# Tolley®CPD

April 2013

## Disclaimer

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

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

# Contents

**Budget 2013** 5

**Personal Tax (Lecture P766 – 17.12 minutes)** 5
Income tax and national insurance 5
Other taxes 5
Tax efficient investments 5
Capital Taxes 6
Other matters already previously announced 9
Expert comments 10

**Employment Taxation (Lecture B767 – 13.42 minutes)** 11
Employment taxes 11
Company cars 11
Company vans and car or van fuel benefits 12
Taxable cheap loans - exemption doubled to £10,000 12
Employee shareholder status - treatment of shares 12
Enterprise Management Incentives (EMIs) 13
New employers' national insurance allowance 13
RTI penalties 14
Simplifying the collection of Class 2 15
PAYE coding notice 15
Other Budget proposals to be consulted on in 2013 15
Expert comments 16

**Pensions (Lecture P676 – 10.57 minutes)** 17
Capped Drawdown 17
Family Pension Plans 18
Pensioners 18

**Business Taxation (Lecture B766 – 13.09 minutes)** 18
Simplified cash basis 18
Capital allowances 19

**Corporation Tax (Lecture B766 – 13.09 minutes)** **20**
Corporation tax rates 20
Above the line R&D tax credit 20
Close company loans 21
Deductions for employee acquisitions of shares 22
Corporation tax loss relief 22
Corporate loss-buying 23
Review of loan relationships and derivative contracts legislation 23
Group Relief Rules 23
Other minor amendments to draft legislation 24
Expert comment 25

**TAXES MANAGEMENT** **26**
General anti-abuse rule 26
Tax information exchange agreements with Crown dependencies 26
HMRC's offshore evasion strategy 27
Application of decisions in test cases 27
'Naming and shaming' of high-risk promoters 27
Tax avoidance using partnerships 28
Expert comments 28

**VAT** **29**
Fuel scale charges 29
Place of supply rules and a mini One Stop Shop (MOSS) 29
Exports 30
VAT retail export scheme 30
VAT refunds for NHS bodies 30
Manufacturer refunds 31
Education and research exemption 31
Energy saving materials installed in a charitable building 32
Expert Comments 32

Other Topical Issues 33

**Personal Tax** 33
Statutory residence test – Year of Death and other provisions (Lecture P768 – 11.11 minutes) 33
Payment for cancellation of share options 36
Interest retained by bank as security for a debt 37
Solicitor: interest on accounts in joint names 37

**Capital Taxes** 39
Painting: whether a wasting asset 39
Two IHT guidance updates (Lecture P769 – 14.30 minutes) 39

**Administration** 42
RTI – Update April 2013 (Lecture P770 – 7.58 minutes) 42
PAYE payment allocations (Lecture B770 – 13.53 minutes) 44
Administrator rather than adviser 47
Harsh penalties reduced 48
Admissible evidence 49
Illness is a reasonable excuse 49
Italian excuse 50
Verbal agreement 51
Inefficiency delays payment 52

**Business Taxation** 53
The Samadian case - end of home as a self-employed business base? (Lecture B768 – 10.00 minutes) 53
Error made in good faith in CIS administration 59
Absolved from liability with CIS with shortfall 60
Still not allowable 61
Radio presenter, claim for expenses: misdirection by HMRC 62
Patent box: reduced CT rate for profits from patents (Lecture B769 – 13.46 minutes) 63

**VAT** 65
Sales promotion scheme 65
Legitimate expectation 65
New or transferred? 66
Not a special investment fund 67
No retrospection 68

# Budget 2013

## Personal Tax (Lecture P766 – 17.12 minutes)

### Income tax and national insurance

The major changes to the rates and allowances for the 2013/14 tax year are as follows:

- the additional rate is reduced from 50% to 45% (the dividend additional rate is reduced from 42.5% to 37.5%)
- the basic rate band limit is reduced from £34,370 to £32,010, which means that the level at which higher rate tax kicks is reduced to £41,450 (down from £42,475 in 2012/13)
- the personal allowance for those born after 5 April 1948 is increased to £9,440.

As announced in Budget 2012, from 6 April 2013 age-related allowances are frozen at 2012/13 levels. and will only be available to those born on or before 5 April 1948.

In relation to the 2014/15 tax year, the major news is that the personal allowance for those born after 5 April 1948 will be £10,000. This was a key aim for the Coalition Government and it has been achieved ahead of the 2015 deadline. The 2014/15 basic rate band limit will be £31,865, which means the higher rate tax kicks in at £41,865, a slight increase from the 2013/14 tax year.

### Other taxes

The CGT exempt amount will increase to £10,900 for 2013/14 (in line with the consumer prices index) and the rates of tax will remain the same.

The Inheritance tax nil rate band remains £325,000 until at least 6 April 2018 (the freeze to the nil rate band is extended for a further three years as a result of Budget 2013).

Also, stamp duty is to be abolished on shares quoted on 'growth markets' such as the Alternative Investment Market (AIM) and ISDX Growth Market. This is to be legislated in Finance Bill 2014, although the proposed operative date is not provided.

### Tax efficient investments

**Seed enterprise investment scheme**

The seed enterprise investment scheme (SEIS) has seen two changes which are both useful for businesses looking to seek investment using this relief. These are:

- the extension of the capital gains tax (CGT) re-investment relief to 2013/14, and
- amendments to make off-the-shelf companies eligible for relief.

There are changes to the CGT re-investment relief which previously applied in 2012/13. In 2012/13, the **entire gain** was exempted if the proceeds were re-invested in a qualifying company in the 2012/13 tax year. For gains realised in 2013/14, **only a proportion** will be exempted from charge. The chargeable gain will be an amount that is equal to half the matched re-invested gain. Also, the relief will be available if the re-investment is made in 2013/14 or 2014/15.

This aspect of SEIS meant that in addition to receiving an income tax reduction of 50% on their investment (up to a maximum of £100,000), the investor could exempt any capital gains they reinvested. This meant that the maximum relief available through the scheme in 2012/13 was £78,000. For 2013/14, the maximum relief will be £64,000.

The exclusion of off-the-shelf companies was an oversight arising from the wording of ITA 2007, s 257DG(2). This section disqualified companies which had previously been controlled by another company. The proposed change will see an exception introduced for the holding companies which owned the subscriber shares where the SEIS company was not trading or preparing to trade at the time.

### Social enterprises investment tax relief

There is to be consultation in the summer of 2013 on the introduction of 'tax relief' to encourage private investment in social enterprises. It appears that the plan is to introduce the relief from April 2014 as it is to be legislated in Finance Bill 2014. It is not known whether this will be an income tax relief, in the same way as SEIS.

