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Contents

Personal Tax

Deduction for the use of a company car

The calculation of the benefit of a company car is a complex calculation involving a number of steps within s121(1) ITEPA 2003 of which the focus of this article is the deduction of the sum paid as a requirement for the private use of the relevant car (Step 8).

It should be noted that in order for a payment to qualify for inclusion at Step 8 and so reduce the level of the taxable benefit, it must be made specifically for private use. In CIR v Quigley it was held that a payment to reimburse a percentage of the car's insurance did not satisfy this test. Equally a payment that is to enable the employee to have the use of a more expensive car, for example, will not qualify.

The relevant legislation is in in S144 ITEPA 2003:

Deduction for payments for private use

(1) A deduction is to be made from the provisional sum calculated under step 7 of section 121(1) if, as a condition of the car being available for the employee's private use, the employee—

(a) is required in the tax year in question to pay (whether by way of deduction from earnings or otherwise) an amount of money for that use, and

(b) makes such payment.

(2) If the amount paid by the employee in respect of that year is equal to or exceeds the provisional sum, the provisional sum is reduced so that the cash equivalent of the benefit of the car for that year is nil.

(3) In any other case the amount paid by the employee in respect of the year is deducted from the provisional sum in order to give the cash equivalent of the benefit of the car for that year.

(4) In this section the reference to the car being available for the employee's private use includes a reference to the car being available for the private use of a member of the employee's family or household.

(5) This section is subject to section 145 (modification where car temporarily replaced).

The exact meaning of the statutory construction of section 144(1) has been subject of a recent decision in the First Tier Tribunal in the case of Peter Marshall v CRC (TC02466) summarised below.

Mr Marshall (M) was a director of a company known as DCD Systems Ltd. He was provided with a company car during tax years 2007-08 and 2008-09 because of his directorship. The company was subject to an enquiry by HMRC as a result of which it became liable to pay £4,196 for Class 1A NICs, interest and a penalty in respect of the car. Since the company was insolvent the liability was paid by personal cheque by M in 2010/11. The issue was whether the payment reduced the taxable benefit of the car for the purposes of M's income tax liability.

HMRC argued that, in order to count as a deduction from the taxable benefit of a company car, any amount paid to the company further to a requirement on an employee to pay a sum for the use of a motor car had to be paid during the tax year in question.

The decision:

The Tribunal (Judge Geraint Jones) decided that HMRC's construction was incorrect because the qualifying words 'in the tax year in question' appeared only in sub sub-section (a) and not in sub-section (b). He demonstrated in the judgement how the preamble in the main body before paragraph 1a would have to be amended to include the words in the tax year in question to achieve the effect that HMRC were advocating.

Accordingly, Geraint Jones held that there was nothing in the law to prevent a payment of £4,196 made in 2010/11 being set off at Step 8 in s.121(1) ITEPA against the calculation of the car benefit for 2007/08 and 2008/09.

This is clearly worth remembering when dealing with payments that may be capable of set off as a condition of the car being available for the employee's private use in the computation of the relevant benefit in kind. However it needs to borne in mind that the taxpayer was fortunate in that the judge potentially overlooked the fact that although the payment was met by the taxpayer it was not initially as a condition of having the car made available to him.

Contributed by Tony Jenkins

Negative Earnings = Negative Taxation? (Lecture P762 – 10.38 minutes)

The case of Julian Martin v HMRC [2013] is an interesting case.

in 2005/06 Mr Martin, an existing employee, was offered a refundable signing bonus of £250,000 on entering into a new contract with his employers. It was repayable on a sliding scale if employment ended within five years. The following year he left the company and repaid £162,500.

PAYE and NIC were accounted for on receipt of the bonus, as one would expect. The problem came when HMRC denied Mr Martin tax relief for the £162,500 that he had refunded to his former employer.

As a consequence, the Judge concluded that if HMRC were correct, “he actually ended up considerably worse off than if he had received no Signing Bonus in the first place”.

He went on to claim that there was “no judicial authority and astonishingly no guidance in the legislation itself”.

Mr Martin’s counsel put forward three contrasting submissions.

1. There had been an error or mistake in the original operation of PAYE.
2. The refund represented negative taxable earnings under s.11 ITEPA 2003.
3. The signing bonus was actually a loan.

The first and third of these submissions were both rejected, which anyone looking from outside would immediately understand as they did not seem to accord with the facts.

With regard to the last, the Judge clarified the position by explaining that “when an error or mistake claim was made what had to be shown was that the initial tax return had contained an error, and not that circumstances arising in some later period indicated that the originally correct return should be amended”.

That left the second submission. Negative income can arise either where associated expenses exceed earnings from an employment or taxable earnings are themselves negative.

‘Negative taxable earnings’ is an odd concept. Here, the Judge decided that any reverse payment of salary i.e. from the employee to the employer must fall within this category. He was keen to emphasise that his decision relied on the contractual obligation under which the bonus was repaid. Without this, it is unclear whether he would have come to the same conclusion.

Having identified that s.11 was in point, it was then necessary to understand the interaction between that and loss relief in s.128 ITA 2007.

The s.11 mechanism offsets negative earnings against positive earnings from the same employment and tax year. In this case, Mr Martin earned £140,000 from the employment in 2006/07.

Next, s.128 lets the taxpayer offset any excess against total income from the same year or the previous year. This could be used to obtain relief for the balance of £22,500.

Could this decision have a much wider application? Mr Martin wasn't a director. Directors are far more likely to have income taxed that they never receive or possibly pay back. Bankers bonuses have been in the news lately and they too might yield repayment situations, if the Chancellor has his way.

If these were paid back, the circumstances might appear similar except that the refund would not be contractual but instead ordered by the state that imposed the tax in the first place. Time will tell regarding this decision's application in such cases.

More common is the situation where a director becomes entitled to a bonus that they never ultimately receive. It appears from the Judge's analysis that an attempt to recover tax in this latter scenario would not succeed as there are no negative taxable earnings to take into account.

This case did not consider the NIC treatment, however it was implied that HMRC would make adjustments in line with the decision.

HMRC has been granted leave to appeal but it is not yet known whether it will do so.

The tribunal report is available at

http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j6943/TC02460.pdf

Contributed by Philip Fisher, Head of Employment Tax and Rewards, PFK (UK) LLP

Payment from retirement benefit scheme on redundancy

An employee (B) worked for a brewery company (Y) from 1979 to 2006, when he was made redundant at the age of 48. Y had operated a funded unapproved retirement benefit scheme, of which B had been a member. On his redundancy, B received shares from the scheme, which he immediately sold. He did not seek further employment, but decided to live off his savings. HMRC issued an assessment charging tax at the higher rate on the amount which B had received from the scheme. B appealed, contending that the receipt and redemption of the shares was a relevant benefit within ITEPA 2003 s 393B and qualified for transitional relief under FA 2004 Sch 36.

Decision:

The First-tier Tribunal accepted this contention and allowed B's appeal. Judge Powell found that B had 'firmly decided to retire during the redundancy process for good reasons connected with his specialist skills and the likelihood (or lack of it) that they would be attractive to other potential employers'. Although he had been forced to accept redundancy, 'he was also entitled to retire from employment'.

Comments - HMRC had formed the view that the payment here should be treated as compensation for loss of employment, and was therefore taxable under ITEPA 2003 s 401. However, the First-tier Tribunal accepted the appellant's contention that because he had decided to retire, rather than to seek further employment, the payment should be treated as a retirement benefit within ITEPA 2003 s 393B. ITEPA 2003 s 401(3) provides that a payment or benefit is not a termination payment or benefit within ITEPA 2003 s 401 if it is 'otherwise chargeable to tax', so that it is necessary to consider whether a payment is chargeable to income tax under any other provisions of ITEPA 2003 before considering ITEPA 2003 ss 401–416.

GF Ballard v HMRC TC2505

EBT - Is a trustee an intermediary?

The taxpayer, a close company, created an employee benefit trust in October 2002. Contributions totalling £265,000 were paid into the trust in October and November that year.

The amounts were paid to the trustees and shown as an accrual in the taxpayer's accounts for the year to 30 September 2002. HMRC disputed the company's right to charge the £265,000 against profits.

The taxpayer said the sum was a payment that fell outside FA 1989, s 43. It argued that the trustees were not an intermediary for the purpose of s 43.

Decision:

The First-tier Tribunal said that, although the word “intermediary” was normally associated with some form of agency, this did not have to preclude trustees on the basis that in exercising their fiduciary duties as trustees, they had to act impartially. The tribunal ruled that there could be two types of intermediary: one who acted as an agent often for remuneration and another who acted as a means of transferring money, etc to a group of recipients who were dependent on the trustee exercising a power of appointment in their favour.

The tribunal did not accept the company's proposition that if a trustee has to act independently in accordance with his duties that automatically means he cannot be an intermediary. Taking this argument further would imply that the trustee had only one duty, when in fact he may have several, some being of a fiduciary nature, others not.

After the decision in Sempra Metals Ltd (SpC698), the tribunal found that the trustee could be an intermediary.

The taxpayer's appeal was dismissed.

Comments – This case deals with the provisions applying to EBTs and demonstrates the importance of the arrangements that applied as to whether the relevant potential emoluments were capable of deduction under the provisions that applied from 27 November 2002 as a result of Sch 24 FA 2003.

B W Male & Sons Ltd TC2383

DTR: Status of a Delaware limited liability company

An individual (S), who was resident in the UK, helped to form a Delaware limited liability company (H). The US authorities charged tax on S's share of H's profits, treating H as a transparent entity. S claimed double taxation relief for the US tax. HMRC issued discovery assessments for 1997/98 to 1999/2000, and amendments to S's self-assessments for 2000/01 to 2003/04, on the basis that H should not be treated as transparent and that S was not entitled to double taxation relief. The Upper Tribunal upheld HMRC's assessments and amendments (see [2011] STC 2126). Mann J held that S was not taxed on 'the same profits that were taxed in the United States', H was not transparent, and S was not entitled to double taxation relief under the US/UK treaty.

Decision:

The CA unanimously dismissed S's appeal against this decision. Arden LJ held that 'the relevant test for determining whether a person is taxed on the same profits or income in both jurisdictions is whether the source of the profits or income in each jurisdiction is the same'. On the facts of this case, H's profits did not belong to its members and S had no 'proprietary right to the profits'.

Comments - The Court of Appeal upheld the Upper Tribunal decision that the investor was not entitled to double taxation relief under the US/UK treaty on his share of the company's profits. The underlying classification of an entity as in this case can have a significant impact on the tax consequences.

Anson v HMRC (aka Swift v HMRC) EWCA

Company cars - advisory fuel rates from 1 March 2013

These rates apply to all journeys on or after 1 March 2013 until further notice. For one month from the date of change, employers may use either the previous or new current rates, as they choose. Employers may therefore make or require supplementary payments if they so wish, but are under no obligation to do either.

Engine size	Petrol	LPG
1400cc or less	15p	10p
1401cc to 2000cc	18p	12p
Over 2000cc	26p	18p

Engine size	Diesel
1600cc or less	13p
1601cc to 2000cc	15p
Over 2000cc	18p

Hybrid cars are treated as either petrol or diesel cars for this purpose.

Assessment following withdrawal of approval of pension scheme

The decision in John Mander Pension Trustees Ltd v HMRC (Upper Tribunal) follows on from the case of R (oao Mander) v CIR (2002 STC 531).

An approved pension scheme had three trustees: a UK company and a married couple who were the only two beneficiaries of the scheme. On 5 November 1996 the couple were replaced as trustees by a Guernsey company. On the same day, the trustees authorised a substantial transfer of funds to another pension scheme, the original UK trustees of which were (also on the same day) replaced by new trustees resident outside the UK. When the Revenue discovered this, it issued a notice under ICTA 1988 s 591B, withdrawing their approval of the scheme with effect from 5 November 1996. It also issued an assessment under ICTA 1988 s 591C on the company which acted as the administrator of the scheme. The company appealed, contending that the assessment was invalid and unenforceable.

The FTT rejected this contention and dismissed the appeal. Judge Mosedale observed that 'the purpose of the 40% charge on assets leaving an approved scheme is to re-coup the tax advantages the funds enjoyed while in an approved scheme. If a scheme member does not wish to abide by the rules, and in particular accept the limitations on what can be done with the funds in an approved scheme, then he is not entitled to the tax benefits, and it seems quite reasonable for the government to seek to recoup them.' She held that the effect of ICTA 1988 s 658A was that 'all administrators from the moment the deemed charge arises onwards are liable, as the charge arises during their control of the funds, although the assessment must be in the name of the administrator at the time of the assessment'. The effect of the legislation was that 'on becoming administrator, the new administrator becomes responsible for the scheme's affairs and liable to discharge its accumulated liabilities. It was not intended by parliament that changing administrator would relieve the fund of liability to pay an assessment to tax under s 658A.' Accordingly, 'current and future administrators are jointly and severally liable', and tax charged under s 591C 'can be recovered in full from any single relevant person (unless they ceased to be a relevant person before the events in question) on the basis that the assessment of only a single relevant person in the name of the administrator of the scheme establishes joint and several liability of all relevant persons. The liability which is joint and several extends to relevant persons not in existence at the time of the assessment.'

Decision:

The Upper Tribunal upheld this decision. Vos J observed that 'there is no reason on earth why the legislation should be read as meaning that HMRC was unable to seek the tax from the trustees in post as administrator at the time when the withdrawal notice was served, if they had chosen to resign before the assessment was served. The suggestion that HMRC must issue repeated assessments on the trustees serving as the current administrator however often they change is a construction that would be unwieldy and often unworkable. Ultimately it might even lead to the time limits operating to prevent collection of the tax at all.'

