June 2009 quarter, which resulted in HMRC imposing a default surcharge of approximately £4,000.

The taxpayer appealed to the First-tier Tribunal which decided that, although the company did not have reasonable excuse for late payment, the penalty was disproportionate. HMRC appealed.

Decision:

The Upper Tribunal said that to satisfy the principle of proportionality, a measure should be suitable for the purpose for which the power had been given; it should be necessary in that the purpose could not have been achieved in a less burdensome way; and it should be proportionate in the narrower sense, ie the burdens created should not be disproportionate to the object to be achieved.

Furthermore, in relation to EU law, the principle of proportionality as applied to a penalty system, was to be applied so as to give the member states the widest discretion in deciding the balance between the public interest and the interests of individual taxpayers.

In this instance, there was nothing in the VAT default surcharge which led to the conclusion that it was fatally flawed. In relation to the taxpayer company, the amount of the penalty had been computed by applying a reasonable scheme of calculation which did not breach the principle of proportionality.

Although the result for the taxpayer might be seen as harsh, it could not be regarded as plainly unfair.

The court concluded that neither the default surcharge regime, nor the penalty imposed on the taxpayer infringed the principle of proportionality.

HMRC's appeal was allowed.

Comments – The Upper Tribunal considered the proportionality argument carefully and found in favour of HMRC. Although the result for the taxpayer might be seen as harsh, it could not be regarded as plainly unfair. Unfortunately it is the unfairness that has to be demonstrated.

Total Technology (Engineering) Ltd v CRC, Upper Tribunal

Mail order company: cash commission to agents

A company (G) sold goods by mail order through agents, to whom it paid commission. Initially it did not claim a deduction for this commission. However, following the CJEU decision in Marks & Spencer plc v C & E Commrs (No. 4), [2002] STC 1036, it claimed a retrospective deduction, backdated to April 1973. HMRC accepted that the effect of article 11C1 of the EC Sixth Directive was that G was entitled to such a deduction for the period from 1 January 1978, but rejected G's claim for the period from 1973 to 1977 on the basis that neither the EC Second VAT Directive nor FA 1972 gave G the right to make such a deduction. The tribunal referred the case to the CJEU for a ruling on the interpretation of article 8 of the Second VAT Directive.

Decision:

The CJEU delivered judgment in favour of HMRC, holding that the Directive 'must be interpreted as not conferring upon a taxable person the right to treat the basis of assessment of a supply of goods as retrospectively reduced where, after the time of that supply of goods, an agent received a credit from the supplier which the agent elected to take either as a payment of money or as a credit against amounts owed to the supplier in respect of supplies of goods that had already taken place'.

Comments - The CJEU rejected the company's contention that it was entitled to a deduction for commission which it paid to agents between 1973 and 1977.

Grattan plc v HMRC (No. 5) (CJEU Case C-310/11)

Construction of house to be used by employee

A woman operated an equestrian business. She and her husband obtained planning permission for the construction of a new dwelling to be used by an employee of her business. They claimed a refund of VAT under VATA 1994 s 35. HMRC rejected the claim on the grounds that VATA 1994 s 35(1)(b) provided that a refund was only due where the works were 'otherwise than in the course of any business'.

Decision:

The First-tier Tribunal dismissed the couple's appeal against this decision, applying the principles laid down in Poultries Al Hilal Ltd (VTD 20381).

Comments - VATA 1994 s 35 provides for refunds of VAT to people constructing 'certain buildings'. VATA 1994 s 35(1)(b) provides that such a refund is only due where 'his carrying out of the works is lawful and otherwise than in the course or furtherance of any business'. The First-tier Tribunal upheld HMRC's contention that the work here was in the course or furtherance of the equestrian business, so that the condition laid down by s 35(1)(b) was not satisfied and no refund was due.