## Capital Taxes

### Trust rate of Income tax

As previously announced, the trust rate of tax applicable to discretionary and accumulation trusts is reduced from 50% to 45% from 6 April 2013. The corresponding dividend trust rate is reduced from 37.5% to 32.5%. Consequently, the tax credits attached to distributions to beneficiaries will also reduce. Where trustees are holding undistributed income covered by the tax pool, it would be advantageous for beneficiaries to distribute it before 5 April 2013. There are no changes in the standard rate of tax of 20% for interest in possession trusts and deceased estates.

**Non-domiciled spouses and civil partners.**

Transfers between UK domiciled spouses and civil partners are fully exempt from inheritance tax, but where one partner is non-UK domiciled, the exemption is limited. The lifetime limit for exempt transfers to non-UK domiciled spouses or civil partners is to be raised from £55,000 to £325,000 with effect from 6 April 2013. Thereafter the exemption will rise in line with the nil rate band. Note that there is no limitation on exempt transfers from a non-UK domiciled partner to a UK domiciled one.

Non-UK domiciled individuals are subject to IHT on assets located in the UK only. The Budget introduces the option for non-UK domiciled spouses and civil partners to elect to be treated as UK domiciled. The effect of such an election would be that their worldwide assets would become subject to IHT, but there will be no restriction on the exemption for assets received from their spouse or civil partner.

The provision is clearly advantageous for couples where the non-UK domiciled partner has few assets outside the UK. The value of their taxable estate will be increased only marginally and transfers from the UK domiciled partner will not be taxed.

Elections must be made in writing to HMRC at any time after marriage or registration of the civil partnership. There will be a provision to backdate lifetime elections up to seven years with an effective date no earlier than 6 April 2013. Once made, the election is irrevocable whilst the individual is resident in the UK. Personal representatives will be able to make the election for a deceased estate within two years of death where the death has occurred after 6 April 2013.

**Limiting inheritance tax deductions for liabilities**

Inheritance tax is charged on the net value of an estate after deduction of liabilities. A liability must be deducted from the asset on which it is secured. The Budget introduced provisions to counter avoidance schemes which have been developed to take advantage of this basic rule.

The most important provision as far as business owners are concerned is that there will be no deduction against the taxable estate for any liability which has been incurred to acquire property on which a relief such as BPR or APR is due. The liability must be deducted from the value of the assets qualifying for relief, which means, of course, that no tax will be saved as the assets are already relieved.

As business owners often obtain finance for the business by mortgaging their home, this will potentially have a significant impact on their liability to inheritance tax. The current legislation allows a debt secured on a property to reduce the value of that property, meaning that the business loan reduces the value of the

taxable estate. The new provisions will alter the present favourable position by requiring the loan to be deducted from the BPR qualifying business assets.

**Estate planning**

The Chancellor confirmed the Government's intention to implement the Dilnot Commission proposals for funding the costs of care in old age. It will introduce a cap of £72,000 on reasonable care costs, and extend the means test from April 2016. Currently, those with savings in excess of £23,000 are required to contribute to their care costs but this level of preserved assets is due to increase to £118,000.

The stated purpose of freezing the nil-rate band for inheritance tax is to contribute to the funding of social care.

Practitioners will be aware that the protection of the estate from potential care costs is a prime motivation for clients to engage in estate planning. It goes hand in hand with inheritance tax mitigation. Simultaneously, elderly clients are usually anxious to hold on to more of their wealth than they need for a comfortable lifestyle, because they are afraid of being left unable to pay for care of an acceptable standard. The new proposals, if implemented and maintained, will introduce some certainty into the estate planning process.

**Vulnerable beneficiaries**

The Finance Bill 2013 will attempt to streamline the tax rules and definitions relating to vulnerable beneficiary trusts. Vulnerable beneficiaries include disabled persons and young people under the age of 25 who have lost one or both of their parents. It is expected that draft legislation published in January will be amended to correct certain details but no further details have been published as yet.

The broad aim of the amendments is to apply the same qualifying conditions to all types of vulnerable beneficiary trusts. The trust assets are to be applied exclusively for the benefit of the vulnerable beneficiary, with the exception of the lower of £3,000 or 3% of trust assets, which may be applied for another person. This provision may be useful where trustees want to include other members of the family, or a carer, in their arrangements, perhaps by paying for a shared holiday or a car.

Where qualifying conditions relating to a vulnerable beneficiary are defined by their eligibility for Disability Living Allowance (DLA), they will be transferred to those eligible for the Personal Independence Payment (PIP), which will begin to replace DLA from April 2013.

The provisions do not deal with the anomolies in the income tax rules relating to vulnerable beneficiary trusts.

**Heritage property trusts**

A small adjustment is to be made to the business asset hold-over rules which will benefit the settlors of heritage maintenance funds. The current arrangements provide both income tax and capital gains tax relief where a settlor has made a gift of heritage property which he continues to benefit from, such as in an 'open house' arrangement. However, if the trustees provide funds to the settlor for maintenance and repair of the property, the settlor is taxed on the receipt as trading income. An amendment to TCGA 1992, s 169D will, by means of a somewhat convoluted route, result in the trustees being allowed to reimburse the settlor without increasing his tax.

## Other matters already previously announced

**Cap on Income Tax Reliefs**

From 6 April 2013 a cap will operate on a number of reliefs that are set off against income. The most important of these are trade and property loss reliefs and qualifying loan interest relief. It will still be possible to carry forward unlimited losses against future trade profits. There are also exceptions for losses attributable to overlap relief and business premises renovation allowances. The cap will not apply to charitable reliefs. The cap is set at the greater of £50,000 or 25% of income (as adjusted).

**Statutory Residence Test**

A statutory test to determine UK residence status will operate from 6 April 2013. The test will contain three parts: an automatic overseas test, an automatic UK test and a sufficient ties test combining time spent in the UK with a person’s ties to the UK.

**Reforms to Ordinary Residence**

The concept of ordinary residence is abolished from 6 April 2013. The effect of this is mitigated by retaining Overseas Workday Relief (OWR) and putting it into statute, broadly replicating the current treatment under SP1/09. OWR will be available to non-domiciled individuals coming to the UK regardless of any intention to settle. It will be available for the tax year in which the individual becomes UK resident and the following 2 tax years. There will be transitional provisions to protect those currently benefiting from OWR who may otherwise lose out on the introduction of the statutory rules.

**Non-domicile Taxation**

Rules relating to the remittance basis and exempt property will be amended to remove a potential tax charge where the property is lost, stolen or destroyed whilst in the UK and to remove a minor anomaly. The range of exempt property is also to be extended and the interaction of various time limits clarified. The changes will be effective on and after 6 April 2013.

Legislation is introduced to ensure that, under certain circumstances, money used to make payments on account will not result in income or gains being regarded as remitted to the UK.