Comments - The Upper Tribunal upheld the FTT decision that an assessment under ICTA 1988 s 591C was both valid and enforceable, regardless of any change in the identity of the administrator of the relevant scheme.

John Mander Pension Trustees Ltd v HMRC (Upper Tribunal)

Statutory residence test – FB 2013 (Lecture P761 – 11.39 minutes)

Automatic residence

The automatic residence tests are considered first in trying to determine whether a person (P) is resident in the UK for tax purposes in tax year X.

This involves considering both the “automatic UK residence” tests, and potentially the “automatic overseas residence” tests.

If the results of the automatic tests are inconclusive, we move on to consider the sufficient ties test, which should then give us a conclusive answer.

The sufficient ties test

P meets the sufficient ties test for a year if the automatic residence test is not satisfied, and P has sufficient UK ties for the year.

The test essentially identifies the number of ties the individual has with the UK in year X and then looks at the number of days spent in the UK to determine whether P is UK resident or not. The day count is applied differently if P has not been UK resident in any of the three preceding tax years to year X (see below). This may mean that in the early years of the statutory residence test, advisers are still considering the “old” residence tests, and in particular the “complete break” concept, which disappears under the new statutory regime.

UK ties defined
The following ties are identified

- A family tie
- An accommodation tie
- A work tie
- A 90 day tie, and
- A country tie

The last of these – the country tie does not apply to persons who have not been resident in the UK during any of the three tax years preceding year X.

Family tie
There is a relevant relationship at any time in year X between P and another person, and that person (Q) is UK resident in year X.

A relevant relationship is with a spouse or civil partner and not separated, living together as if man and wife or civil partners, or with a child under the age of 18. The tie with a minor child is excluded if P sees the child for fewer than 61 days in year X.

When determining whether Q is resident in the UK for this purpose, a family tie with P is ignored. Where a child under the age of 18 is in full time education in the UK, and is UK resident only by virtue of time spent in the UK in term time, they will be treated as non-resident, provided the number of days spent in the UK outside term time is less than 21.

Accommodation tie
If P has a place to live in the UK (a home, a holiday home or a temporary retreat, or accommodation available to him) and this is available to P for a continuous period of at least 91 days, and P spends at least one night there in the year, then P meets the accommodation tie test.

However, if the available accommodation is the home of a close relative of P the number of nights spent there increases to at least 16 (a close relative is a parent or grandparent, sibling, child or grandchild aged 18 or over). Where there is a gap in availability, gaps of fewer than 16 days are ignored.

Work tie
P has a work tie with the UK if P works in the UK for at least 40 days in year X. Work for this purpose is more than 3 hours in a day. There are other provisions covering international transport workers.

90 day tie
90 day tie – P has a 90 day tie in the tax year is P has spent more than 90 days in the UK in either or both of the tax year preceding year X, and the preceding year to that.

Note that the sufficient ties test can permit P to remain in the UK for more than 90 days in some cases (see tables below), and retain non residence. However, this would then affect residence in a subsequent year as the 90 day tie test could then be satisfied.

Country tie
This test only applies to P if P has been resident in the UK for any of the three preceding tax years.

If the country in which P meets the midnight test for the greatest number of days in year X is the UK (or highest equal with at least one other country).

Number of ties / number of days present
The law now uses the number of ties and compares the number of days present in the UK with the following two tables. This gives a conclusive answer to the test for year X.

Table 1
Where P was resident in the UK for any of the 3 tax years preceding year X, the following Table applies :

Days spent by P in the UK in year X	Number of ties that are sufficient
More than 15 but not more than 45	At least 4
More than 45 but not more than 90	At least 3
More than 90 but not more than 120	At least 2
More than 120	At least 1

Where P dies in the tax year, the words “more than 15 but” are omitted from Table 1.

Table 2
Table 2 applies where P was not resident in the UK for any of the 3 tax years preceding year X.

Days spent by P in the UK in year X	Number of ties that are sufficient
More than 45 but not more than 90	All 4
More than 90 but not more than 120	At least 3
More than 120	At least 2

In addition, if P dies before 1 March in year X, both Tables are treated as if the number of days are reduced by apportioning for the number of whole months after P’s death.

Counting days

The current test, using midnight has been carried into the new legislation with some amendments. The exception for transit passengers and unavoidable detention in the UK (using "Exceptional circumstances beyond P's control") remain (subject to a total maximum of 60 in any tax year), but the legislation also deems days in the UK.

A deeming rule applies if P has at least 3 UK ties in a tax year, and was UK resident for at least one of the tax years preceding year X, and spends at least 30 days in the UK at some point, but not at the end of the day (these are termed qualifying days). Once the number of qualifying days reaches 30 (starting from the beginning of the year and counting forward), each subsequent qualifying day is deemed to be a day spent in the UK by P.

Home

A home can be a building or part of a building, or a vehicle, vessel or structure of any kind. The facts will determine whether a particular place is a home, but somewhere used only as a holiday home or retreat will not be regarded as a home. Ownership is not conclusive that something is or is not a home.

Work

Anything in the performance of the duties of an employment or in the course of a trade is work. Travelling time is included if the cost of the journey would be allowable for tax against either employment income or the profits of a trade. Time spent on training is work if provided or paid for by the employer and undertaken by P to help him in performing the duties of the employment, or where the cost would be deductible in arriving at the profits of a trade.

Work done in the course of travelling to or from the UK is treated as done overseas, even if part of the journey is in the UK. Travelling for this purpose is from the time of embarkation to the time of disembarkation.

Full time work is an average of 35 hours per week.

Example

Carlo is Spanish by birth. He came to the UK in 1980 and settled here. He married a UK national and started up a business here. There were no children of the marriage and the marriage broke up in 2009. Carlo returned to Spain for a period of time to collect his thoughts and left his business under the control of a manager – keeping in touch by internet. While in Spain he met and married a younger woman and decided to settle there. He bought a house, and now has a young daughter. He continues to run his business in the UK remotely, making trips as and when needed to see clients and suppliers. He has retained his former matrimonial home and his car so that when he comes to the UK he can stay there. He spends on average around 75 days a year in the UK.

Thoughts on Carlo

The automatic residence tests are not covered here, but Carlo does not meet any of the automatic UK tests, nor does he meet any of the automatic overseas tests, so we are considering his ties with the UK.

Family tie – this test is not met. His family are resident in Spain and he has no family links with the UK.
Accommodation tie – Carlo certainly meets this test through his ownership of a house in the UK
Work tie – Carlo meets this test too, as he works here for around 75 days a year
90 day tie – Carlo has not spent more than 90 days in the UK since he left in 2009.
Country tie – this is potentially relevant to Carlo – his residence in 2010/11, 2011/12 and 2012/13 is under the old rules, and he may have a problem with "complete break", so we will assume that it applies. However, as Carlo spends the rest of the year (when not in the UK on business) in Spain, the country tie is not met.

So Carlo has two ties with the UK. Turning to the Tables, it is fairly likely that Carlo cannot meet the non residence tests for all of the preceding three years. If we take this as "worst case scenario" we can advise as follows :

Using Table 1, if Carlo is in the UK for 90 days or more, with 2 ties he would be UK resident, so he will need to keep his number of days below 90 – which is what he intends.

Had Carlo been non resident for the last 3 years, Table 2 would permit him to be here for more than 90 days, but this would create a potential for a third tie in the next tax year, so our advice would be to restrict to 90 days in any event.

Contributed by Rebecca Benneyworth

Capital Taxes

BPR denied (Lecture B761 – 16.57 minutes)

Business Property relief is an incredibly important relief in IHT so it is important that the conditions are met. The conditions to be satisfied are:

a) the business, whether unincorporated or incorporated into a company in respect of which relief is claimed, is a qualifying business, and
b) the asset must be relevant business property, and
c) the asset must have been owned for a minimum period.

There is an important exclusion from a qualifying business which is that a business or interest in a business, or shares or securities of a company, do not qualify if the business (or the business of the company) consists wholly or mainly (see below) of dealing in securities, stock or shares, land or buildings or making or holding investments,

This was demonstrated recently in the case of HMRC v Lockyer & Robertson (Mrs NV Pawson's Personal Representatives) (Upper Tribunal) where the Upper tribunal overturned the decision of the FTT which had been in favour of the taxpayer. The case is summarised below.

At the time of her death in June 2006 Mrs Pawson (P) owned a 25% share in a property called Fairhaven (F) in Suffolk. F was a large bungalow overlooking the sea. It could accommodate up to 11 people and was let for periods of up to two weeks. A number of bookings were made for long weekends. In the last three years before P's death income from the property was £4,342 (profit £680), £6,072 (profit £802) and £8,120 (loss £2,071). The loss was caused by redecoration and improvements. In the year of P's death the income had been £16,589 (profit £4,449). Each year family members occupied the property for three weeks during the holiday season. Adjustments were made for private use based on HMRC guidelines in 'Notes on Land and Property.'

HMRC refused to grant business property relief for the property in determining the IHT on P's estate. The executors appealed.

Before the First-tier Tribunal, the key issue was whether the business was disqualified from BPR because it consisted wholly or mainly of 'holding investments'. The FTT found that significant services were provided to the occupiers of the property and that these services were not incidental to the holding of the property as an investment. The need constantly to find new occupants and to provide services unconnected with and over and above those needed for the bare upkeep of the property led to the conclusion that F could not be correctly characterised as an investment, but a business asset to be exploited as part of the provision of services going well beyond an investment as such. The executors' appeal was allowed. HMRC appealed.

The Upper Tribunal said that owning and holding of land in order to obtain an income from it was generally to be characterised as an investment activity. Further, it was clear from the authorities such as *Martin, Weston* and *George*, that such an investment could be actively managed without losing its essential character as an investment.

Accordingly, the fact that the Pawsons carried on an active business of letting Fairhaven to holidaymakers did not detract from the point that the business was basically one of an investment nature. In any normal property letting business, the provision of additional services or facilities of a non-investment nature would either be incidental to the business of holding the property as an investment, or at least would not predominate to such an extent that the business ceased to be mainly one of holding the property as an investment.

The critical question was whether these additional services were of such a nature and extent that they prevented the business from being mainly one of holding Fairhaven as an investment.

On the basis of the FTT's findings of primary fact, the only conclusion which it was reasonably open to them to draw was that the business carried on at Fairhaven did indeed remain one which was mainly that of holding the property as an investment. The services provided were all of a relatively standard nature, and they were all aimed at maximising the income which the family could obtain from the short term holiday letting of the property. Looking at the business in the round, there was nothing to distinguish it from any other actively managed furnished letting business of a holiday property, and certainly no basis for concluding that the services comprised in the total package preponderated to such an extent that the business ceased to be one which was mainly of an investment nature.

Another aspect that needs to be considered in the context of furnished holiday lettings is the difference in the rules that apply for IHT as compared with Income Tax and Capital Gains Tax. You will note rather unusually a case is referred to below which has occurred and been reported at the same time dealing Capital Tax aspects.

Contributed by Tony Jenkins

No relief

In September 2004, the taxpayers, a married couple, bought a property in County Antrim intending to use it for short-term holiday lettings. The property was let for 64 days during the 12-month period ending on 8 July 2006 which was also the first day of a 14-day letting period. The last letting ended on 9 December 2006 and the property was sold in June 2007.

HMRC assessed the taxpayers to capital gains tax on the proceeds. The taxpayers appealed on the grounds that the property was let for more than 70 days in the first year of letting and that any taper relief should be spread over the whole period that the property was available to be used as furnished holiday lettings. They argued that, although the property was occupied for only 64 days in the first year, it was let for more than 70 days if the 14-day let beginning on 8 July was included.

Decision:

The First-tier Tribunal said the taxpayers' argument that the 14-day let should be included in the first year "must fail as the legislation clearly states that the property must be let for at least 70 days during the 12-month period". The fact that the tax rules under Schedule A may have required income from the 14-day to be included in the first year did not mean the same was the case with regard to capital gains tax. TCGA 1992, s 288 defined chargeable period as a year of assessment.

The taxpayers' appeal was dismissed.

Comments – This case is interesting coming in the same period as the Pawson case. The rules for Income tax and CGT changed recently and this case demonstrates the importance of the day counting rules in Income Tax albeit that these are demonstrative of the rules well before the recent changes. It also demonstrates how there are very different provisions in respect of IHT and other taxes.

D Horner; E Horner TC2498

CGT exemption for employee shareholder shares (Lecture B762 – 22.02 minutes)

Following the publication of a consultation document by the Department for Business, Innovation and Skills last autumn, legislation was introduced on 11 December 2012 to exempt from tax any gain made on the disposal of shares acquired through the adoption of the 'employee shareholder status' set out in S205A Employment Rights Act 1996 (*not* 2006, as the draft legislation incorrectly states!).

The relevant details can be found in new Ss236B – 236G TCGA 1992.

The shares:

(i) must be issued in consideration of an employee shareholder agreement, ie. an agreement under which the employee gives up:
  - his right to statutory redundancy pay;
  - his unfair dismissal rights (except for reasons which the law specifically regards as unfair such as whistle-blowing – or which relate to discrimination); and
  - certain rights to request flexible working and time to train;

(ii) must be classified as 'qualifying shares', ie. shares in the employer company or in an associated company; and

(iii) must have a value of at least £2,000.

Shares cannot be exempt if the shareholder and/or anyone connected with him has a material interest in the company – a material interest is defined as 25% or more of the company's voting rights (S236D TCGA 1992).

By virtue of S236C TCGA 1992, an employee shareholder holding is only exempt from CGT if the total value of qualifying shares issued to the employee does not exceed £50,000. If the shares issued exceed £50,000 in value, the holding must be divided into two tranches:

(i) the maximum number of shares which may be received without breaching the £50,000 limit; and
(ii) the balance.