Mr & Mrs S Gardiner v HMRC TC2390

VAT: application for late appeal

A company submitted a repayment claim following the CJEU decision in HMRC v Canterbury Hockey Club (CJEU Case C-253/07), on the grounds that it should have treated its green fees as exempt of VAT. HMRC rejected the claim. Following the First tier Tribunal decision in HMRC v Bridport & West Dorset Golf Club Ltd (TC01214), the company applied to lodge a late appeal. HMRC opposed the application but the First-tier Tribunal granted it.

Decision:

Judge Radford observed that the Upper Tribunal had referred the Bridport & West Dorset Golf Club Ltd case to the CJEU, so that 'allowing this appeal out of time would cause no serious prejudice to HMRC'.

Comments - The substantive issues in this case are similar to those raised in the Bridport & West Dorset Golf Club case, which the CJEU has registered as Case C-495/12. The First-tier Tribunal accepted the company's application to lodge a late appeal. Judge Radford's comments are self-explanatory.

PB Golf Club Ltd (t/a Potters Bar Golf Club) v HMRC TC2346

Supply was in the UK

In January 2009, after a sale by auction, the taxpayer purchased a personalised registration number “1O” for a hammer price of £170,000 and buyer's premium of £12,750, to each of which standard-rate VAT was added by the auctioneer, SMA. The taxpayer was resident in Saudi Arabia, and argued that the DVLA had no legal right to charge VAT. The First-tier Tribunal dismissed the taxpayer's appeal.

The taxpayer appealed to the Upper Tribunal. He argued that the First-tier Tribunal had been wrong to conclude that the supply did not fall within VATA 1994, Sch 5 para 1 and to conclude that the underlying supply had not been made outside the EU.

Decision:

The Upper Tribunal decided that the First-tier Tribunal had reached the correct conclusion that the supply had not fallen within Sch 5 para 1. The sale of the registration mark constituted a supply of services and the place of supply was where the supplier was based, ie the UK.

The taxpayer's appeal was dismissed.

Comments – The case is self explanatory - The sale of the registration mark constituted a supply of services and the place of supply was where the supplier was based, ie the UK.

Tanjoukian v CRC, Upper Tribunal

Date on which VAT assessment issued

An individual (D) registered for VAT in 2000. He ceased trading in 2007, after having submitted several returns claiming repayments. HMRC had attempted to arrange a meeting with him to discuss these repayment claims, but in November 2007 D emigrated to Spain without informing HMRC or arranging a meeting. In April 2008 HMRC issued assessments to D's last-known UK address. They subsequently discovered his Spanish address and sent copies of the assessments to that address. D appealed, contending that he had not received the original assessments and that the copies had been issued outside the statutory time limit.

Decision:

The First-tier Tribunal dismissed his appeal, finding that the original assessments had been validly issued within the time limit. Judge Cannan found that D had failed to comply with VAT Regulations, SI 1995/2518, reg 5(2), which required him to notify HMRC of his change of address. In issuing the assessments, HMRC had complied with VATA 1994 s 98(4), which provided that 'any notice, notification, requirement or demand to be served on, given to or made of any person for the purposes of this Act may be served, given or made by sending it by post in a letter addressed to that person or his VAT representative at the last or usual residence or place of business of that person or representative'.

Comments - Sometimes people leave the UK without settling their tax liabilities or informing HMRC of their new address. In such cases HMRC will normally send correspondence, including notices of assessment, to the last-known UK address of the person concerned, as was the case here. The First-tier Tribunal upheld HMRC's contention that the assessments had been validly issued within the statutory time limit.

C Dockett v HMRC TC2391

Floor- based method is fair

Lok'nStore supplied taxable self-storage services. It also offered exempt supplies of insurance for customers' goods while they were stored by the company.

The company decided that the standard method of apportionment, which must be used by partly exempt businesses unless a different method has been agreed with HMRC, did not produce a fair result. It proposed an alternative special method that attributed residual input tax, input tax relevant to both taxable and exempt sales, according to floor area. On this basis, Lok'nStore calculated that it was entitled to deduct 99.98% of the VAT incurred on construction, maintenance and operation of the stores and that only 0.02% of its income was attributable to insurance sold through the reception areas.

HMRC rejected the taxpayer's proposed special method, saying that the standard method based on income was the most accurate way of apportioning input tax.