## Expert comments

**Welcome changes to SEIS - Yvette Nunn - President of the ATT**

The extension for a further year of the CGT relief on gains reinvested into seed enterprise investment scheme (SEIS) qualifying shares (albeit at half the level for 2012/2013) will be welcome by new small companies looking for an injection of kick-start funds. It is also good to see that the drafting error which denies SEIS relief where the investment is in a company that was formed by a corporate formation agent is being corrected for share issues from April 2013. The puzzle is why the error could not have been corrected when it came to light or indeed why the change could not now be backdated to April 2012. Some small companies have been denied access to vital funds in 2012/2013 because of the error.

**Change in the deductibility of debts for IHT purposes - Bob Trunchion - Tax partner, MHA MacIntyre Hudson**

Currently you would look at how a debt is secured for IHT purposes rather than the purpose for which the debt was used for working out a liability on death. For example: where a landowner or a small business owner buys a factory or additional tranche of land, currently they would look to secure the debt on an investment property or their house. The business property would attract BPR and the debt would reduce the value of their house for IHT purposes. From Royal Assent of the Finance Act 2013 (about 20 July 2013), the debt will now be deducted from the value of the business asset rather than the investment.

For example, a person buying a factory today for £400,000 with an investment property (worth £500,000), with no debt secured upon it, would look to secure the debt to buy the factory on the investment property. The debt is deducted for IHT purposes from the value of the investment property, which brings the value of that property to just £100,000 (i.e. £500,000–£400,000). However, the factory will attract business property relief at 100% so the net estate would be substantially reduced. But clearly this increases the risk if the business fails as the investment property will be lost. From Royal Assent, the tax advantage is lost – meaning that the business risk should now be the prime reason for securing the debt on the factory.

# Employment Taxation (Lecture B767 – 13.42 minutes)

## Employment taxes

There were two key announcements with respect to employers' NICs and remuneration planning. These are:

- the introduction of an employment allowance worth £2,000 for all employers, and
- the increase in the threshold for the exemption for employment-related loans to £10,000.

The employment allowance will be introduced from April 2014 and will be claimed through RTI. This should help this relief be delivered automatically to all businesses, especially small businesses which are not represented. It will be available to all businesses, unlike the Regional Employers NICs Holiday which is available to new business only until 5 September 2013.

The Regional Employer's NICs Holiday failed to make a significant impact on its intended targets. HMRC estimated that the number of businesses that would claim the holiday was 400,000. As of April 2012 less than 14,000 businesses had successfully claimed the holiday.

The doubling of the employment-related loans exemption is predicted to benefit 7,000 businesses. This is presumably considering the number of businesses that offer loans to employees for things such as season tickets. However, it may well have a small benefit for many owner-managed businesses. Overdrawn loan accounts can be a cause of significant issues for many OMBs. This is particularly true for those who have operated as an unincorporated business before incorporating and have got used to taking drawings without the need for paperwork. This may reduce the number who are required to submit P11Ds purely for the purpose of disclosing an overdrawn loan account.

## Company cars

As has been the practice in recent years, the Budget documents provide advance information about the company car tax rates that will apply from 2015/16 to 2019/20, but this focuses only on the changes for 2015/16 and 2016/17 as the rates for later years could well change again before coming into use.

The rates for 2015/16 will be included in Finance Bill 2013. The appropriate percentage to be applied to the price of a car to arrive at the taxable benefit continues to be determined by reference to the CO2 emissions level of the vehicle, with the lowest appropriate percentages applying to the vehicles with the lowest levels of CO2 emissions.

For 2015/16 there will be a new band of 0 to 50g CO2 per km for which the appropriate percentage is 5% and another of 51 to 75g CO2 per km for which the appropriate percentage is 7%.

The appropriate percentages for all other bands above 75g $CO_2$ per km will increase by 2% compared with 2014/15 up to a maximum of 37%.

For 2015/16, the appropriate percentage for each band will increase by a further 2%, again to a maximum of 37%.

## Company vans and car or van fuel benefits

The rate of the benefit charge for company vans and for fuel provided for company cars or vans will be increased in line with inflation in autumn 2013, based on the Retail Price Index figure for September.

## Taxable cheap loans - exemption doubled to £10,000

When an employer provides an employee with an interest-free (or low interest) loan, it may give rise to a tax charge as a benefit under ITEPA 2003, s 175. The current law states that if the total of all employment-related interest-free or low interest loans outstanding in the tax year does not exceed £5,000, no tax charge arises. The Budget included an announcement that this £5,000 exemption will be doubled to £10,000 from 6 April 2014.

## Employee shareholder status - treatment of shares

Proposals in the Growth and Infrastructure Bill currently before Parliament create a new class of employee now labelled "an employee shareholder" (called an "employee owner" when the policy was first announced). This class of employee is only open to individuals employed by companies. There are three conditions to be met for an employee to become an employee shareholder:

- both the employer and the employee must agree that the individual employee is to become an employee shareholder
- the employing company must issue fully-paid shares worth at least £2,000 to the employee in consideration of that agreement (the shares may either be in the employing company or its parent company), and
- the employee must give no other consideration for those shares beside entering into the agreement

If an individual does become an employee shareholder, his rights under the Employment Rights Act 1996 are reduced. An employee shareholder does not have any right to request to undertake study or training, to request flexible working arrangements or to receive a redundancy payment and has only limited protection against unfair dismissal. An employee shareholder taking parental or adoption leave (or additional leave)

would also have to give more notice of his intention to return to work (16 weeks in place of the normal 6 or 8 weeks as the case may be).

In the Budget, the Chancellor confirmed that Finance Bill 2013 will include measures to reduce possible tax liabilities on the shares given as consideration for the agreement to be an employee shareholder. Finance Bill 2013 will include provisions to treat the employee as if he had paid £2,000 for the shares, so there will be no income tax charge on the first £2,000 worth of such shares. Normal tax and NIC rules apply to any shares above that level. Regulations will also be made to ensure the same treatment for national insurance purposes. The Finance Bill will also include an exemption from capital gains tax on the first £50,000 gain made by the employee on the eventual disposal of all the shares he received as consideration for the agreement.

**However**, in the evening, after the Budget the House of Lords **blocked** the employee shareholder clauses in the Growth and Infrastructure Bill. The fate of this scheme is currently in limbo.

## Enterprise Management Incentives (EMIs)

Legislation will be introduced in Finance Act 2013 to remove, for shares acquired through the exercise of a qualifying EMI option on or after 6 April 2012, the requirement for entrepreneurs' relief that the person must hold 5% or more of the ordinary share capital in the company. This measure will have effect for eligible shares disposed of on or after 6 April 2013. The period during which the option is held will count towards the qualifying 12-month holding period requirement, and the relief will also apply to the disposal of shares that replace EMI shares following a company reorganisation and to certain shares following an exchange for shares in another company.