For this purpose, the value of a share is always taken to be its unrestricted market value.

The normal share pooling and matching rules in Ss104, 105 and 106A TCGA 1992 are disapplied by S236E TCGA 1992. If an individual holds both exempt and non-exempt employee shareholder shares and if he disposes of some (but not all) of these, he is entitled to specify how many exempt shares he has sold (up to the number which he held) – there is no pro rata requirement.

For obvious reasons, S236F TCGA 1992 prevents the 'no disposal' provision in S127 TCGA 1992 from applying to exempt shares where there has been a share-for-share exchange, a company reorganisation or a reconstruction.

Companies of any size are able to use this new employment status, but the Government have indicated that it is principally intended for fast-growing companies which want to benefit from the flexibilities available under these arrangements. In summary, therefore, employers are able to offer their staff fully paid up shares worth a minimum of £2,000 and a maximum of £50,000. The Government have confirmed that all classes of share will be eligible for the exemption and that these shares can carry rights to dividends, votes or an entitlement to participate in the company's assets if it is wound up.

The CGT aspects of the legislation are now reasonably clear and, although the tax exemption appears attractive, it is worth noting that a CGT charge on exit is not usually a major concern when planning employee share schemes. More pertinent problems are the income tax which will be due on the acquisition of free shares in an employer company and finding the cash to pay that tax. Since the amount charged to income tax is added to the base cost of the shares and the employee has their (and, sometimes, their spouse's) annual CGT exemption to reduce the gain still further, there is often little or no CGT to pay in any event.

Illustration 1

In 2013/14, Kevin, a 45% taxpayer, is awarded shares worth £20,000 in his employer's company. Let us suppose that these shares are sold for £45,000 in two years' time.

Ignoring the operation of the new regime, Kevin is charged to income tax (and possibly NICs) on the acquisition of these shares and so his base cost for CGT purposes becomes £20,000.

Shortly before the sale, Kevin transferred one half of his holding to his wife who has no taxable income, with the result that both spouses are taxed on a gain of £12,500 (½ x £25,000). Given that each of them will have an annual CGT exemption of £11,100 for 2015/16, this leaves a chargeable gain of £1,400 for both Kevin and his wife.

Their aggregate CGT liability will be:

	£
Kevin (£1,400 @ 28%)	392
Wife (£1,400 @ 18%)	252
	£644

Seen in this light, the CGT exemption does not look especially generous. Moreover, Kevin's income tax liability at the time of the share award would have been 45% x £20,000 = £9,000 (with the possibility of an NIC charge on top of that), but he has no additional cash to settle this tax bill until two years later.

The income tax difficulty highlighted in the above illustration appears to have been recognised by the Chancellor who recently proposed that only the excess over £2,000 should be subject to income tax under the scheme. Unfortunately, the draft legislation issued late last year did not include this provision. As one commentator has put it:

'While this is welcome, the figure of £2,000 is still somewhat low and is likely to restrict the take-up of the scheme.'

The same commentator goes on:

'There are other problems too. There is the issue of liquidity – the scheme is supposed to be aimed at small or medium-sized businesses, but such companies' shares are highly illiquid assets. Dividends may not be regular or paid at all and there may be no opportunity to sell the shares for many years, if ever.

The Treasury have stated that, where the employee departs while holding shares acquired in this manner, he or she can require the company to repurchase them. Aside from a question of how the repurchase price should be arrived at, the repurchase would be likely to be taxed as a dividend rather than a capital gain and thus the . . . CGT exemption would not be in point.'

Although we may expect to see some further legislation to clarify the income tax position, the latest proposal is little better than the share schemes currently available and so, unless further concessions are made, it is likely that practitioners will not be advising too many of their clients to follow this new strategy.

Contributed by Robert Jamieson

CGT – Main Residence Elections (Lecture P765 – 12.56 minutes)

Background

The capital gains tax (CGT) legislation on principal private residence (PPR) relief includes a helpful election facility for cases where an individual has two or more residences. The election broadly allows an individual to nominate which of the individual's residences should be treated as his or her only or main residence for PPR relief purposes.

Legislation

The main provision dealing with the main residence election is contained in TCGA 1992, s 222(5), which states:

"(5) So far as it is necessary for the purposes of this section to determine which of 2 or more residences is an individual's main residence for any period—

(a) the individual may conclude that question by notice to an officer of the Board given within 2 years from the beginning of that period but subject to a right to vary that notice by a further notice to an officer of the Board as respects any period beginning not earlier than 2 years before the giving of the further notice…"

The first hurdle

A prerequisite for making the election is that the individual must have more than one 'residence'.

Once this fact is established, the election facility is available to determine which of those residences is the individual's 'main residence'.

Ellis v HMRC

In Ellis v HM Revenue & Customs [2013] UKFTT 775 (TC), Mr and Mrs Ellis made an election under TCGA 1992, s 222(5) in respect of a property, which they occupied and later sold. Following an enquiry into the tax returns of both individuals, HMRC raised CGT assessments, which were appealed.

At the tribunal hearing, HMRC accepted that the property had been used as a residence of the taxpayers, but argued that the property had not been the taxpayers' main residence.

The tribunal pointed out that once HMRC conceded that the property was a residence, and it was accepted that the taxpayers had two residences, the effect of s 222(5) was to allow the taxpayers to elect which of the two residences was, for CGT purposes, his or her main residence.

Consequently, HMRC could not argue that the residence was not the taxpayers' main residence, as s 222(5) conclusively deals with the question of which property is the main residence. As HMRC accepted that the property was a residence, the appeal must succeed. The appeal was therefore allowed.

HMRC agrees!

Interestingly, the tribunal's conclusion in Ellis was already supported in HMRC's guidance. The capital gains manual states (at CG64485):

"When nominating which residence is to be treated as the main residence, an individual is not obliged to nominate the residence which is factually his or her main residence; they may nominate whichever residence they choose."

It would appear that HMRC's argument in Ellis was a tactical error, rather than a change in its approach in respect of s 222(5) elections.

Married couples

For spouses or civil partners who are living together, there can only be one residence or main residence for them both. If the election affects both of them, it must be made in writing to HMRC, and must be signed by each of them (s 222(6)).

Late elections

Concession D21 allows for the possibility of a late election in certain circumstances involving a residence with "…no more than a negligible capital value on the open market" (e.g. a weekly rented flat or employer provided accommodation).

Varying an election

An election under s 222(5) can be varied at any time by notice to HMRC. The notice can effectively be backdated by up to two years. HMRC guidance appears to accept variations as an acceptable way to secure the "final period" exemption (in s 223(1)); see CG64510.

Contributed by Mark McLaughlin

Administration

Dealing with director loan accounts under RTI (Lecture B763 – 7.24 minutes)

Debit balance on loan account

Commonly, a director of his own company will draw against his loan account throughout the year, and at the end of the tax year, the accountant will resolve this by putting through an annual salary and reporting this on form P35. Commonly the salary is insufficient to generate tax or NI, but sufficient to allow the director to obtain state pension credits. Where the loan account is in debit, this presents a problem under RTI.

Because the salary has in effect been "paid" when the director drew against his loan account during the year, the employer has a breach of the "on or before" reporting requirement, unless the director at that point draws the amount of net pay – possibly repaying the sum to the company to reduce his loan account balance. This may not be practical – the company may not have sufficient funds to make such a payment.

Where the loan account is in credit throughout the year this is not such a problem – see below for guidance.

Possible solution – monthly payroll run

There is no restriction on filing FPS's in advance, so the adviser could run 11 or 12 months' payroll and RTI submissions in April 2013, each for 1/12 of the anticipated annual salary. If the director is to be paid at just below the NIC threshold of £148 per week, this could be for £640 per month (all amounts for 2013/14). Assuming that the director is entitled to a full personal allowance of £9,440 in 2013/14 there would be no tax or NIC to report. The net pay of £640 per month should be paid monthly at the end of the month – either by cheque or standing order. The director could thus reduce his periodic drawings against loan account, with a minute that amounts drawn will be subsequently cleared by dividend or will be treated as a loan.

This would resolve any difficulty with "on or before" and in addition would exclude the risk of NIC being due as the funds were drawn, based on a payment on account of pay. Creating a minute for the dividend / loan avoids other payments being regarded as payments on account of pay. If it is decided to pay a director's bonus at the end of the year, say in month 12, the amount should be calculated at the time of payment and a cheque drawn – if the proceeds are to be set against the loan account, there should really be an exchange of cheques to eliminate any "on or before" problems.

Potential flaws

If the expected salary changes for any reason, there might be a number of FPS filings which were incorrect. In cases where the director works on contract and is not successful in securing work part way through the year and therefore returns to paid employment, FPS filings may have been made when no payment will be made. In this case, it might be preferable to run FPS only in respect of the known balance of the contract and review the position at the end of the contract once it is known whether further contract work can be secured.

If the director's tax code changes part way through the year so that some of the payments would be liable to tax based on a reduced code, the employer will have made inaccurate FPS filings. This may be more trouble to correct than it is worth, but leaving month 12 unfiled would allow the correct code to be applied in that month, and the cumulative nature of PAYE would allow this to correct the position for the majority of directors.

In summary, this does offer a solution for many employers but will need to adopted sensibly if the solution is not to create more problems than it solves.

The key aspect will be communication with the director so that he is aware of the issues with on or before, and appreciates the need to take more care. Although penalties are not chargeable in 2013/14 for late RTI submissions, they will arise in 2014 and it would be wise to ensure that clients are compliant from the beginning.

Annual / quarterly payment

Where the payment is to be made on a different frequency, such as quarterly, this presents no problems, and allows the adviser to review the position for the company in a little more detail.

An annual payment is possible, if the director is set up on an annual pay interval. In this case, a month 12 code would be used, meaning that no tax would be due provided the amount paid is below the tax threshold. NIC is calculated on an annual basis for the director so this presents no problems. (See Employer's Further Guide to PAYE and NIC CWG 2 at page 8.) However, in this case the employer would need to file "Nil payment" returns each month using EPS, or an inactivity report using EPS to indicate that no payments have been made during the remaining months.

Inactivity reports at present can only be filed for up to 6 months in advance, so the employer would be forced to file more than one to cover the whole tax year.

Credit balance on loan account

Where there is a credit balance on the loan account, the "earliest event" (which triggers the requirement to account for PAYE / NIC) would be the crediting of a salary to the loan account. This is the effective date of payment where a loan account is in overall credit, and so the RTI filing can easily be aligned with the date on which the credit is made. Drawing against the loan account can then follow at leisure, as the balance is drawn against. Once again, the adviser will need to decide which is the simplest mechanism for filing under RTI, but without needing to tie in the actual drawing of funds with the "date paid" field on the RTI submissions.

Contributed by Rebecca Benneyworth

Isle of Man Disclosure Facility

HMRC has signed an agreement with the Isle of Man which establishes a new disclosure facility.

The main features of the facility are:

- The disclosure facility will run from 6 April 2013 until 30 September 2016 (the same as the closing date for the LDF).
- All outstanding tax for all years since 5 April 1999 along with interest and penalties must be paid when applying, although time to pay agreements may be possible. Under the LDF there is no requirement to pay immediately.
- A person is eligible to participate if they are not under investigation by HMRC on 6 April 2013.
- A person may not participate if they are a 'relevant person' for the purposes of the UK/Swiss agreement, for example an individual with a Swiss bank account.
- HMRC will not seek to collect any unpaid tax for periods before 5 April 1999.
- The maximum penalty will be 10% for periods up to April 2009. After that it will be the minimum penalty for deliberate inaccuracy in Sch.24 FA 2007.
- Unlike the LDF, there is no offer of immunity from prosecution.
- It will be possible for a professional adviser to approach HMRC and discuss a proposed disclosure on a 'no names' basis. This is not available under the LDF.
- Professional advisers are offered the possibility of having a single point of contact within a discrete HMRC team to ensure consistency of treatment.
- There is no Composite Rate Option under this facility such as that offered by the LDF

This facility will allow investors with accounts in the Isle of Man to come forward and settle outstanding tax liabilities before information on their accounts is automatically shared.

HMRC enquiry into company return

HMRC issued a notice of enquiry under FA 1998 Sch 18 para 24 into a company's tax return. The company appealed. HMRC applied for the appeal to be struck out on the grounds that there was no right of an appeal against the opening of an enquiry under Sch 18 para 24.

Decision:

The FTT accepted this contention and struck out the appeal. Judge Mosedale observed that 'there is no right of appeal against a notice opening an enquiry. This is not surprising as one is not needed: the notice of enquiry is nothing more than an opening of enquiries to check the correctness of the return.'

Comments - The FTT upheld HMRC's view that there is no right of an appeal against a notice opening an enquiry. Judge Mosedale's comments are self-explanatory.

Spring Capital v HMRC TC2461

Alleged failure to submit return: whether reasonable excuse

An individual (F) appealed against a penalty imposed for failure to submit his 2009/10 tax return, contending that he had submitted it online on 27 January 2011.

Decision:

Judge Khan allowed his appeal, observing that F had given the precise time and day of filing and that 'it was clear that he had used HMRC's computers to calculate his tax liability on the same day'. He had 'received replies which related to his online filing which suggested to him that the filing was completed'. It appeared 'possible that the error lay with HMRC's online computer facility dealing with online filing'. F 'genuinely and honestly believed that he had completed the online filing', so that the circumstances constituted a reasonable excuse.

Comments - The FTT found that appellant's contention that when he used HMRC's online facility, he had believed that his return had been successfully transmitted, even though HMRC denied receiving the return, constituted a reasonable excuse.

R Fergus v HMRC TC2452

Administrator rather than adviser

The taxpayer had appointed an accountant to handle his tax return. The accountant, who was a sole practitioner with no employees, did not file the return on time, so HMRC issued late filing penalties.