Decision:

The First-tier Tribunal found that the taxpayer used 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”. A fair and reasonable attribution of the residual input tax would reflect that. On that basis, the special method proposed by the taxpayer was more accurate than the standard method.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said that both the standard method based on income and the special method proposed by the taxpayer based on floor area produced sensible results in terms of input tax recovery. He added: “HMRC have always been suspicious of special methods involving floor space calculations. This case is another example of how their concerns are often unjustified and where the end result of such a calculation is often both fair and logical.”

Lok'nStore Group plc TC2266

Input tax reclaimed on supplies received by associated company

A company (L), which was not registered for VAT, was the lessee of several shops which were occupied by an associated company (H). H reclaimed input tax on the payments. HMRC rejected the claim on the basis that the supplies were made to L rather than to H.

Decision:

The tribunal dismissed H's appeal against this decision. Judge Cornwell-Kelly held that 'since (L) was not at the material times registered for VAT and had not opted to tax property rents, it could not pass on the right to deduct tax on the rents to the taxpayer company'.

Comments - The FTT upheld HMRC's view that since the appellant company was not the recipient of the supplies in question, it could not reclaim the relevant input tax.

Hawes & Curtis Ltd v HMRC TC2415

Invoices allegedly issued by deregistered supplier

A contractor (N) reclaimed input tax in respect of invoices purportedly issued by a deregistered supplier (H). HMRC rejected the claim on the grounds that the invoices did not appear to be authentic.

Decision:

The FTT dismissed N's appeal. Judge Khan observed that N had clearly received some supplies, but that he had not shown that he had received them from a taxable person.

Comments - The FTT upheld HMRC's view that the appellant had not shown that the supplies in question had been made by a taxable person, so that he was not entitled to credit for input tax.

KC Noble v HMRC TC2417

Date from which voluntary registration effective

A company (C) had applied in November 2011 to be registered from 1 January 2012. In February 2012 it applied for its registration to be backdated to April 2009, so that it could reclaim input tax incurred in 2009 and 2010. HMRC rejected the claim, and appealed.

Decision:

The First-tier Tribunal directed that 'the matter be referred back to HMRC for a reconsideration of the decision to refuse (C's) backdated registration to 1 April 2009 and to substitute a new decision'. Sir Stephen Oliver observed that HMRC's VAT Manual V1-28, para 8.8, stated that 'in limited circumstances we may permit a retrospective change to the effective date of registration if there has been a genuine error in completing the VAT1 by the person registering'. On the evidence, C's director appeared to have made a genuine error in originally requesting an effective date of registration of 1 January 2012, because he had not realised that this would prevent C from reclaiming some of the input tax which it had incurred.

Comments - Previous tribunal decisions such as Attwater (VTD 15496) and Edwards (VTD 15533) indicate that HMRC generally reject applications for voluntary registration to be backdated. However the First-tier Tribunal observed that HMRC's VAT Manual suggested that such applications should be accepted where 'there has been a genuine error in completing the VAT1', and directed that HMRC should reconsider this application in the light of the statement in its VAT Manual.

Cambrian Hydro Power Ltd v HMRC TC2423

Removal of threshold for an overseas business (Lecture B760 – 14.04 minutes)

If an overseas trader makes taxable supplies of goods or services in the UK (excluding those covered by the reverse charge etc) it will need a UK VAT number with effect from 1 December 2012. Under previous legislation, there was no requirement for an overseas business to VAT register if taxable sales in the UK were less than £77,000 in the previous 12 months and were expected to be less than £77,000 in the next 30 days i.e. an overseas business was entitled to a VAT threshold in the UK the same as a UK based business. From 1 December 2012, the threshold was reduced to zero.