## New employers' national insurance allowance

The Chancellor announced that a new allowance of £2,000 per year will be made available to all businesses and charities to be offset against their employer Class 1 secondary NICs bill from April 2014. The allowance will be claimed as part of the normal payroll process through RTI.

The Government will consult on the detail of how this initiative will be implemented before introducing legislation later in 2013.

This is intended to be an incentive for job-creation. It is more generally available but a less generous follow-up to the Regional Employer NICs holiday, which is another form of NIC allowance, available only to start--up businesses in certain geographic regions, which comes to an end on 5 September 2013. Being of more general application and with fewer conditions to satisfy, it should be easier to administer both for

employers and HMRC. There is currently no indication whether this is a temporary or a permanent measure.

### Tax-free Childcare Scheme

A tax-free childcare scheme is to be phased in from autumn 2015. It will be worth up to £1,200 per year for each child (i.e. basic rate relief on childcare costs up to £6,000 a year). It will be available to families where all parents are working and not receiving tax credits or Universal Credit so long as neither parent earns over £150,000 a year.

Current Employer-supported Childcare arrangements will be phased out for new applicants from autumn 2015.

## RTI penalties

Real Time Information ("RTI") is the new system for employers to communicate PAYE information to HMRC electronically and in 'real time'. The vast majority of employers will have to operate RTI from 6 April 2013.

The Budget confirmed that, following on from consultation that took place last year, legislation will be introduced in Finance Bill 2013 to set out a new model for late filing penalties for RTI which will apply from April 2014.

Penalties will apply to each PAYE scheme, with the size of the penalty being based on the number of employees in the scheme. Each scheme will be subject to only one late filing penalty each month, regardless of the number of separate returns due in the month. An employer may miss one deadline per year without penalty, but all subsequent defaults will attract a penalty. Penalties will be charged quarterly, and subject to the usual reasonable excuse and appeal provisions.

In cases of late payment, penalties will be based on the number of previous late payments in the tax year. Regulations are likely prevent penalties being issued where there is only a small discrepancy between the return figures and sums paid over each period

There will also be amendments to the existing legislation on penalties for inaccuracies, allowing a tax year to be treated as a single tax period for penalty purposes.

The penalties rates themselves will be set by regulation once the penalty framework has been put in place in Finance Bill 2013.

## Simplifying the collection of Class 2

Self-employed people currently pay Class 2 national insurance via monthly via direct debit or via half-yearly bills. To simplify the administration for these people, the proposal is that Class 2 will be collected via Self Assessment, in the same way as Class 4 national insurance is collected. There will be a consultation with interested parties and legislation will be brought forward if required. There is no time scale given, but it is hoped that this could be included in Finance Bill 2014..

## PAYE coding notice

The Budget contains a proposal to review the rules related to the collection of debts via the PAYE coding notice with a view to increasing the size of the debt which can be collected.

## Other Budget proposals to be consulted on in 2013

### Tax relief for health interventions

This Budget proposal is for a limited exemption from a benefits charge on health-related interventions made by employers to support employees returning to work after sickness. The outline of the proposal so far is that it would exempt up to £500 paid by employers on interventions recommended by the Health and Work Assessment and Advisory Service to support employees to return to work after a period of sickness absence. A consultation is expected later in 2013 with legislation in Finance Bill 2014.

### OTS recommendations on approved employee share schemes

In its report published in March 2012, the Office of Tax Simplification ("OTS"), recommended that the current system of HMRC approval of tax advantaged employee share schemes should be replaced with a form of self certification similar to that in place for the Enterprise Management Incentive. The Government has accepted that recommendation and the Budget confirmed that a consultation on a proposed self certification system will be published shortly with a view to legislation in Finance Bill 2014.

### OTS recommendations on unapproved share schemes

The Government's plans for picking up on the recommendations in the OTS report on unapproved share schemes, published in January 2013, are less well covered in the Budget. The only comment is that the Government will consult on a number of the recommendations made, with no indication when such consultation may take place or in which Finance Bill any changes might be implemented.

### Employee ownership

The Budget confirmed the Govenment's intention to introduce a new relief from capital gains tax on the sale of a controlling interest of a business into an employee ownership structure. That new relief will be consulted on before introduction in Finance Bill 2014. There is also likely to be consultation on ideas for further incentives in this area, including measures targeted at employees through indirect ownership models.

### Payroll giving

There is currently a consultation underway on ways to improve payroll giving, setting out a range of options to increase amounts received by charities through payroll giving, including opening up the market to non-charity participants. The consultation closes on 19 April 2013. Future news articles will report on the outcome of that consultation.

## Expert comments

### Government to proceed with ‘employee-shareholder’ plans - Lynda Finan - Legal director, tax group, DLA Piper

Despite the less-than lukewarm response to its proposed new ‘employee-shareholder’ status (free shares in return for giving up certain employment rights), the government is proceeding with it, although implementation has now been deferred – it will apply to shares received on or after 1 September 2013. As anticipated, an income tax and NICs exemption will be available for the first £2,000 of shares awarded. Corporation tax relief will also be available for businesses, presumably limited to the first £2,000 of shares per employee.

In support of the objective of widening employee share ownership, a new CGT relief is to be introduced in 2014 for the sale of a controlling interest in a business into an employee ownership structure. This may

facilitate the succession of some closely-held companies, though given it will only apply to controlling interests, is unlikely to attract many takers. A lower threshold would do more to achieve the government's objective. Other measures are promised, including a £50m annual budget in support. From April 2014, a new national insurance employment allowance of £2,000 will be available to all businesses and charities to set against their employer NICs bill. This will to remove one third of all employers from the obligation to pay employer NICs and encourage small business to create new jobs.

# Pensions (Lecture P676 – 10.57 minutes)

**Pensions**

As announced in the Autumn Statement 2012, from 2014/15 the annual allowance is to be reduced from £50,000 per year to £40,000 per year and the lifetime allowance will drop from £1.5m to £1.25m.

Individuals who have or expect to have pension pots in excess of £1.25m at retirement (and who do not already have lifetime allowance protection) will be able to use the 'fixed protection 2014' regime to protect their pension savings. Individuals who register for the fixed protection 2014 will be entitled to a lifetime allowance which will be the greater of:

- £1.5m
- the standard lifetime allowance

As was the case in previous lifetime allowance protection regimes, the individual will not be able to contribute to any defined contribution pension scheme from 6 April 2014 and any benefit accrual in a defined benefit scheme must be limited to a 'relevant percentage'.

Anyone intending to register for fixed protection 2014 will need to follow the automatic enrolment consultation carefully. Currently, all employees must be enrolled in the employer pension scheme and then they must opt-out. The Department of Work and Pensions proposes that those with lifetime allowance protection be exempted from the automatic enrolment.