The taxpayer appealed. He claimed reasonable excuse on the basis that his accountant was unable to complete the return because of ill health.

Decision:

The First-tier Tribunal judge said that the accountant in this instance was acting as a functionary, rather than in a professional advisory capacity. The taxpayer should have made alternative arrangements for the return to be completed by someone else if the accountant was no longer able to deal with the return. Had the taxpayer been relying on professional advice, with no reason to believe that the advice was wrong, the conclusion would usually be that the taxpayer had not acted negligently. This was not the case in this instance.

The taxpayer's appeal was dismissed.

Comments – The facts in this case demonstrate that the ultimate responsibility for the filing lies with the taxpayer and this is demonstrated particularly here where the accountant was acting as a functionary of the taxpayer.

Lithgow v HMRC TC2296

Harsh penalties reduced

The taxpayer, a builder, made 16 late returns under the construction industry scheme. HMRC imposed penalties totalling £54,100 which they later offered to reduce to £14,600 under TMA 1970, s 102 “mitigation of penalties”.

The taxpayer refused the offer and appealed, saying that the returns had been filed on time, he had not received the penalty notices until June 2010, and the fines were unjust and breached his human rights.

Decision:

The First-tier Tribunal said the taxpayer's evidence was not credible. It was not believable that 16 returns could have been lost in the post. Nor was it likely that the taxpayer had not received any of the penalty notices until June 2010.

On the penalties, the regime was intended to punish those who did not comply with the rules and was therefore criminal in nature for the purposes of article 6 of the European Convention for the Protection of Human Rights and Fundamental Freedoms 1950. The taxpayer's human rights had not been breached.

However, the fixed penalties had operated disproportionately against the taxpayer in this instance. They totalled £19,300, which was harsh and “plainly unfair”. The judge decided that the fixed penalties operated “so harshly in this case that they should all be reduced to zero”, although, in so doing, the judge did not condone the taxpayer's “repeated defaults”. Rather, any other approach was “fraught with difficulties”.

The month 13 penalties were also excessive and should be reduced to £6,287.25. The taxpayer's appeal was allowed in part.

Comments – This is another case which demonstrates that the application of certain penalties can result in penalties where bear little correlation with the behaviour. The judge’s comments demonstrate the severity of the penalties and therefore the need for the Tribunal to reduce them to a more appropriate level. They are self explanatory.

Bosher v HMRC TC2307

Costs: company applying for 1986 rules to continue to apply to appeal

HMRC issued an assessment on a company (U) in 2006. U appealed. In January 2012 HMRC withdrew the assessment. U applied for costs, and applied for a direction that the VAT Tribunal Rules, SI 1986/590, rule 29 should apply to the proceedings rather than the Tribunal Procedure (First-Tier Tribunal) (Tax Chamber) Rules, SI 2009/273, rule 10.

Decision:

Judge Scott granted the application, observing that 'the case was sisted for very long periods, both before and after 1 April 2009, and that primarily at the request of HMRC'. She concluded that 'in order to achieve fairness and justice, in the particular and unusual circumstances of this case, the 1986 Rules should apply'.

Comments - As a general rule, where an appeal was lodged before the introduction of the new Tribunal system on 1 April 2009, but was not decided until after that date, it is the new rules set out in SI 2009/273 that apply, rather than the old rules set out in SI 1986/590. In the particular circumstances of this case, however, where the hearing of the appeal had been delayed for a long time at the request of HMRC, Judge Scott accepted the company's contention that the 1986 Rules should apply.

Usha Martin (UK) Ltd v HMRC TC2444

Company applying for 1986 Rules to continue to apply to appeal

Where the substantive issue concerned the zero-rating for books and related products, the successful appellant company applied for a direction that the VAT Tribunal Rules, SI 1986/590, rule 29 should apply to the proceedings rather than the Tribunal Procedure (First-Tier Tribunal) (Tax Chamber) Rules, SI 2009/273, rule 10.

Decision:

The FTT dismissed the application, applying the principles laid down by Warren J in HMRC v Atlantic Electronics Ltd (No. 3) [2012] UKUT 45 (TCC).

Comments - As a general rule, where an appeal was lodged before the introduction of the new tribunal system on 1 April 2009, but was not decided until after that date, it is the new rules set out in SI 2009/273 that apply, rather than the old rules set out in SI 1986/590. The FTT rejected the company's contention that the old rules should continue to apply to its appeal. This case can be contrasted with Usha Martin (UK) Ltd v HMRC (TC02444), where Judge Scott had accepted a company's contention that the 1986 Rules should apply.

Hewlett Packard Ltd v HMRC TC2459

Admissible evidence

The case of B & D Foulser v HMRC (Upper Tribunal — 25 January) follows on from the CA decision in Foulser & Foulser v MacDougall (2007 STC 973), which concerned an attempt to avoid CGT on a share disposal by a complex avoidance scheme (which was implemented in 1997/98).

The CA had remitted the case to the FTT to consider the amount of the assessment. After the beginning of the hearing, the appellants lodged an application that the tribunal should decline to admit further evidence from HMRC, since their tax adviser had been arrested on suspicion of cheating the public revenue and false accounting, and following his arrest, HMRC had obtained information relating to their tax affairs which they considered to be legally privileged.

Decision:

The FTT dismissed the application, holding that it did not have the jurisdiction to make the order sought. Judge Berner held that any allegation that 'prosecutors have been guilty of such serious misbehaviour that they ought not to be allowed to benefit to the defendant's detriment' would be a matter for the High Court. However the Upper Tribunal remitted the case for rehearing. Morgan J expressed the view that Judge Berner appeared to have misunderstood one of the appellants' contentions. He held that the FTT had jurisdiction to determine the tax appeal under TMA 1970, and that if the information which HMRC had obtained had produced a risk of unfairness, it was for the FTT to make appropriate directions.

Comments - This case illustrates the difficulty of defining what Lord Scarman described as 'the limit beyond which the safe channel of acceptable tax avoidance shelves into the dangerous shallows of unacceptable tax evasion'. The case of Foulser & Foulser v MacDougall is often viewed as a case concerning avoidance rather than evasion, but HMRC took the view that the tax adviser involved had 'crossed the line' from avoidance to evasion, and arrested him on suspicion of cheating the public revenue and false accounting. HMRC will be disappointed that, more than 15 years after the transactions which gave rise to the appeal, the Upper Tribunal has remitted the case to the FTT to reconsider the consequences of the arrest of the appellants' adviser.

B & D Foulser v HMRC (Upper Tribunal)

Upper Tribunal reversing FTT decision to grant adjournment

A company (P) reclaimed substantial amounts of input tax in 2006. HMRC rejected the claim on the grounds that the transactions appeared to be connected to MTIC fraud. P appealed, and after long delays, the appeal was listed for hearing in February 2013. In December 2012 P applied for the hearing of its appeal to be adjourned on the grounds that its controlling director (W) was undergoing psychiatric treatment. The FTT granted the application but HMRC appealed to the Upper Tribunal.

Decision:

The Upper Tribunal reversed this decision and directed that the substantive appeal should be set down for hearing. Proudman J observed that a report from an independent psychiatrist had contradicted some of the claims made by W's own psychiatrist, and had indicated that 'although (W) does suffer from a moderate depressive disorder, it is not a severe one'. There had already been substantial delay, and 'this appeal cannot go on for ever'.

Comments - The Upper Tribunal reversed the FTT decision and upheld HMRC's view that, in view of the substantial delays that had already taken place, the appeal should be set down for hearing despite the director's illness.

HMRC v Purple Telecom Ltd (Upper Tribunal)

Illness is a reasonable excuse

The taxpayer appealed against penalties imposed for the late payment of PAYE tax and National Insurance in 2010/11. Mrs Fisher, who was one of the directors of the company, had been diagnosed with cancer during the year and died in March 2011. She had tried to cope with her duties while she could. Her daughter also worked for the company but was not experienced in PAYE matters. The other company director was busy taking on extra duties to keep the company going.

HMRC said that Mrs Fisher's illness was not a reasonable excuse because there were two directors and alternative arrangements should have been made.

Decision:

The First-tier Tribunal accepted that Mrs Fisher's illness placed a great strain on the company. Further, since she was the sole signatory of cheques for much of the time, it was difficult for them to be signed in her absence.

The judge concluded that the company had a reasonable excuse for the first six months of 2010/11 but, after that, it should have put in fresh procedures.

The taxpayer's appeal was allowed in part.

Comments – The concept of reasonable excuse can appear to be harsh at times. In this case there was a combination of events which when they happen in a small business are likely to have consequences detrimental to the business in the form of penalties. The judge applied compassion by determining that there was a reasonable excuse for part of the time but clearly as the time continued the business needed to put other procedures into place.

Four Colours Print Services Ltd (TC2356)

Penalty for late payment of tax

An employee (J) retired in September 2012. He filed his 2010/11 tax return on 9 January 2012. This showed a tax underpayment of £13,841, because J's employer had only deducted basic rate tax from a payment of severance pay awarded to him on his retirement. J did not pay the tax due until 23 March, and HMRC imposed a penalty under FA 2009 Sch 56 para 3(2).

Decision;

The FTT allowed J's appeal, finding that J had 'believed that the appropriate tax had been deducted by his employer under the PAYE provisions', so that he had a reasonable excuse for the late payment.

Comments - The appellant had a reasonable excuse for not having realised that his employer had only deducted basic rate tax from a large severance payment, and for not paying the higher rate liability until after the statutory deadline.

JB Jackson v HMRC TC2448

Italian excuse

The taxpayer was a freight forwarding company whose head office was in Italy. The company was in financial difficulties and relied for its survival on receiving funds from the head office. It fell into arrears with its PAYE liabilities. HMRC sent a penalty warning letter but the company said it had not received it. Instead the letter had gone to the company's accountants, so the taxpayer was unaware of the problem.

HMRC imposed penalties against which the taxpayer appealed. It said the penalty was disproportionate and HMRC had a duty of care to warn the company. Although HMRC said they had called the company and spoken to an employee, the managing director disputed the claim saying that there was someone answering the business's telephone from 7am to 6pm, but no calls had been received from HMRC. He went on to say that the payment of the PAYE tax was delayed because the Italian head office was late sending money.

Decision:

The First-tier Tribunal said the penalty was not disproportionate but complied with the legislation. The judge did not accept that the taxpayer had not received any calls from HMRC, but did find that the company had no option but to wait for money from Italy before it could pay its PAYE liabilities.

The penalties were cancelled for two months on the basis that the late receipt of money from Italy provided an initial reasonable excuse, but confirmed for the other months.

The taxpayer's appeal was allowed in part.

Comments – This is another case looking at the concept of reasonable excuse. The UK company was clearly dependent upon the Head Office. The Tribunal took this into consideration when it determined that the penalties were cancelled for two months.

Franco Vago UK Ltd TC2386

Verbal agreement

The taxpayer ran care homes in the south west and employed 100 people. As a result of financial difficulties, the taxpayer's representative reached a spoken agreement with HMRC to defer the company's PAYE payments. Despite the agreement, HMRC imposed penalties for late payment of PAYE tax and National Insurance.

HMRC argued that there was no written agreement for a time-to-pay arrangement, apart from one for two months which had been taken into account when setting the penalties.

Decision:

The First-tier Tribunal said that it seemed HMRC were not clear about what had been agreed with the taxpayer or which payments from the company should be allocated to which months.

The company's "genuine belief" that it had been given time to make the payments should therefore constitute a reasonable excuse under FA 2009, Sch 56 para 16(1).

The tribunal decided the firm's cashflow problems should not be taken into account because the debtor, although late in paying, did make regular payments which could not then be described as unforeseen.

The taxpayer's appeal was allowed in part.

Comments – This case demonstrates how important it can be particularly when a business is experiencing financial difficulties for the management of affairs to be properly dealt with. It certainly did not help matters with late payments up to nine months late from Cornwall County Council who formed a twelfth of the company's income. Clarity of understanding of the responsibilities and arrangements would go a long way to ensuring defaults do not occur through a lack of understanding.

Cornwallis Care Services Ltd TC2388

Penalties for failure to make payments: reasonable excuse

An individual (B) sold some land to a property developer in 2010, incurring a CGT liability for 2010/11. However the developer failed to pay the agreed amount. In February 2012 B asked HMRC for additional time to pay the CGT due. HMRC rejected this request, and subsequently imposed a penalty under FA 2009 Sch 56.

Decision:

The First-tier Tribunal allowed B's appeal, holding that the circumstances constituted a reasonable excuse.

Comments - The First-tier Tribunal observed that the appellant was being required to pay capital gains tax although he had not yet received the consideration which gave rise to this tax liability. In the circumstances, the Tribunal accepted that there was a reasonable excuse for the late payment of the tax due.

S Brand v HMRC TC2434

Two or one?

The taxpayer's individual tax return and partnership tax return for 2007/08 were submitted to HMRC in August 2008. Both forms were incomplete and sent back to the taxpayer. HMRC said that she returned her individual tax return in September, but did not resubmit the partnership return. As a result, penalties were imposed.

The taxpayer disputed HMRC's assertion that the partnership return was not submitted, saying that it was included with her personal tax return. She went to explain that her self-employment and the partnership ended on 5 April 2008 and that, when appealing against incorrect assessments, a second and a third return had been submitted to HMRC. She had then written to HMRC's complaints department.

Decision:

The First-tier Tribunal accepted the taxpayer's evidence and concluded that she had submitted the partnership tax return to HMRC.

The taxpayer's appeal was allowed.