No need to register in many situations

What exactly is a non-UK business? The exact phrase is NETP (Non-Established Taxable Person) and you can be a NETP if you are based in an EU or non-EU country. The phrase basically means the business is 'not normally resident in the UK, does not have a UK establishment and, in the case of a company, is not incorporated here.' (HMRC Notice 700/1, para 9.1) A UK establishment generally exists if the business' 'central administration' is in the UK or 'essential management decisions' are taken in the UK, or it has a 'permanent physical presence' in the UK, 'with the human and technical resources to make or receive taxable supplies in the UK' (extracts are from Notice 700/1, para 9.2). However, there will be no need for an overseas based business to register for VAT in the following circumstances:

> *The customer who the overseas person is providing services to is 'in business' in the UK and accounts for VAT on his own return by doing the reverse charge calculation (this applies to all services covered by the general B2B (business to business) rule). This is because the person receiving the service is deemed to have made the sale, rather than the overseas supplier.*

Example – a consultant based in Sweden invoices ABC Ltd in the UK for £10,000. ABC will account for output tax in Box 1 on this service (£10,000 x 20%), and claim input tax in Box 4 if it is a fully taxable business i.e. not partly exempt etc. This is the general rule for B2B (business to business) services and avoids the need for the Swedish consultant to get a UK VAT number.

The place of supply is based in the supplier's country so UK VAT is not an issue – this is common with most B2C (business to non-business) sales.

Example – a firm of accountants in Italy completing a private tax return for a UK based person will charge Italian VAT because the place of supply is Italy.

Goods are sold directly to UK customers by an EU business from premises in its own country – in which case, the sale will be based on the rate of VAT that applies in that country, unless the sale is to a business customer that has a UK VAT number, in which case the sale is zero-rated.

Example – Dino is VAT registered in Italy and sells a computer to Dean in the UK. Dino will charge Italian VAT on the sale. However, if Dean goes into business and gets a UK VAT number, then the computer sales by Dino for Dean's business will be zero-rated for Italian VAT purposes, and then Dean accounts for the VAT on his UK VAT return (acquisition tax) in Box 2.

Note – in respect of the sales to UK customers without a VAT number, Dino will need to be aware of the 'distance selling' rules – if his UK sales to non-VAT registered customers exceed £70,000 on a calendar year basis, he will then need a UK VAT number and charge UK VAT on future sales.

Land services

Pierre is a builder resident in France and is doing two jobs in the UK:

- He is going to work for a building contractor who is VAT registered in the UK in connection with a new restaurant being built in London;
- He is also going to build a new conservatory for a private house owner, charging £5,000 for his labour. (the house owner will buy the materials separately from B&Q).

What is the VAT position after 1 December 2012?

The place of supply for a 'land' service is where the land is based i.e. UK in both cases but the VAT is dealt with by the customer with the reverse charge calculation if he has a UK VAT number i.e. in relation to the work on the restaurant for the building contractor. This is because of the extension of the reverse charge to land services where the customer has a VAT number.

Since 1 December 2012, however, he has needed a VAT registration number in relation to the private job – the date of registration is when he knows he will be making taxable sales in the UK in the next 30 days. However, Pierre will still not charge VAT to the building contractor in relation to the restaurant job where the reverse charge is still carried out by the contractor.

As a practical challenge, what is the situation as far as Pierre's expenditure in the UK is concerned? If he didn't have a UK VAT number and wanted to recover VAT on his UK costs in relation to his restaurant contract e.g. hotel bills, van hire costs, subsistence expenses, then he would need to submit an overseas VAT repayment claim to HMRC's office in Londonderry (by making an electronic claim via his own tax authority in France). But with his new VAT number after 1 December, he can recover all of the VAT on his UK expenses (subject to normal rules) as input tax in Box 4 of his return.

Performance services

Another batch of services affected by the changes relate to B2C sales of what are known as the 'performance' services e.g. the services of an entertainer – see Box 1 overleaf.

For these services, the relevant issue for a B2C sale is where the service is performed rather than where the supplier is based.

Box 1 - HMRC Notice 741A – para. 8.1 – what services are supplied where performed

Services relating to cultural, artistic, sporting, scientific, educational, entertainment or similar activities (including fairs and exhibitions); **and** ancillary services relating to such activities, including services of organisers of such activities.