## Capped Drawdown

Legislation will be introduced in Finance Act 2013 to increase the maximum income which a drawdown pensioner with a capped drawdown pension fund can choose to receive. The maximum for a drawdown pension year will go up from 100% to 120% of the basis amount, for all drawdown pension years starting on or after 26 March 2013.

## Family Pension Plans

From 6 April 2013 a payment by an employer into the registered pension scheme of an employee's spouse or family member will be subject to income tax and National Insurance contribution liabilities on the employee and employer respectively.

## Pensioners

**Single tier pension**

The single tier pension is to be brought forward to April 2016. It is unclear whether the other state pension reforms recommended in the White Paper will be introduced at the same time (ie the increase in the qualifying years from 30 to 35, the need for a minimum number of qualifying years before becoming entitled to the state pension and the removal of the ability to inherit or derive rights to the state pension from a spouse / civil partner).

The single-tier pension will necessitate the closure of the state second pension (S2P) which is based on the national insurance contribution record. Therefore the biggest beneficiaries of these changes will be women, the low paid and the self-employed.

# Business Taxation **(Lecture B766 – 13.09 minutes)**

## Simplified cash basis

The simplified cash basis was announced at Autumn Statement 2012 and draft legislation for Finance Bill 2013 was published on 11 December 2012 for consultation purposes. Following feedback HMRC have decided to amend the proposed legislation.

The changes that will be introduced include:

- businesses using the cash basis will continue to do so until their circumstances are no longer suitable for them
- businesses using the cash basis will not have to use the simplified flat rate expenses for their cars; and
- simplifying the legislation

This appears to mean that businesses will no longer simply be able to opt out of the cash basis when it suits them. This might deter some businesses from using it but it will eliminate the possibility of deliberately taking advantage by joining and leaving the simplified cash basis at will. It also simplifies considerations as the cash basis is a one-off decision for clients.

The removal of the mandatory use of the flat rate for cars (and presumably motorcycles) will give the trader more opportunity to gain tax relief for the costs of running their vehicle. However, it seems that they will not be able to get relief for the capital element of the vehicle if they take this option.

A genuine simplification of the legislation, even at the expense of 'fairness', is desirable given that the aim of the regime is to provide simplicity.

## Capital allowances

Legislation will be introduced in Finance Bill 2015 to extend the 100% first year allowance (FYA) for expenditure incurred on cars with low carbon dioxide emissions and electrically propelled cars for an additional three years to 31 March 2018.

Expenditure on railway assets and ships as defined in CAA 2001 is currently excluded from access to 100% FYAs for new energy saving plant and machinery. This exclusion will be removed in respect of qualifying expenditure on railway assets or ships incurred on or after 1 April 2013.

An announcement was made at the time of the Autumn Statement on the increase in the threshold for AIAs to £250,000 (from £25,000) for the two years from 1 January 2013.

# Corporation Tax (Lecture B766 – 13.09 minutes)

## Corporation tax rates

Reductions in the main rate of corporation tax for non ring-fenced profits have been announced in previous Budgets. An additional 1% reduction was confirmed in the Autumn Statement 2012, reducing the rate from 24% to 23% in April 2013 and then to 21% in April 2014. In an effort to become the most competitive tax regime of any major economy, the Chancellor has confirmed that the main rate of corporation tax will be reduced to 20% from 1 April 2015. The main rate and small profits rate of corporation tax are therefore being unified, such that marginal relief calculations will no longer be required.

The rates of corporation tax since 1 April 2010 are summarised in the following table:

| Year commencing 1 April | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| Small Profits Rate | 21% | 20% | 20% | 20% | 20% | - |
| Marginal Relief Lower Limit | £300,000 | £300,000 | £300,000 | £300,000 | £300,000 | - |
| Marginal Relief Upper Limit | £1,500,000 | £1,500,000 | £1,500,000 | £1,500,000 | £1,500,000 | - |
| Standard Fraction | 7/400 | 3/200 | 1/100 | 3/400 | 1/400 | - |
| Main Rate of Corporation Tax | 28% | 26% | 24% | 23% | 21% | 20% |
| Marginal rate of corporation tax | 29.75% | 27.5% | 25% | 23.75% | 21.25% | - |

## Above the line R&D tax credit

The introduction of an above the line R&D credit was announced at Autumn Statement 2011 and is available for qualifying expenditure incurred on or after 1 April 2013. Following a period of consultation, legislation was published in the draft Finance Bill 2013. The draft legislation states that the rate of the credit is equal to 9.1% of the total qualifying R&D expenditure incurred in the accounting period. However, the Chancellor confirmed in the Budget that the rate of the credit will be increased to 10%, which will be reflected in the updated version of the Finance Bill 2013.

## Close company loans

The Government announced that three changes would be made to the implementation of the corporation tax charge on loans to participators under CTA 2010, s 455 (formerly ICTA 1984, s 419). These changes have effect from 20 March 2013 and are intended to:

- ensure that loans to partnerships and trusts are caught
- bring transfers of value other than loans within the scope of the charge, and
- prevent temporary repayment of loans ('bed and breakfasting')

In HMRC's technical note HMRC say that some companies have argued that where loans are made to partnerships which include corporate partners, CTA 2010, s 455(1) does not apply. Changes will therefore be made to bring such arrangements within scope of the charge.

There will be exceptions where loans are made in the ordinary course of business.

HMRC list situations where they consider that loans to trustees should fall within CTA 2010, s 455. These include where:

- shares in the close company are held in the trust
- the loan is to trustees who are associates of a participator, and
- the trustees are all relevant persons and each is a participator or associate of a participator

Some of these arrangements might already fall within the scope of the rules on disguised remuneration..

The rules involving the extraction of 'value other than loans' is also targeted at the use of partnerships. The rules aim to establish that where profits of a corporate partner are not withdrawn from the partnership a withdrawal of excessive capital by a participator may be caught by CTA 2010, s 455.

At present, it is not clear that these structures are not already caught by s 455, as HMRC implies in its technical note at paragraph 24. However, this will put the matter beyond doubt.

To prevent 'bed and breakfasting' there will be a new '30 day rule' which will mean that relief from s 455 under CTA 2010, s 458 is withdrawn where repayments of more than £5,000 are made which are redrawn within 30 days. Furthermore, if the outstanding amounts are £15,000 or more and there is an intention to redraw an amount, then relief is also withdrawn.

'Redrawing' in this situation will include any of the arrangements caught by s 455 under these new rules.

## Deductions for employee acquisitions of shares

Legislation will be introduced in Finance Bill 2013 to clarify the availability of the corporation tax deductions for companies granting share options or issuing shares to employees. The new legislation will have effect for accounting periods ending on or after 20 March 2013 and has not been the subject of previous consultation.