Comments – This is another case which one wonders how HMRC allowed the matter to be brought before a Tribunal. The case was upgraded from a paper case so the taxpayer and her former partner could give evidence which made it clear that the taxpayer had actually made a partnership return on more than one occasion,

C Newton TC2526

Business Taxation

Cap on unlimited income tax reliefs (Lectures P763/764 – 16.39/22.05 mintes)

While the feared basic rate restriction for pension contributions did not materialise in the Budget last year, the so-called 'tycoon tax' emerged in the form of a ceiling on the ability of wealthy individuals to claim certain income tax deductions. This is a completely new concept for UK taxation.

With effect from 6 April 2013, taxpayers seeking to obtain more than £50,000 of otherwise unlimited income tax reliefs in any one year will find their deductions capped at the greater of:

(i) 25% of their total income; or
(ii) £50,000.

On 13 July 2012, the Government released a technical consultation document entitled 'Delivering A Cap On Income Tax Relief', setting out the reliefs which will be affected and explaining the manner in which the cap will operate. This has now been followed up by draft legislation published on 11 December 2012.

The cap will not apply to SEIS, EIS, VCT or pension contribution reliefs, all of which have an upper limit. Nor will it impact on the reliefs for charitable donations such as:

(i) Gift Aid;
(ii) gifts of quoted shares and land; and
(iii) payroll giving,

despite the fact that these are unrestricted. Following complaints about the possible repercussions of this measure on charities and their wealthy donors, the Chancellor decided, in an about-turn last summer, that he did not wish charitable donations to be caught.

In summary, therefore, ignoring charitable giving, the cap will apply to reliefs which are:

(i) offset against an individual's total income; and
(ii) not otherwise capped.

The main reliefs to be affected are:
(i) trading loss relief against total income under S64 ITA 2007;
(ii) relief for losses in the early years of a new trade under S72 ITA 2007;
(iii) property loss relief against total income under S120 ITA 2007;

(iv) share loss relief under S131 ITA 2007; and
(v) qualifying loan interest relief under S383 ITA 2007.

Note that losses which are carried forward against future profits from the same trade under S83 ITA 2007 are not included nor are interest deductions against rental income from let properties – in neither case is the relief given against the individual's total income.

As expected, there are provisions to ensure a level playing field for individuals who make tax-relievable pension payments and charitable donations in different ways. For example, an individual with an income of £400,000 who makes a pension payment of £40,000 under a net pay arrangement will have a total income of £360,000. An equivalent individual who pays his pension contribution under deduction of basic rate tax would have a total income of £400,000 – for this purpose, the latter individual's income will be adjusted downwards by £40,000 in order to ensure a comparable 25% calculation.

Where a loss claim is restricted by the cap, there will be nothing to stop the taxpayer seeking to relieve the balance of his loss in another tax year – the capped loss will not be wasted. However, where the capped deduction is interest, it is not possible to carry such payments backwards or forwards and so it would appear that the restricted amount will lapse.

Following the consultation process in 2012, a number of last-minute improvements have been made to the operation of the capped reliefs:

(i) The restriction will *not* apply to losses caused by:

- overlap relief; and
- business premises renovation allowances (it should be noted that the time limit for this capital allowance has recently been extended to April 2017).

This covers both S64 and S72 ITA 2007 losses.

(ii) Losses caused by business premises renovation allowances are also excluded from any S120 ITA 2007 relief cap.

(iii) There will be no restriction to relief under S131 ITA 2007 where it relates to EIS or SEIS shares. This is logical, given that any EIS or SEIS investment can never be capped.

Illustration 1

In 2013/14, Thomas' income is £550,000 from his employment and he is also entitled to a £90,000 profit share from a partnership. He has losses from a property rental business in the same tax year amounting to £205,000 for which he wishes to make a claim under S120 ITA 2007 against his total income for that year. There are no business premises renovation allowances.

Thomas' cap for 2013/14 is 25% x £640,000 = £160,000. He can therefore make a claim for £160,000 of his property losses in 2013/14, leaving £45,000 unrelieved. Given that the provisions for property loss relief allow claims to be made for the same or the following tax year, Thomas is able to set off the remaining balance of £45,000 against his 2014/15 income (subject, of course, to his cap position for that year).

Where an individual has more than one deduction which may be affected by the cap, he is allowed to decide which relief(s) he wishes to prioritise for that particular tax year.

Although the cap only comes into effect for 2013/14 onwards, transitional provisions apply so that, where, say, a 2013/14 trading loss claim under S64 ITA 2007 is capped, any balance which is carried back to 2012/13 will still be subject to a similar restriction.

Even though relief for pension contributions is not directly affected by the cap, the fact that such contributions must be deducted in arriving at the total income figure means that a taxpayer will need to consider his pension payments for the year in the light of the impact which they may have on his ability to claim other reliefs.

Illustration 2

Jonathan has total income of £280,000 for 2013/14. His pension contributions amount to £30,000 (gross). He also pays qualifying loan interest of £48,000 and has a property business loss of £20,000. He made an EIS investment of £60,000.

Given that Jonathan's uncapped reliefs (which come to £48,000 + £20,000 = £68,000) exceed £50,000, a cap of 25% of his total income will apply. For this purpose, his income is taken as £280,000 – £30,000 = £250,000. Therefore, his total uncapped relief is 25% x £250,000 = £62,500.

Jonathan will have to decide whether he wishes to claim the interest relief ahead of the property business loss or vice versa. The former is likely to be his preferred course of action.

In that case, the unrelieved part of the property business loss (£5,500) can be set against Jonathan's total income for 2014/15.

Jonathan's EIS income tax relief is unaffected by the cap.

By contrast, if Jonathan had made no pension contributions in 2013/14, he could have claimed tax relief of up to £70,000 (25% x £280,000), in which case both his loan interest and his property business loss would have been fully tax-deductible in 2013/14.

Finally, there are a number of relevant practical matters which wealthy clients may wish to consider over the next month or so:

(i) Review investments in unquoted trading companies to ascertain whether negligible value claims should be made in order to crystallise income tax losses in advance of the cap being introduced.

(ii) Review existing loan arrangements and consider whether changes should be made so that loan interest is relieved under computational rules (such as mortgage interest relief on rental properties) rather than against total income (such as loans to buy an interest in a partnership).

(iii) Accelerate business expenditure in order to increase losses prior to the introduction of the cap. Conversely, delay trading income for the same reason.

(iv) Consider an immediate cessation of trade (where this is imminent) in order to maximise the impact of terminal loss relief.

Contributed by Robert Jamieson

Error made in good faith in CIS administration

The taxpayer, PDF, was a small electrical business which, despite suffering financial difficulties during the recession, always paid its taxes on time. In March 2009, N&N was engaged as a subcontractor. The office administrator incorrectly showed payments should be made to N&N gross. As a result, payments were made without any tax being deducted.

HMRC discovered the error during a compliance visit and refused PDF's application for payments to be made to N&N gross.

The taxpayer appealed.

Decision:

The First-tier Tribunal was satisfied that PDF had taken reasonable care to comply with the construction industry scheme, and that the administrative error had been made in good faith. Indeed it was the only error the business had made under the scheme in ten years.

The judge decided that the refusal notice should not have been issued and ordered that the taxpayer's application be accepted.

The taxpayer's appeal was allowed.

Comments – This case demonstrates a number of important aspects. A good record is always a good advocate on behalf of a client. The fact that the business had an almost exemplary record meant they were likely to get better treatment in the First Tier Tribunal. Additionally the case highlights how different aspects of the tax code have different rules. The complexity of the rules was not the cause of the failure simply an error made in good faith. The regulations take that possibility into account and hence the judge found that the company had exercised reasonable care which is what is required not perfectio.

PDF Electrical Ltd TC2375

Absolved from liability with CIS with shortfall

The taxpayer made an error in its operation of tax deducted, under the construction industry scheme, on payments to subcontractors. It had not taxed parts of payments relating to travel and accommodation expenses. HMRC issued determinations to collect the underpaid tax.

The taxpayer's accountant requested that HMRC make a direction under the Income Tax (Construction Industry Scheme) Regulations 2005, reg 9(5) absolving the taxpayer from having to pay the additional tax. Under reg 9(5), a Revenue officer can relieve the taxpayer of paying any shortfall of tax if one of two conditions is fulfilled.

In this instance, the accountant said that condition A was satisfied. This required HMRC to accept that an error had been made in good faith and that the taxpayer had taken reasonable care to comply with the legislation.

Decision:

The First-tier Tribunal noted that, since the appeal, further evidence had been produced which had been unavailable to the HMRC officer who made the original decision to refuse the request. The evidence made it clear that the taxpayer had taken reasonable care to comply with his obligations.

The determinations were set aside. The taxpayer's appeal was allowed.

Comments – The CIS imposes a duty on contractors to ensure that the correct deductions are made in respect of payments to subcontractors. The guidance makes it clear what must be deducted and what does not need to be deducted. As mentioned also this month the importance of making an error in good faith cannot be overemphasised. Accordingly the Tribunal exercised its judgement demonstrating fairness.

Refit Shopfitting Services Ltd TC2462

Late claim to group relief: application for judicial review

Several associated companies, whose accounting periods were not identical, submitted claims to group relief in excessive amounts, because the relevant profits and losses had been time-apportioned incorrectly. The companies' accountants subsequently made a late claim for some of the relief to be set against the profits of another company in the group. HMRC rejected the claim on the basis that it had been made outside the statutory time limit. The companies applied for judicial review, contending that HMRC should have alerted them to the mistakes in the original claims more promptly, and that the rejection of the late claim was irrational. The QB rejected these contentions and dismissed the applications. Blair J held that 'in a commercial setting such as this, the responsibility for formulating a claim for group relief correctly must lie with the group. It was for the group to apportion losses in a way that maximised relief, not the Revenue'. He also observed that there was 'no reason in principle why the tax avoidance factor should not be taken into account in deciding whether to admit a late claim or not. In reaching its decision, HMRC must be entitled to take account of the fact that (for example) the relevant losses have not been incurred in the course of the group's trading activities, but have been acquired for the purpose of increasing the claim to group relief.'

Decision:

The CA unanimously upheld this decision. Arden LJ held that 'none of the passages in Code of Practice 14 relied on by the appellants imposed an obligation on HMRC to disclose a matter which had been spotted prior to the enquiry but which was not present to the minds of the officials of HMRC handling the affairs of the taxpayer during the enquiry. To hold otherwise would indeed without justification shift the responsibility for those errors from those who had caused the error, namely the taxpayer and its advisers, to HMRC.'

Comments - The CA unanimously rejected the company's contention that it should be entitled to make late claims to group relief, because HMRC had failed to alert it to mistakes in its original claims.

R (oao Bampton Group Ltd) v King (HMRC) (and related applications) EWCA

Claims to cross-border group relief: application for reference to CJEU

The decision in Claimants under Loss Relief Group Litigation Order v HMRC (No 2) (Ch D — 11 February), follows on from the CA decision in HMRC v Marks & Spencer PLC (No. 3) (and cross-appeal), CA [2012] STC 231.

Thirty-nine companies which had made claims for cross-border group relief applied to the Ch D for a direction that their claims should be referred to the CJEU. The Ch D rejected the applications. Henderson J observed that HMRC had appealed to the Supreme Court against the CA decision reported at [2012] STC 231, and that 'if the Revenue's interpretation of the no possibilities test is correct, and is ultimately upheld either by the Supreme Court or (following a further reference) by the CJEU, then their claims could not succeed, even if the group structure issues were to be decided in their favour. This is in my opinion a powerful reason for waiting at least until the Supreme Court has ruled on the no possibilities test, or formulated the terms of a further reference to the CJEU, before making a final decision whether or not to refer the group structure questions.' He also observed that the claimants had failed 'to provide detailed answers to the Revenue's enquiries relating to the no possibilities test, which are of course predicated upon the law as stated by the Court of Appeal'. He held that the companies' application was 'both premature and (at best) procedurally questionable'.

Comments - The Supreme Court is due to begin hearing the Marks & Spencer case on 10 June 2013. The Ch D upheld HMRC's contention that in view of this, the companies' application for a further reference to the CJEU was premature.

Claimants under Loss Relief Group Litigation Order v HMRC (No 2) (Ch D)

Effect of joint election within group of companies

A company (D), which was a member of a group, had sold its shares in a New Zealand subsidiary in exchange for loan notes which were qualifying corporate bonds, so that the gain on the sale was held over until D disposed of the loan notes. D's holding company (B) had realised significant capital losses. B and D entered into a series of transactions with the aim of setting B's capital losses against some of D's held-over gains. In November 2003 D redeemed the loan notes. In December 2003 D and an associated company (G) made an election under TCGA 1992 s 171A as then in force, deeming the disposal of the loan notes to have been made by G rather than D, with the intention that the held-over gain would accrue to G rather than to D and could be set against the capital losses (which had accrued to G by virtue of an election under TCGA 1992 s 179). HMRC began an enquiry into the transactions, and issued a ruling that the election under s 171A was not effective, so that D was required to account for the CGT due on the redemption of the loan notes.

Decision:

The First-tier Tribunal (FTT) dismissed D's appeal. Judge Cannan held that 'the CGT legislation is concerned with the underlying debts, even where they are in the form of a debenture. It is the debt which is the asset for CGT purposes. On redemption or repayment there is a disposal of the debt but there is no corresponding acquisition of any asset'. Since s 171A required the disposal and acquisition of an asset, it followed that the election purportedly made under s 171A was not effective and did not cover the redemption of the loan notes. (HMRC accepted that, if D had transferred the loan notes to G before their redemption, then that transfer would have fallen within s 171(1).)