B2C supplies are made where the activities actually take place. (*Author comment* – **B2B** supplies follow general rule ie place of supply is where customer is based)

B2B supplies of services in respect of <u>admission</u> to cultural, artistic, sporting, scientific, educational, entertainment or similar events (including fairs and exhibitions); **and B2B** supplies of ancillary services relating to admission to such events. (*Author comment* – same outcome applies for **B2C** supplies of admission because of first paragraph)

Example

Maria is an Italian opera singer, who I have asked to fly to the UK in April next year and sing a few songs for me at my private birthday party. This is a B2C service performed by an 'entertainer' and until 30 November, Maria could have avoided a UK VAT issue because her annual fees in the UK were less than £77,000. But unfortunately the zero VAT threshold means she is required to become VAT registered in advance of her performance and charge me UK VAT at 20%.

Selling goods

Jan is resident in Holland and comes to the UK for about three months a year to do cricket coaching for players at local clubs – he also buys and sells a small amount of cricket equipment e.g. bats, balls, pads etc. He is a sole trader, so his coaching work is VAT exempt under the 'private tuition' rules and is therefore ignored as far as either the VAT registration limit or output tax is concerned. However, he buys the kit items from a supplier in Northampton and then sells them separately – about £3,000 of sales a year and he makes about £1,000 net profit. With effect from 1 December, if he applies the new legislation correctly, he will need a UK VAT number because he is a NETP making taxable sales in the UK above the zero threshold.

Getting a UK VAT number

The end result of the above analysis is that our French builder, Italian opera singer and Dutch cricketer will all need a UK VAT number for their various activities. How do they get it? In basic terms, there are four possibilities:

1. They could deal with the registration issues themselves by directly liaising with HMRC's NETP Unit in Aberdeen (Ruby House, 8 Ruby Place, Aberdeen. AB10 1ZP). NETPs can also register by using HMRC's new online service, effective from 5 November 2012.

2. They could appoint a UK tax representative to deal with their affairs – this is not the most desirable outcome because the representative is 'jointly and severally liable for any VAT debts' incurred by the business (HMRC Notice 700/1, para 11.1). This procedure involves the completion of a VAT1TR form to give authority to the representative and all matters are dealt with by HMRC's Registration Service in Wolverhampton rather than Aberdeen (Deansgate, 62-70 Tettenhall Rd, Wolverhampton. WV1 4TZ). An NETP using the online registration service can provide details of its tax representative at the time of completing the online form.

3. Appointing a UK tax agent is another option – and means the agent will be responsible for maintaining VAT records and accounting for UK VAT on behalf of the NETP – but will not be jointly and severally liable for any VAT debts. Tax agent registrations are again dealt with by HMRC's Wolverhampton office rather than Aberdeen. A letter of authority needs to be completed and signed by the client to confirm its appointed agent with HMRC.

4. An accountant could be appointed by the overseas client with authority to liaise with HMRC on VAT issues through form VAT64-8.

Exemption for zero-rated sales

A NETP business that only makes zero-rated sales in the UK will not need to register for VAT if it does not want to do so. VATA1994, Sch. 1A, para. 13(1) and (2) will allow a business to apply for exemption in such cases.

When does a business need to register under the new regulations?

If a business knows it will make taxable supplies in the UK in the next 30 days – registration takes effect from the beginning of the 30-day period, notification must be made before the end of the 30-day period.

Example – order received on 1 December 2012 by a French business to buy some goods in the UK and sell them to private individuals on 1 February 2013. Effective date of VAT registration is 2 January 2013.

A business has made taxable supplies – it must notify HMRC within 30 days of when it made the supply and registration takes effect from the date of the first supply.

Example – a French business had an unexpected chance to buy some goods from a UK supplier on 16 December 2012 and sell them on the same day to a private person, also in the UK. The effective date of VAT registration is 16 December 2012 – the French business must notify HMRC and request its VAT registration number by 16 January 2013 – the effective date of VAT registration is 16 December 2012.

VATA1994, Sch 1A, paras(1),(5),(6)

Contributed by Neil Warren