Under the current legislation set out in CTA 2009, Part 12, the value of the corporation tax deduction available is equivalent to the amount which is chargeable on the employee at the time the option is exercised or shares are acquired. No other deduction is available for expenses directly related to the provision of shares.

The new provisions clarify that where relief is claimed under CTA 2009, Part 12, no deduction is available for any other expenses relating to the provision of shares, or for any connected matter. In addition, a deduction will not be available in respect of the grant of share options, unless the employee actually acquires shares under the option.

## Corporation tax loss relief

Three new anti-avoidance measures relating to loss relief have been announced, which will be introduced in Finance Bill 2013. These rules close loopholes which enable companies to pass on the benefit of losses to third parties, or to access greater amounts of group relief than would otherwise be available.

The first measure relates to the availability of group loss relief in the context of Controlled Foreign Companies (CFCs) and applies to surrender periods ending on or after 20 March 2013. Under current legislation, UK property business losses, management expenses, and non-trading losses on intangible fixed assets can only be surrendered if the aggregate amount exceeds the surrendering company's gross profits for the surrender period (CTA 2010, s 105). Apportioned CFC profits are not currently included in the computation of gross profits for this purpose. These profits will be included as gross profits under the new legislation.

The second measure relates to the treatment of losses in the event of a company re-organisation resulting in a change of ownership and applies to transactions that occur on or after 20 March 2013. Under current legislation set out in CTA 2010, Part 14, Chapter 2, the use of losses is restricted where a trade is transferred between unconnected companies and there is a major change in the nature or conduct of the trade within three years following the change in ownership, or where trading activities become small or negligible before any significant revival. However, a loophole exists where the restriction does not apply in the case of a transfer of trade which occurs after the re-organisation. This loophole will be closed under the

new legislation, such that trading losses will not be available where the trade, or part of the trade, is transferred within the new group either before or after the change in ownership.

The third measure restricts the availability of non-trading debits, non-trading loan relationship deficits and non-trading losses on intangible fixed assets following the change in ownership of a dormant company, in order to target loss buying. This amendment will have effect in relation to surrender periods ending on or after 20 March 2013.

## Corporate loss-buying

Targeted anti-avoidance rules will be introduced with immediate effect in order to prevent 'loss buying'. Under current legislation, companies are able to acquire unrealised losses from unconnected companies and subsequently relieve them against profits which arose from unconnected activities.

Three new provisions will be introduced to combat such loss buying arrangements. The first extends the application of CAA 2001, Part 2, Chapter 16A, such that relief for allowances in respect of expenditure in new pools (which arise where the tax written down value of the assets exceeds the balance sheet value), or losses attributable to such allowances, is restricted.

The two other rules will amend CTA 2010 to counter tax motivated re-organisations between unconnected parties and to counter arrangements that aim to transfer profits to companies so that the relevant deductions can be used.

## Review of loan relationships and derivative contracts legislation

A consultation will be launched setting out a number of proposals to modernise the corporation tax treatment of corporate debt. It is anticipated that legislation will be included in Finance Bill 2014 and Finance Bill 2015. Details of the consultation are expected to be available in the summer of 2013.

## Group Relief Rules

The group relief rules are to be amended as follows:

- there will be fewer restrictions on when EEA resident companies can surrender losses from their UK permanent establishments as group relief in the UK. Currently such losses can only be surrendered if they are not relievable against non-UK profits in any period. From 1 April 2013 such losses can be surrendered provided the loss is not actually used against the non-UK profits of any person in any

period. The group relief will, however, be subsequently withdrawn if the losses are later used against non-UK profits;

- conditions imposed by a statutory body stipulating that one company will leave a group at a pre-determined date will not prevent claims to group relief on the grounds that there are 'arrangements' in place for a company to cease to be a group member. These provisions will apply for accounting periods ending on or after 1 April 2013;
- losses can only be surrendered to other group companies after they have been relieved against the 'gross profits' of the company in which they arose. For controlled foreign company (CFC) accounting periods ending on or after 20 March 2013 'gross profits' will include apportioned CFC profits made to the surrendering company; and
- the current restriction on the availability of trading losses, when in any 3-year period there is both a change in the ownership of a company and a major change in the nature or conduct of its trade, is to be amended to disallow trading losses where there is a transfer of the trade within the new group following the changes in ownership. Furthermore, non-trading debits, non-trading loan relationship deficits and non-trading losses on intangible fixed assets will be restricted following a change in ownership of a shell/dormant company. These provisions will apply for changes in ownership on or after 20 March 2013.

## Other minor amendments to draft legislation

Amendments have been made to some of the legislation included in the draft Finance Bill 2013, following a period of consultation which closed on 6 February 2013. The Finance Bill 2013 is due to be published on 28 March 2013 and will contain the changes summarised below.

**Controlled foreign companies (CFCs)**

In addition to the measures relating to the new CFCs regime contained in the draft Finance Bill 2013, the Government has announced that three further provisions will be included in the Finance Bill 2013. These are:

- the definition of a group treasury company will be aligned for both the CFC and worldwide debt cap regimes
- a relaxation on the limitation or qualifying resources funded from UK debt
- application of the matched interest rules to left-over profits

The new regime applies to CFCs with accounting periods beginning on or after 1 January 2013.

**Foreign currency assets and chargeable gains**

The provisions set out in the draft Finance Bill 2013 require companies with a non-sterling functional currency to use their functional currency to calculate any chargeable gains and losses on disposals of shares not covered by the substantial shareholdings exemption. At Budget 2013, the Government extended the

measure to include disposals of ships and aircraft. These provisions will have effect for relevant disposals on or after the date that Finance Bill 2013 receives Royal Assent.

**Deferral of payment of exit charges**

An exit charge arises when a UK company changes its place of effective management and control to another EU territory or European Economic Area (EEA) member state, and is based upon the market value of the company's assets at the time of migration. See the Outbound migration guidance note for further background information.

Legislation contained in the draft Finance Bill 2013, which seeks to minimise the impact on the EU concept of freedom of establishment, has been amended following consultation. In addition to the existing rules requiring payment of the charge within nine months and one day following the end of the accounting period, two additional payment options will now be included in the Finance Bill 2013, rather than the single additional option proposed in the draft Bill. These are as follows:

- staged payments made in six equal annual instalments, the first payment being due within nine months and one day following the end of the accounting period
- computation of the tax due at the time of exit, allocated on an asset by asset basis. The tax will become due as and when assets are realised. An annual statement must be provided to HMRC setting out which assets have been realised. The tax may be deferred for a maximum period of 10 years, or until disposal if sooner.