Comments - There was a great deal of money at stake in this case. However it appears to be largely of historical interest, as TCGA 1992 s 171A was subsequently amended by FA 2009 s 31. See now TCGA 1992 s 171A(4), which enables two group companies to make a joint election. As Helen Lethaby observed, in this case the FTT 'found that “disposal of an asset to a third party” required there to be a disposal by the group company and an acquisition by the third party and that the third party issuer of the relevant notes did not acquire anything on their redemption. Interestingly, the case turned entirely on this technical point and there was no suggestion on the part of HMRC that the planning would not have been legitimate had it worked. Section 171A is more favourably framed these days.'

DMWSHNZ Ltd v HMRC TC2457

No bad debt relief due

The taxpayer company was owned by Mr S and Ms J. The shareholding was split so that the former owner held 49% and the latter 51%.

Mr S resigned as a director in April 2008 and took a job at a bank, although he remained a primary signatory on the company's bank account. Between 28 March and 24 April, he withdrew £110,900 from the accounts. Mr S and Ms J separated in October 2008.

HMRC made an amendment to the taxpayer's corporation tax self-assessments for the years ended 31 March 2008 and 2009.

Decision:

The First-tier Tribunal found the sums withdrawn by Mr S were lent by the company as shareholder loans, and were not held on trust for the business, which had subsequently written off the amounts as bad debts and claimed a deduction as a trading expense.

The judge said the withdrawals were not undertaken in the course of the company's trading activities because Mr S had ceased as a director from April 2008. Therefore, they did not qualify for bad debt relief.

Finally, the loan was made to Mr S as a participator (he was still a shareholder), so a charge arose under CTA 2010, s 455 (formerly TA 1988, s 419).

The appeal was dismissed in respect of the adjustment for the year ended 31 March 2009 but allowed for the year ended 31 March 2008.

Comments - The judge’s comments are self explanatory and demonstrate the importance of the proper treatment of items in owner managed businesses.

Mirror Image Contracting Ltd (TC2350)

Amendment to partnership statement

A limited liability partnership made losses on the purchase and resale of three commercial properties. It treated these as trading losses. HMRC issued a 'discovery amendment' for 2005/06 under TMA 1970 s 30B(1), reclassifying the losses as 'property losses' (so that the members of the partnership would not be able to set the losses against their general income). The partnership appealed, contending that the amendment was not authorised by s 30B(1), since this only applied where profits had been omitted, or where 'an amount of profits so included is or has become insufficient', and did not apply in a situation where there had only been losses and there had not been any profits.

Decision

The FTT accepted this contention and allowed the appeal. Judge Raghavan held that the reference to profits in s 30B could not be construed so as 'to cover negative amounts'. He also accepted the partnership's contention that the losses were trading losses, finding that 'the appellant's intention was to trade in the properties not hold onto them to earn rental income from them'.

Comments - This is an interesting case, because the FTT specifically rejected HMRC's interpretation of TMA 1970 s 30B(1), which provides that HMRC may amend a partnership statement where they discover 'that any profits which ought to have been included in the statement have not been so included, or that an amount of profits so included is or has become insufficient'. The FTT decided that the reference to 'profits' could not be construed as including 'negative profits', so that s 30B(1) did not apply in cases concerning loss claims. The FTT also accepted the partnership's contention that it had held the properties as trading stock rather than as investments. (The Tribunal Centre has not yet released this decision, but it is available on the Pump Court website.)

Albermarle 4 LLP v HMRC TC2843

Still not allowable

The taxpayer, Interfish, became a sponsor of a local rugby club and made a series of payments to it. Interfish claimed a deduction for the payments in its profits for corporation tax. HMRC refused the claim on the basis that the payments had a dual purpose, ie they benefited the club as well as the company.

The First-tier Tribunal dismissed the company's appeal against HMRC's decision. That appeal was heard in May 2010 (TC520) and reported in Taxation, 15 July 2010, page 4. The case later returned to the same tribunal for a ruling on what sums, if any could be apportioned.

The taxpayer and HMRC had agreed that expenditure on hoardings at the ground would be allowed as a deduction.

The items remaining in dispute included logos on players' shirts, promotion of Interfish on tickets and programmes, access to hospitality areas, availability of players to promote the company's business, being known locally as a supporter of the club and access to key business figures.

HMRC said they were prepared to allow "5% of the expenditure based on an estimate of the cost at which the advertising and promotion could have been purchased on the basis of the club's published rates".

Decision:

The tribunal judge said there was no evidence to show that any part of the payments had been made wholly and exclusively for the purposes of obtaining "visible promotion". With regard to HMRC's offer to allow a 5% deduction, the judge said this sat "awkwardly" with their argument that none of the expenditure was allowable. He concluded that none of the payments, other than the amount relating to the hoardings already allowed by HMRC, were deductible.

The taxpayer's appeal was dismissed.

Comments – Sometimes in life it is better to accept something in offer rather than end up with nothing which is happened in this case. A key question to consider is what can clients do to ensure that sponsorship payments stand the best chance of achieving a deduction for tax purposes? It is worth looking at the article "sponsor me" in Taxation of 7 February 2013 for a resume of this case and its predecessor and other cases such as the McQueen case.

Interfish Ltd (No 2) TC2275)

Radio presenter, claim for expenses: misdirection by HMRC

A self-employed radio presenter (S) had claimed deductions for expenditure on clothing, cosmetics, hairdressing, and subsistence expenses. HMRC issued amendments to her returns for 2006/07 to 2008/09 disallowing the deductions. S appealed, contending that when she began self-employment in 2001, she had been informed by a HMRC officer (C) that she could claim a deduction where she spent money for the specific purpose of making public appearances, and that she could claim subsistence expenses if she was working at least five miles away from her normal place of work.

Decision:

The First-tier Tribunal (FTT) accepted S's evidence, holding that as a matter of law, the expenditure was not deductible, applying the principles laid down in Mallalieu v Drummond and Caillebotte v Quinn, but finding that S had been given incorrect advice by an HMRC officer. Judge Cannan expressed the view that he 'would expect HMRC to amend the review decision to allow (S's) claim under these headings for 2006/07'. However, by the time S came to complete her returns for 2007/08 and 2008/09, she was aware that HMRC had queried the claims which she had made for 2006/07, and she had been told by the officer conducting the enquiry that 'the wardrobe costs and subsistence expenses were not allowable for tax purposes'.

Therefore S was no longer entitled to rely on the incorrect advice which C had given her. Judge Cannan observed that 'it would be unfair on taxpayers generally if (S) were able to insist on entitlement to relief where none would otherwise be available in the absence of clear unambiguous advice to the contrary' (see decision TC01806). Following further representations by both parties, the FTT upheld HMRC's amendments for 2007/08 and 2008/09, rejecting S's claim that she should be allowed further deductions for expenses. Judge Cannan held that 'it is now too late to challenge the amendments on a completely different basis'.

Comments - The FTT upheld its earlier decision that, in view of the clear evidence of misdirection, the expenditure which the appellant had claimed should be allowed for 2006/07, but not for the two subsequent years, since the appellant had by then been correctly advised by a different HMRC officer that the expenditure was not allowable, and it would be 'unfair on taxpayers generally' if she could continue to claim deductions for such expenditure. The FTT rejected the appellant's attempt to claim further deductions for 2007/08 and 2008/09.

Ms L Stones v HMRC (No. 2) TC2446

Limited partnership claiming capital allowances

The members of a Jersey limited partnership claimed research and development allowances for expenditure on vaccine research and development. They claimed loss relief totalling more than £192m. HMRC rejected the claims, accepting that a Jersey company (N), which was a member of the partnership, had paid a subcontractor (P) £14m on research and development, but considering that the partnership had not been trading and that the other partners were not entitled to the allowances which they had claimed. The partners appealed, contending that N had been working for the partnership as a contractor.

Decision:

The FTT reviewed the evidence in detail and allowed their appeals in part but rejected the majority of the partners' claims for relief. Judge Williams held that only the £14m which N had paid to P could in law 'be regarded as incurred on research and development'. The other sums which the partners had contributed to the partnership had not been spent on research and development, and thus did not qualify for allowances.

Comments - This is an important victory for HMRC. This type of avoidance scheme, where investment in a limited partnership is used as a vehicle for very substantial claims for tax relief, has gained considerable publicity. In this particular case, Judge Williams noted that the claims for tax relief totalled more than £192m, although only £14m had actually been spent on research and development. He held that only this £14m qualified for capital allowances, and that this qualifying expenditure would have to be apportioned between the partners.

Avoidance scheme: manufactured overseas dividend

An individual (C) had entered into a complex avoidance scheme, designed to obtain a tax deduction of more than £300,000 in respect of purported payments of 'manufactured overseas dividends' which he claimed to have made to a company (B). HMRC rejected the claim

Decision:

The First-tier Tribunal dismissed C's appeal, applying the principles laid down in Moodie v CIR & Sinnett ([1993] STC 188) and WT Ramsay Ltd v CIR ([1981] STC 174). Judge Walters observed that the various transactions, which had taken place within a few days, were self-cancelling, and held that they were 'artificial steps which should be ignored'. Furthermore, applying the CA decision in the 1919 case of Earl Howe v CIR (7 TC 289), 'only annual payments which are payable under deduction and retention of tax as between the payer and the payee can be allowed as deductions from the income of the payer for income tax purposes'.

Comments - There has been much public discussion of this type of avoidance scheme, where an individual enters into self-cancelling transactions with the sole aim of producing a tax loss. The First-tier Tribunal held that the scheme here failed both on technical grounds and under the Ramsay principle. The particular loophole which the appellant's advisers had attempted to exploit was blocked by ITA 2007 s 581A, which was introduced by FA 2008 Sch 23.

A Chappell v HMRC TC2516

VAT

Postage is not a separate supply

The taxpayer sold novelty items on the internet through eBay, Amazon or its own website. Customers could collect the goods from the premises of the business or pay an extra charge to have them delivered.

The appeal concerned whether sums paid by customers for postage should be treated as disbursements on the basis that the taxpayer was acting as an agent of its customers, or whether they were part of the consideration for a single supply of "delivered goods" to the customer.

In the former case, the sums would not be liable to VAT because postal services provided by Royal Mail are generally exempt while, in latter case, the whole charge would be standard rated.

Decision:

The First-tier Tribunal found that the facts pointed to a single supply of delivered goods by the taxpayer. Customers made a single payment for the goods, regardless of the fact that the postage charge was identified separately. There was no evidence to suggest that the taxpayer accounted for the sums paid for postage differently from how it treated its turnover generally. From the customer's point of view, he paid the taxpayer for the supply and delivery of the goods. No agreement existed between the customer and Royal Mail. The judge said it was:

"fanciful to suggest that in making payment the appellant was at that stage merely acting as agent for customers and satisfying an obligation of its customers. There is no indication that the post office [sic] was entering into contractual relations with anyone other than the appellant. Identifying a name and delivery address on the proof of posting does not itself indicate that the post office [sic] was contracting with the identified recipient."

The judge concluded there was a single supply of delivered goods.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent tax adviser, said: "There are two key questions in the world of VAT: what is the supply and who does the customer consider he is dealing with when he agrees to buy goods or services? It has largely been accepted in recent years that delivery costs and charges relate to the supply of goods in question if they are delivered to the customer."

Orchardcrown Ltd v HMRC TC2285

Supplement is due

The taxpayer, a company, filed VAT returns for the periods 1/06 and 2/06 claiming repayment of VAT. It later realised it had underclaimed input tax, so submitted voluntary disclosures for these periods, seeking repayment of about £1.5m.

HMRC repaid the tax and, because of the length of time involved, the company received a 5% repayment supplement in relation to the tax repayable on the VAT returns. The department refused to pay any supplement in respect of the £1.5m on the basis that VAT credits claimed by means of voluntary disclosure were "not eligible for repayment supplement".

The taxpayer appealed.

Decision:

It said that, according to VATA1994, s 79, repayment supplement was not limited to repayments claimed on a return, but applied also to claims made in other ways, eg by voluntary disclosure. HMRC stated that based on the wording in s 79, supplements could only be made on repayments arising from a return "furnished on time for the relevant periods".

The First-tier Tribunal rejected HMRC's interpretation of s 79, saying that the wording was clear. It "is neither necessary nor correct to restrict that section to VAT credits claimed in a return". This would not create anomalies.

The tribunal judge noted that the aim of the repayment supplement scheme was to encourage "efficiency" in HMRC's handling of claims, and this should apply to both VAT return and disclosure claims:

"It seems strange to us that the government should, as a matter of policy, encourage the efficient payment of a VAT credit claimed in a return but not one claimed as allowed or directed by HMRC … otherwise than in a return. In our view, the efficient processing and payment of claims for VAT credits is as desirable in the case of claims made in returns as it is in the case of late claims."

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: "the key issue is whether HMRC appeal this verdict or accept that they must allow repayment supplements to be paid in respect of delayed VAT 652 claims as well."

Our Communications Ltd v HMRC TC2281

Legitimate expectation

A trader (N) registered for VAT in 2009. In his first return, he reclaimed input tax on services which he had received more than six months before the date of registration. HMRC rejected the claim by virtue of VAT Regulations, reg 111. N appealed, contending that he had previously telephoned HMRC's National Advice Service and had been told that that there was a three-year period for reclaiming input tax.

Decision:

The Upper Tribunal upheld HMRC's rejection of N's claim. Warren J held that 'parliament did not intend to confer a judicial review on the VAT tribunal or the First-tier Tribunal', and that the First-tier Tribunal 'does not have jurisdiction to give effect to any legitimate expectation which (N) may be able to establish in relation to any credit for input tax'. Furthermore, 'no reasonable tribunal properly directing itself in law could have concluded that (N) had a legitimate expectation such that it would be so unfair as to amount to an abuse of power for HMRC to refuse his claim in respect of the VAT on the invoices'.

Comments - This is an important victory for HMRC on the principle of 'legitimate expectation'. Warren J held that the First-tier Tribunal had exceeded its jurisdiction in allowing the trader's claim.