## Expert comment

**R&D 10% boost will get Britain back on track - Diarmuid MacDougall - Partner, PwC**

Manufacturers and high technology industries are set to benefit from 10% funding by government of their research and development which could help Britain get back on track.

This is fantastic news for British business, especially those in high end technology sectors such as automotive, life sciences and aerospace. This credit, which will come into place on 1 April, will provide vital extra funding for businesses that may now be able to pursue projects that would otherwise have been abandoned.

It will make the cost of doing R&D in the UK lower, thereby making our R&D centres more globally competitive, which in turn should help us attract and secure vital skills. Additionally, smaller businesses (less than 500 employees) will for the first time get a payable credit on R&D for customers.

Many of these businesses face the risk that when they undertake R&D to develop a component for a customer, they may or may not recoup the cost when the item goes into larger scale production. Once in place, the payable credit will provide some protection against projects not reaching the production stage.

With interest rates remaining low, the US economy recovering, and continuing expansion in the fast growing economies of China and India, now is perhaps better than ever for British businesses to invest in the innovation that is needed to secure our future economic growth.

# TAXES MANAGEMENT

## General anti-abuse rule

The Chancellor first announced his intention to introduce a UK GAAR in Budget 2012. Following a period of consultation during 2012, responses to the consultation and draft Finance Bill 2013 clauses were published on 11 December 2012.

The GAAR legislation will come into force on the date of Royal Assent to the Finance Act 2013. There is an exception for NICs as it was confirmed in the Budget that separate NICs legislation will be introduced after Royal Assent to Finance Bill 2013 when parliamentary time allows.

## Tax information exchange agreements with Crown dependencies

Jersey, Guernsey and the Isle of Man have entered into tax information exchange agreements with the UK Government as part of the strategy to target offshore tax evasion.

Disclosure facilities will also be put in place to allow investors with accounts in these Crown dependencies to settle their past tax affairs with HMRC in advance of the information being automatically exchanged. The Government expects to raise over £1bn through these disclosure facilities over the next five years. Although very little detail is currently in the public domain, these disclosure facilities may be operated along the same lines as the Liechtenstein disclosure facility (LDF).

Interestingly, in terms of the categorisation of these Crown dependencies for penalties for offshore matters, Guernsey and the Isle of Man are category 1 territories and Jersey is a category 2 territory. This means that higher penalties are charged in relation to an offence where the offshore matter relates to Jersey. With the signing of this information exchange agreement perhaps Jersey will now be reclassified as a category 1 territory?

These increased penalties are only applicable where the tax at stake is income tax or capital gains tax.

## HMRC's offshore evasion strategy

HMRC published its promised offshore evasion strategy document 'No safe havens' on 20 March 2013. Essentially, the strategy is:

- there will be no jurisdiction where UK taxpayers feel safe to hide their income and assets due to:
  - more automatic information exchanges
  - resources that will be focused on the highest priority jurisdictions and specialist staff who will be recruited to identify and profile high-risk taxpayers
- tax evaders will be encouraged to voluntarily pay the tax due
- tax evaders who do not come forward will be subject to sanctions (such as penalties of up to 200% and the potential widening of penalties for offshore matters which are currently limited to income tax and capital gains tax inaccuracies)
- there will be no place for people who facilitate UK tax evasion (the Government will consider widening the powers in relation to high-risk promoters to encompass facilitators)

## Application of decisions in test cases

It is proposed that if HMRC is successful an 'avoidance case' in court, it will be able to **require** taxpayers who have used the same avoidance scheme or similar to acknowledge that the judgment applies to them and either:

- amend their Returns accordingly, or
- confirm that they stand by their original Returns

A tax-geared penalty would be charged, subject to safeguards, if they failed to take reasonable care. This is expected to be legislated in Finance Bill 2014.

It is unclear whether the reverse will also be true: that HMRC will be required to accept a taxpayer's Tax Return as filed if another taxpayer is successful in a similar avoidance case.

## 'Naming and shaming' of high-risk promoters

The dishonest agents regime begins on 1 April 2013. Under this regime, HMRC has the power to levy penalties of up to £50,000 on an individual tax agent found to be acting dishonestly. HMRC also has the power to publish the agent's details.

In the Autumn Statement 2012, the Chancellor announced that new penalty rules would be introduced for promoters of tax avoidance schemes. The proposals announced in the Budget go further and suggest that a

raft of new measures will be introduced including information powers, penalties and the power to publish the promoter's details. These sound very similar to the dishonest agents regime and there is the potential that either:

- the dishonest agents regime could be extended to high-risk promoters, or
- the high-risk promoters regime could be modelled on the dishonest agents regime

## Tax avoidance using partnerships

The Chancellor announced in the Autumn Statement 2012 that HMRC would be pursuing 'abusive' partnership arrangements. Following Budget 2013, the Government will consult on measures to:

- remove the presumption of self-employment for limited liability partnership (LLP) partners -- to tackle the disguising of employment relationships through LLPs
- counter the manipulation of profit / loss allocations by partnerships including a company, trust or similar vehicle in order to secure tax advantages

The use of corporate partners within partnerships has been almost standard planning over recent years. HMRC is obviously taking a closer look at these arrangements.

There are also provisions in Budget 2013 to ensure that loans from close companies to partnerships are caught by the loans to participator rules in CTA 2010, s 455.

## Expert comments

**Anti-avoidance: 'every step forward seems to coincide with a step back' - Sandy Bhogal Head of tax, Mayer Brown**

The government is trying to design a tax system which is attractive for business but the pressure to collect tax revenue is intense, so every step forward seems to coincide with a step back. A further drop in the corporation tax rate may fuel the argument that the UK is becoming a corporate tax haven, but one hopes that people will recognise the merits for doing so. However, a low tax rate does not of itself encourage businesses to invest in the UK. Certainty and predictability in the tax system is more important. The government has obscured the line between avoidance and evasion and brought questions of morality into the debate and risks alienating business as well as undermining the fundamental concept of the rule of law by allowing this to continue.

A good example of this is the GAAR. It could be seen as either a reasonable compromise that will not affect the centre ground of tax planning, or as another example of using a sledgehammer to the crack the nut of a minority of aggressive tax avoidance schemes which are generally being knocked down by the courts and, if legislation was appropriately drafted, such schemes would not even be contemplated. However, what cannot be argued is the uncertainty that it creates, and maybe more consideration should have been given as to whether it was really necessary.

# VAT

**VAT registration and de-registration thresholds**

With effect from 1 April 2013 the following thresholds will apply:

- the VAT registration threshold will increase to £79,000
- the VAT de-registration threshold will increase to £77,000

## Fuel scale charges

The Government announced in Budget 2012 that they intend to revise the existing VAT fuel scale charges in order to bring long standing concessions into law and to withdraw the concession for partly exempt businesses. The annual revalorisation will also be simplified.