HMRC v Noor (Upper Tribunal)

VAT: three-year time limit

A company (T), which was the representative member of a VAT group and had accounted for VAT on income from bingo and gaming machines, submitted a repayment claim covering the period from 1973 to 1998, contending that it should have treated the relevant income as exempt. HMRC made the repayment in 2009, but subsequently issued assessments to recover the tax, on the basis that the claim had been made outside the three-year time limit laid down by VATA 1994 s 80(4). T appealed.

Decision:

The First-tier Tribunal dismissed the appeal (but gave T leave to apply for a further hearing to consider the principle of 'legitimate expectation'). Judge Reid also observed that the company (C) which had made the relevant supplies had left T's group in 1998, and held that C, rather than T, would have been entitled to any repayment.

Comments - The First-tier Tribunal upheld HMRC's contention that the repayment claim had been lodged outside the statutory three-year time limit. The case also concerned the question of which company should be entitled to receive any repayment: the company (C) which had originally made the supplies in question, or the company (T) which had been the representative member of its VAT group at the time the supplies were made. In view of his conclusions on the first issue, Judge Reid's conclusions on this second issue are obiter, but he held that any repayment should go to the company which had actually made the supplies, rather than to the representative member. He also gave the appellant company leave to apply for a further hearing to consider the principle of 'legitimate expectation'. This question is currently the subject of an appeal to the Upper Tribunal in HMRC v Noor, where Warren J heard an appeal by HMRC on 10 and 11 December, and his decision is currently awaited.

Taylor Clark Leisure plc v HMRC TC2443

Legal costs of action by former employee

A family partnership dismissed an employee (B). He sued the partnership for wrongful dismissal. The County Court ordered the partners to pay B's legal costs. The partnership reclaimed input tax on this. HMRC rejected the claim on the basis that the supplies had been made to B rather than to the partnership.

Decision:

The FTT dismissed the partners' appeal against this decision.

Comments - The FTT upheld HMRC's view that the partnership could not reclaim input tax on supplies which had been made to the successful plaintiff.

M & SN Saheid v HMRC TC2458

Construction of house adjacent to caravan park

An individual (D) lived in a bungalow in the grounds of a caravan park. He built a house adjacent to the park. The relevant planning permission stipulated that the house should only be occupied by 'a person solely or mainly employed, or last employed prior to retirement, at the adjacent caravan park', and explained that new housing should only be allowed in this location 'where it is essential in the interests of a site manager or other essential worker', D reclaimed VAT on the cost of constructing the house, under VATA 1994 s 35. HMRC rejected the claim on the basis that, since the planning permission prohibited the separate use of the house, the effect of VATA 1994 Sch 8 Group 5 Note 2(c) was that it did not qualify as a 'building designed as a dwelling'.

Decision:

The FTT dismissed D's appeal against this decision.

Comments - VATA 1994 Sch 8 Group 5 Note 2(c) provides that a building can only fall within the definition of a dwelling if 'the separate use or disposal of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision'. The FTT upheld HMRC's contention that since the relevant planning permission prohibited the separate use of the house, it did not qualify as a 'dwelling'.

R Drummond v HMRC TC2456

Conversion of outbuilding within grounds of protected building

A company had purchased a school, which was a grade II listed building, from a council with the intention of developing it. The school site included a separate building. The company arranged for a contractor (B) to convert this building into residential accommodation. B treated its supplies as zero-rated. HMRC issued an assessment charging tax on the basis that the work did not qualify for zero-rating, since the relevant planning permission prohibited the separate use of the building, and the work therefore failed to meet the conditions of VATA 1994 Sch 8 Group 6 Note 2(c).

Decision:

The FTT dismissed B's appeal, applying the Upper Tribunal decision in HMRC v Lunn, [2010] STC 493. Judge King specifically disapproved the earlier decisions in Wendels v HMRC, [2010] UKFTT 476 (TC), TC00737, and Phillips v HMRC, [2011] UKFTT 372 (TC), TC01227.

Comments - VATA 1994 Sch 8 Group 6 Note 2(c) provides that a building can only fall within the definition of a dwelling if 'the separate use or disposal of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision'. This is an important decision because Judge King specifically disapproved the earlier decisions in Wendels and Phillips, observing that they were inconsistent with the Upper Tribunal decision in Lunn. She upheld HMRC's contention that since the relevant planning permission prohibited the separate use of the building in question, it did not qualify as a 'dwelling'.

Brims Construction Ltd v HMRC TC2455

Monthly fee to internet retailer

A company (N) sold retail goods by the internet. Customers who paid it a monthly fee of £19.95 were entitled to purchase certain goods at below their normal retail price. Where customers purchased goods, N treated the monthly fees as taxable consideration for their purchases and accounted for VAT accordingly. However, where customers paid the monthly fee but did not purchase any goods, N did not account for VAT on the fees. HMRC issued an assessment charging tax on the fees, and N appealed, contending that they were exempt from VAT under VATA 1994 Sch 9 Group 5, as being consideration for the management of their accounts.

Decision:

The FTT rejected this contention and dismissed the appeal. Judge Bishopp held that the monthly fees were 'consideration for the taxable supply of the right to purchase goods at a preferential rate. Whether or not the customer chooses to exercise the right is immaterial; he has paid for it.'

Comments - The company was required to account for VAT on the monthly fees which it charged its customers.

Nettexmedia.com Ltd v HMRC TC2470

Cultural services

The Institute, which is a non-profit-making body, had accounted for output tax on its admission charges to films which it showed at the National Film Theatre and at various festivals. In 2009 it submitted a repayment claim on the basis that it should have treated these supplies as exempt under article 13A(1)(n) of the EC Sixth Directive. HMRC rejected the claim on the basis that Article 13A(1)(n) did not have direct effect. BFI appealed.

Decision:

At a preliminary hearing, the FTT accepted BFI's contention that article 13A1(n) had direct effect, applying the CJEU decision in EC Commission v Spain [1998] STC 1237. The tribunal also held that BFI's films were 'cultural services', specifically declining to follow the VAT tribunal decision in Chichester Cinema at New Park Ltd (VTD 19344). (Both sides were given leave to seek a further hearing to consider the application of the partial exemption provisions, and the question of 'unjust enrichment'.)

Comments - This is an important decision for two reasons. Firstly, the FTT rejected HMRC's contention that article 13A(1)(n) of the EC Sixth Directive had not had direct effect. Secondly, the tribunal held that the films which the BFI screened qualified as 'cultural services'. Judge Kempster specifically declined to follow the earlier decision in Chichester Cinema at New Park Ltd, where Judge Nowlan had held that the exemption for cultural services should be restricted to live performances, and did not include 'attendance at the cinema to watch a film'.

British Film Institute v HMRC TC2490

New or transferred?

A restaurant operated by the taxpayer through a limited company ceased trading in February 2009. The company was later struck off the Companies House register and dissolved. The suppliers repossessed the remaining stock. Meanwhile, a few days after the company ceased trading, the taxpayer reopened the restaurant as a sole trader. The only asset he acquired from the previous business was goodwill. He applied to be VAT registered from 1 September 2009.

HMRC said the taxpayer was liable to be registered for VAT as soon as he began trading, on the basis that there had been a transfer to the taxpayer of a going concern and as such the turnover of the company passed over to the sole trader for registration purposes (s.49 VATA 1994).

The taxpayer appealed.

Decision:

The First-tier Tribunal said that when the taxpayer restarted the restaurant as a sole trader, “fundamentally” he saw it as the same business as previously, “just free of the debts”. Little changed apart from a minor name change. Otherwise the restaurant used the same premises and equipment and was in effect the same business. The tribunal agreed with HMRC that it was a going concern and the taxpayer was liable to be registered the day he started trading.

The taxpayer's appeal was dismissed.

Comments - This decision raises questions about the VAT position when a business is deemed to be new or is being taken over from an existing person, said Neil Warren, independent VAT consultant. He cites a caterer who takes over the catering function at a sports club after the previous owner has left. “He has never met the previous owner, presumably has no knowledge of his annual sales, and has made no payment to the previous owner for stock, assets, goodwill etc. But if he is continuing a business that was trading in the same activity as before, he will need to treat the situation as a transfer of a going concern and could be liable to become VAT registered on his first day of trading.”

Mark Young (trading as The St Helens) TC2371

Input tax on costs incurred before company joined VAT group

A large Spanish company (F) had arranged for the incorporation of a new company (AD) with the aim of making a 'takeover bid' for another company (B), which operated several British airports. The bid was successful, and AD incurred significant costs in relation to the acquisition. After the takeover, AD joined B's VAT group. The representative member of the group (BL) claimed a deduction for input tax of more than £6m which AD had incurred in relation to the takeover. HMRC issued an assessment to recover the tax on the grounds that there was no direct and immediate link between the supplies on which this VAT was incurred and any taxable supplies made, or intended to be made, by BL's group. The Upper Tribunal upheld the assessment

Decision:

The CA unanimously dismissed BL's appeal. Mummery LJ held that, at the relevant time, there was no evidence that AD had made taxable supplies or had an intention to make taxable supplies. There was no 'direct and immediate link between the input tax on the supplies of services to (AD) and the output tax on the supplies of taxable services made by (B)'. B's supplies were 'not connected at the relevant date with the supplies to (AD) on which input tax was incurred'.

Comments - In BLP Group PLC v C&E Commrs ([1995] STC 424), the CJEU held that input tax was only deductible if the goods or services in question had a 'direct and immediate link' with taxable transactions. The Upper Tribunal and CA have both unanimously upheld HMRC's view that there was no such direct and immediate link in this case.

BAA Ltd v HMRC EWCA

Set-off of credits

A company (B) which was a registered charity, and operated a theatre, had accounted for VAT on supplies which qualified for exemption as 'cultural services'. In 2007 it submitted a claim for repayment covering the period from 1990 to 1996. HMRC rejected the claim on the grounds that for 2000 and 2001 B had reclaimed substantial input tax on the refurbishment of its theatre, which should have been attributed to exempt supplies, and that the effect of VATA 1994 s 81(3A) was that the previous underclaim of input tax should be set against the subsequent overclaim.

Decision:

The First-tier Tribunal accepted this contention and dismissed the appeal, and the Upper Tribunal upheld this decision. Proudman J held that 'the operation of s 81(3A) is not precluded by the principles of legal certainty, equality, equivalence, or the supremacy of Community law'. (HMRC had raised an alternative contention that the claim was 'abusive'. The tribunal rejected this contention.)

Comments - VATA 1994 s 81 provides for the set-off of credits. The Upper Tribunal upheld HMRC's interpretation of s 81(3A). For a discussion of the implications of this case, written immediately after the First-tier Tribunal decision, see the commentary by Giles Salmond ('In brief', Tax Journal, dated 4 March 2011 p 6). Although HMRC won the case on the construction of s 81, the Upper Tribunal rejected HMRC's alternative contention that the claim was 'abusive'. The decision also contains an interesting discussion of the principle of 'effectiveness', in respect of which the tribunal preferred the interpretation propounded by counsel for the appellant company to that propounded by counsel for HMRC.

Birmingham Hippodrome Theatre Trust Ltd v HMRC (Upper Tribunal)

Licence to trade from antique centre

A company operated an 'antique centre', and rented out about 70% of its floor space to stallholders. It did not account for tax on the payments it received from the stallholders. HMRC issued an assessment charging tax on them, and the company appealed, contending that it was supplying a licence to occupy land, which was exempt from VAT.

Decision:

The First-tier Tribunal allowed the appeal in part. Judge Mitting held that the company was making two separate supplies, i.e. an exempt supply of land and a taxable supply of a sales service, so that the consideration should be apportioned.

Comments - The First-tier Tribunal held that the company was making two separate supplies, so that part of its consideration was standard-rated but part was exempt from VAT.

Antiques Within Ltd v HMRC TC2507

VAT: principle of abuse

The Supreme Court has spent four days hearing argument in the case of WHA Ltd v HMRC (CA 2007 STC 1695). The case is notable for the unusually long time between the CA decision in 2007 and the Supreme Court hearing in January 2013. group of companies instituted a complex scheme which was intended to allow the recovery of input tax charged on repair services made under insurance policies relating to vehicle breakdown ('MBI policies'). The scheme involved the use of two Gibraltar insurance companies, one of which appointed a UK company (W) to handle claims and pay the repair bills. HMRC rejected the repayment claims, considering firstly that the garages which provided the repair services were making their supplies to the insured customers, rather than to W, and additionally that the scheme was an 'abuse', within the principles laid down by the CJEU in Halifax plc v C & E Commrs. The CA unanimously accepted this contention. Lord Neuberger of Abbotsbury held that fiscal neutrality required that an insurer who provided insurance services, which were exempt from VAT in the EU, could not recover input tax attributable to those services. Accordingly the companies were not entitled to the repayments which they had claimed.

The non-business challenge (Lecture B764 – 15.23 minutes)

In the world of VAT, there are two main issues to consider with a 'non-business' situation:

1. Are supplies being made that are taxable – and therefore subject to output tax and classed as taxable income for VAT registration purposes;

2. Is an expense relevant to a non-business activity (either partly or completely) and therefore no input tax can be claimed.

Note – remember the basic definition of 'input tax' – an expense that relates to a taxable supply.

Note – the VAT registration threshold (since 1 April 2012) is £77,000 – so a business needs to register for VAT if its taxable sales have exceeded £77,000 in any rolling 12-month period, or are expected to exceed £77,000 in the next 30 days.

Input tax apportionment

Example 1

Luton Homeless Charity has purchased new kitchen equipment for £20,000 plus VAT. The equipment will be partly used for non-business purposes (free meals to the homeless) and partly for business purposes (hot meals are sold to members of the public on a commercial basis and the Charity accounts for output tax on these sales because it is VAT registered).

Input tax can only be claimed on an expense that is used for taxable purposes or, equally importantly, for an intended taxable purpose. VATA1994, s24(5) deals with the situation where an expense or asset has part 'business' use and part non-business or private use, confirming that an input tax apportionment is necessary at the time the expenditure is incurred so that only the VAT relevant to the business (taxable) use is treated as deductible input tax. The law does not specify how this apportionment should be made – but it must be carried out on a 'fair and reasonable' basis. And as a tip to advisers, don't write to HMRC when you buy an asset asking them to approve your chosen method – they will not rubber stamp any method you propose. The apportionment method is down to the taxpayer and HMRC's job is to challenge any method that is biased or unfair.

In our example, the Charity must make an input tax apportionment on the cost of the equipment - a fair and reasonable basis would be to make an apportionment based on the number of meals served to each group of users.

Note – an alternative accounting treatment (the Lennartz mechanism) is available in relation to certain fixed asset purchases, where input tax Is fully claimed when the asset is bought, with output tax being accounted for on private use over the life of the asset (10 years for land and buildings, five years for other assets). However, Lennartz has not been an option since 22 January 2010 for Luton Charity because there is no ‘private’ use of the equipment, only ‘non-business’ use.

Key dates for Lennartz accounting:

22 January 2010 – from this date, it has no longer been possible for the Lennartz approach to be adopted where an asset has part business and part non-business use i.e. it is only an option where the ‘other’ use is for a private purpose, such as private/business use with a computer purchase (ref: R&C Brief 02/10).

1 January 2011 – from this date, it is has no longer been possible to use the Lennartz approach for the following assets, even where part of the use is for ‘private’ purposes: land and buildings (or part of a building), aircraft, ships, boats or other vessels (ref: R&C Brief 53/10).

GOODMAN EQUINE LTD (TC2243) – buying a horse – business or non-business for input tax purposes?

The company purchased a horse ‘For Fun’ and claimed input tax of £73,167 on the basis that the horse would be used to generate taxable income from various activities, including its eventual sale at a profit. HMRC disallowed the input tax claim as being relevant to non-business purposes. The key question therefore was whether an ‘economic activity’ was evident (this being the phrase for ‘business’ in EU law).

The VAT registration form submitted by the company estimated annual taxable sales of £500,000, which was confirmed as an expectation that ‘For Fun’; would be sold in the future at a profit. However, this sale did not materialise – he was unwell for a period of time, and at the age of 14/15, his resale value had fallen so much that he was kept by the company as an asset and still competed in races.

The company accounts showed ‘nil’ turnover for two years, although there was income from prize money (outside the scope of VAT) and losses had been funded by the sole director/shareholder Mrs Jennifer Goodman who had loaned the company nearly £600,000. HMRC took the view that the company was not trading ‘in business’ but was merely a vehicle to promote Mrs Goodman’s personal hobby and therefore lacking in commercial character. HMRC analysed the six business tests established in the well-known VAT case involving Lord Fisher and concluded that no business arrangement was intended or in place as a statement of fact. The tribunal agreed.

Comment:

The absence of profit does not necessarily mean that a venture is not a ‘business’ arrangement – there are many examples of projects failing to produce the results expected of them when they are first started. However, a key factor in this case was the fact that offers to sell the horse (when received) were not seriously considered, suggesting a pursuit based on the personal interest of the director rather a serious business venture. Taxpayers need to be very careful trying to gain an input tax advantage when a personal interest is involved, be it the purchase of boats aeroplanes, racing cars.......or horses!

Recent cases – are supplies being made for business purposes?

PEOPLE'S DISPENSARY FOR SICK ANIMALS (PDSA) (TC2048)

Pet owners on low incomes paid a registration fee of £7.50 to the charity through the Pet Aid scheme – in return for which they would get free veterinary treatment if their pet was sick. The vet fees were funded by the charity – which received large sums of money in donations.

The taxpayer put forward the argument that the registration fees created a 'business' activity (with output tax due on the fees) and therefore the charity could reclaim input tax on all of the vet fees – the case involved VAT repayments in excess of £8m (disclosures were submitted by the charity but declined by HMRC). Nearly 94% of the veterinary fees were funded by donations made to the charity rather than registration fees.

The tribunal concluded that the £7.50 payments did not create a business activity – there was no link between the value of the fees and service received by the pet owners. And even if the fees were 'business', the vets were supplying their services to the pet owners rather than the charity, so input tax was still not claimable by the charity.

Comment:

The VAT system relies on there being a direct link between outputs and inputs otherwise activities where large deficits are funded by donations or grants would produce big VAT repayments in many cases (input tax greater than output tax), particularly for charities. The legislation and guidance about what is defined as a 'business' or 'non-business' activity largely ensures that the VAT system is fair and that refunds are only appropriate on an ongoing basis to a business that makes either zero-rated sales or sales that are subject to the reduced rate of VAT.

Dr John Smalley (TC1008) – was there a business?

The challenge for the Tribunal was to determine whether Dr Smalley was actually carrying on a business, and therefore entitled to claim £1,652 of input tax on his July 2009 return. The main claim related to VAT paid on legal fees (£1,282)

The business had supposedly ended in 1998 – the activity was the import and export of machinery spares

The taxpayer claimed he was still in business supplying computer software services for an American customer called Sunburst, but there had been no payments received or invoices raised to support this contention. There was no evidence of trading in machine spares since 1999.

The Tribunal had to consider whether the activities of Dr Smalley represented a business – one of the conditions for any input tax claims is that they must relate to business supplies.

The main input tax related to legal fees incurred in litigation against Midland Bank for an alleged breach of contract but this was not an expense incurred for the ‘purpose’ of the business.

Overall, therefore the taxpayer did not have a business, so the appeal was bound to fail and the input tax claim was reduced from £1,652 to nil

Comment: It is possible for a business to have a long period of time when inputs are incurred (and input tax claimed) before any outputs (or output tax) are generated. This situation mainly applies where a business is classed as an ‘intending trader’ for VAT purposes i.e. there is an intention to make supplies in the future. An example is where a builder constructs a new house or dwelling to sell in the future – there could be a number of years before he sells the completed property and makes a taxable (zero-rated) sale but he is entitled to input tax recovery on his costs (building materials etc) while the property is being built.

Contributed by Neil Warren

Input tax – four key conditions for making a claim (Lecture B765 – 13.57 minutes)

The following conditions must be met for input tax credit to be available:

- A supply must have taken place;
- The input tax credit must be claimed by the taxable person to whom the supply is made,
- The supply must be chargeable to tax at the rate claimed;
- The claimant must hold satisfactory evidence of his entitlement to input tax credit.

In this session, I am going to highlight some tribunal cases on the above conditions – and also dispel the myth that the key conditions for claiming input tax are ‘which business has paid the bill?’ and ‘which business is the purchase invoice made out to?’ In most cases, these answers will apply to the business that has claimed the input tax – but VAT is a tax on the supply of goods and services rather than based on the payment for goods and services, a subtle but important difference.

Condition1 - Input tax evidence

Case 1 – Robert Edgar (TC 00574)

The taxpayer claimed input tax on small tools and petrol, without any tax invoices or documentary evidence to support his claim. HMRC therefore disallowed a claim for £36,786.

This is an interesting case because, although lost by the taxpayer, it highlights the fact that the regulations do allow input tax to be claimed even if a tax invoice is not held i.e. where 'alternative evidence' is available to confirm payment of VAT. To quote from the case:

"7. Under Regulation 29(2) of the 1995 Regulations the Commissioners are given the power to require a taxable person to hold or provide such other evidence in support of a claim for input tax. The Commissioners have issued a Statement of Practice (SP 7/2003) effective from 16 April 2003, regarding the circumstances in which input tax recovery will be allowed in the absence of a valid VAT invoice. A taxpayer is required, in addition to providing alternative evidence, to be able to answer satisfactorily most (or, in the case of supplies involving specified goods, all or nearly all) of the following questions:

- Is there alternative documentary evidence other than an invoice (e.g. supplier statement)?
- Is there evidence of receipt of a taxable supply on which VAT has been charged?
- Is there evidence of payment?
- Is there evidence of how the goods/services have been consumed within the claimant's business or their onward supply?
- How did the claimant know that the supplier existed?
- How was the claimant's relationship with the supplier established?

The following conditions must, therefore, be met for input tax credit to be available:

- A supply must have taken place;
- The input tax credit must be claimed by the taxable person to whom the supply is made,
- The supply must be chargeable to tax at the rate claimed;
- The claimant must hold satisfactory evidence of his entitlement to input tax credit.

The Tribunal finds that a re-done set of accounts did not constitute satisfactory evidence of the Appellant's entitlement to input tax credit. The Appellant held no valid VAT invoices to support his repayment claim. The Tribunal, therefore, dismisses the appeal."

Case 2 - Special Metals and Engineering Ltd ((TC2362) – evidence for input tax deduction

What is the situation when a customer claims input tax on a series of supplies in a high risk trade category (the business was trading in scrap metals) – and HMRC discover that the suppliers have not accounted for output tax on the transactions in question and, in one case, the business was already deregistered at the time it issued the invoices? This question was considered in this case, with HMRC disallowing £66k of input tax claimed by the appellant. The tribunal considered HMRC's powers to accept alternative evidence for input tax deduction, and the strategy to adopt when there was a tax loss to HMRC. The tribunal concluded that supplies had taken place in all three cases and that the appellant had made enough checks to confirm the supplies were all subject to VAT (even holding a copy of the suppliers' VAT certificates). The tribunal was unconcerned that the suppliers were paid in cash for the 'net' amount of the purchases and cheque for the VAT amount (an unusual practice) and allowed the appeal.

Comment:

The outcome of this case confirms then in relation to fraudulent transactions, or suspected fraudulent transactions, the onus is on HMRC to prove a taxpayer's knowledge of an irregularity i.e. the taxpayer is innocent until proved guilty. Although there was a tax loss of £66k to HMRC (through output tax not being accounted for by the suppliers), the customer (appellant) had carried out enough checks to confirm the VAT charge by his suppliers was appropriate.

Condition 2 – only the business receiving a supply can claim input tax -

Case 1 - Airtours Holiday Transport Ltd (Upper Tribunal case) (UKUT404(TCC))

The taxpayer had financial difficulties – bank called in PwC to review finances – but fees of PwC were invoiced to company to settle payment

HMRC disallowed input tax claimed by Airtours because they maintained that PwC were providing services to the bank

HMRC had lost appeal at first tribunal but won this case in Upper Tribunal through appeal. The engaging body was deemed to be the bank – it was their decision to appoint PwC even though Airtours had input into the scope of work carried out.

Comment: VAT issues involving three parties are always complex and need careful consideration. The fact that two courts reached different conclusions on this case illustrates this point.

The issues involved 'sticking tax' (VAT paid to the exchequer and not reclaimed as input tax by any party) because the bank cannot claim input tax – the expense to them would be relevant to an exempt supply of financial services.

Case 2 – Hawes and Curtis Ltd – input tax disallowed on property rent

This is an unfortunate case – the facts were as follows:

Low Profile Properties Ltd (LPP) leased a number of properties from landlords in London, which were used for the trading purposes of a clothes retailer Hawes and Curtis Ltd (H&C) – the two companies were under common ownership.

The landlords invoiced LPP for the rent (plus VAT) but it was H&C that claimed input tax on its VAT returns – a total of £369k over a three-year period. LPP was not VAT registered and had not opted to tax the properties. HMRC disallowed the input tax on the basis that the supply of land (rent) was to LPP and not H&C.

Comment:

The tribunal supported HMRCs assessment but noted that the VAT loss would have been avoided if LPP had become VAT registered, opted to tax the properties and claimed input tax on the rent, which it could have recharged (plus VAT) to H&C which, as a retailer, gets full input tax recovery on its costs

Condition 3 - The supply must be chargeable to tax at the rate claimed

Example 1

John is a property developer and he is converting an office into a bungalow (new dwelling) which he will sell on a freehold basis once the project is completed. He uses the services of a contractor to do the building work, who charges him £100,000 plus £20,000 VAT for the complete job and issues a tax invoice for his services.

What is the input tax position?

Builder services in converting a non-residential property to a dwelling are subject to VAT at 5% and not 20%. So John's input tax claim on the builder services is restricted to £120,000 x 5/105 = £5,714. Even though he has paid £20,000 VAT to the contractor, he has failed condition 3 in being able to reclaim this amount of money as input tax. John should ask the builder for a VAT credit of £15,000, and then his input tax claim will be £5,000.

Author comment – the same outcome would apply in relation to an incorrect VAT charge on a supply that should be zero-rated. So if John bought a book from Amazon on 'building work' and was charged £20 plus £4 VAT – he could not claim input tax because the VAT charge is incorrect. Again, a VAT credit of £4 should be acquired from Amazon.

Condition 4 - A supply must have taken place;

Example 2

A large petrol company paid £10,000 to a rugby club in order to be able to acquire the rights to buy the club's allocation of international rugby tickets at Twickenham. The petrol company claimed input tax on the payment – on the basis that it was paying for a supply of taxable services received from a taxable person (the 'right' to buy rugby tickets). The club has not accounted for output tax on the basis that the payment by the petrol company is a donation.

What is the VAT position here?

In reality, a supply has definitely taken place here – the donor (petrol company) has received clear benefits in return for its payment. If the club had not been able to provide access to rugby tickets, the petrol company would not have made such a generous payment. A donation (no supply) only takes place when the donor receives no goods or services in return for his payment, although HMRC accept that an acknowledgement of thanks in a programme, website or other publication would not constitute a benefit for the donor.

Contributed by Neil Warren