The VAT fuel scale charge annual adjustment will take effect from 1 May 2013 to bring the charges in line with current fuel prices. Further details on the revised fuel scale charge will be provided when they have been released by HMRC.

## Place of supply rules and a mini One Stop Shop (MOSS)

As previously announced the VAT rules regarding the place of supply of telecommunication, broadcasting and e-services will be amended with effect from 1 January 2015. From this date the place of supply for B2C sales will be the country where the customer belongs. The Government will introduce new legislation covering the revised VAT treatment of these services.

The Government announced in Budget 2013 that it will introduce a mini One Stop Shop with effect from 1 January 2015 that will give businesses the option of registering for VAT in the UK in order to account for VAT due in other EU countries on supplies of telecommunication and broadcasting services, etc. Businesses will be able to VAT register under the MOSS scheme with effect from October 2014. This measure will be

similar to the existing single online VAT registration procedure that can be used by non-EU businesses that provide B2C electronically supplied services within the EU. This measure will undoubtedly reduce the administrative burden that will be placed on businesses that supply these services across the EU to private or non-business customers. However, it is likely that the business will need to submit 8th Directive refund claims in order to recover any foreign VAT incurred if they do not VAT register.

Further details will be announced by the Government in due course and will be included in Finance Bill 2014.

## Exports

In Autumn 2013 amended legislation will be introduced that will extend the zero-rating provisions to non-resident businesses that are VAT registered in the UK, who export goods located in the UK to non-EU countries. As per existing legislation, where a non-resident business is VAT registered in the UK, the purchase of the goods from a UK supplier will be liable to UK VAT because the zero-rating provisions have not been satisfied.

Under the amended legislation, it should be possible for UK VAT registered businesses that sell goods to overseas customers who are VAT registered in the UK to zero-rate the sale providing that they hold evidence that the goods have been exported to a non-EU country.

## VAT retail export scheme

The Government has announced that it intends to consult on possible options that could be implemented to amend the existing retail export scheme in order to make the scheme easier to administer and understand and to reduce errors.

## VAT refunds for NHS bodies

As previously announced in the 2012 Budget, the Health and Social Care Act 2012 will exempt the following organisations from corporation tax and include them within the VATA 1994, s 41 VAT refund scheme:

- the NHS Commissioning Board
- clinical commissioning groups
- National Institute for Health and Care Excellence, and
- Health and Social Care Information Centre

The Government also announced in Budget 2013 that the following bodies would also be included in the VATA 1994, s 41 refund scheme and the relevant legislation would be included in the Finance Bill 2013 and 2014 respectively:

- Health Research Authority, and
- Health Education England (Finance Bill 2014)

## Manufacturer refunds

The Government has announced that it will introduce legislation that enables manufacturers to reduce their VAT payment to take into consideration any refunds (for discounts, faulty goods or customer complaints, etc) that have been made directly to the end consumer. A consultation will take place during 2013 that will allow affected businesses to comment on the intended changes and provide information on current industry practices before the revised legislation is introduced. The relevant legislation will be introduced in Finance Bill 2014.

Further information will be provided once the consultation document has been released.

## Education and research exemption

In Budget 2012, a review of the VAT treatment of university degree education was announced and a consultation document was issued in 2012.

The review has been completed and a number of interesting issues were raised. The Government has indicated that it will take these into consideration when considering possible changes to the existing VAT exemption. Further information will be released by the Government later this year.

In December 2012 a consultation document was issued on the withdrawal of the VAT exemption for business research that has been supplied by one eligible body to another. The Government has announced that, subject to the responses it received during the consultation period which ended on the 14 March 2013, it will introduce legislation withdrawing the exemption with effect from 1 August 2013.

## Energy saving materials installed in a charitable building

The 2013 Budget confirmed that the reduced VAT rate will no longer be applied to energy saving materials that are installed in a charitable building. These supplies will be liable to VAT at the standard rate with effect from 1 August 2013.

## Expert Comments

The chancellor didn't have much room for manoeuvre in the Budget, but it's clear that he's tried to help SMEs with the initiatives that he's announced.

The reduction in employer national insurance contributions of up to £2,000 per business was one of the biggest surprises of the Budget. It remains to be seen if it's enough to encourage SMEs to take on additional staff, but it will certainly be welcome by the owners of smaller companies – particularly family owned businesses and one-man bands – in this tough economic climate.

However, the initiatives designed to improve the supply of funding to SMEs are likely to prove to be the most effective measures in the longer term. Extending the CGT exemption under the SEIS is a smart move at a time when many businesses are struggling to get hold of debt funding from traditional sources. We've started to see interest from clients wanting to take shareholdings in SMEs through tax efficient schemes like SEIS, demonstrating that sensible tax incentives can help plug the funding gap provided the Treasury gets the balance right.

For more established SMEs, the abolition of stamp duty on AIM shares is something for which the Stock Exchange has long lobbied. Reducing the cost of capital in this way could provide a much-needed boost for businesses using markets like AIM to continue to expand.

That said, the chancellor's intention to launch a consultation on the (currently presumed) self-employed status of partners and the allocation of profits to partners is a potential concern for SMEs that operate as partnerships. Tax abuse needs to be tackled, but it's essential that the Treasury doesn't use a sledgehammer to crack a nut and inadvertently harm this important segment of the business community.

# Other Topical Issues

# Personal Tax

## Statutory residence test – Year of Death and other provisions (Lecture P768 – 11.11 minutes)

Budget 2013 announcements

The last elements of amendment have now been applied to the draft legislation, and this new test is "ready to go". After quite a number of iterations of draft legislation, this summary looks only at the draft legislation issued in December 2012 and assumes no prior knowledge of the previous versions. Further amendments were announced at Budget 2013 which will affect:

- Full time work definition
- International transport workers, and
- Split year treatment

As these issues will be dealt with in the Finance Bill, they are not dealt with here in detail in their updated form.

Year of death

Both the automatic UK test and the automatic overseas test include a specific provision to deal with the year of death of the taxpayer. There are also modifications to the tables used in the sufficient ties tests for the year of death.

Automatic UK residence:

Where the taxpayer, P dies in the year, and

- For each of the last 3 tax years, P was resident in the UK by virtue of meeting the automatic residence test, and
- Even if P was not UK resident in year X, the preceding year would not have been a split year, and
- When P died either his only home was in the UK, or he had at least one home in the UK.

Automatic overseas residence:

The taxpayer, P dies in year X, and

- P was not UK resident for either of the two tax years preceding X, or
- P was not resident for the preceding tax year before X and the pre-preceding year was a split year by virtue of Case 1, 2 or 3,
- and P spent less than 46 days in the UK in year X.

FB 2013 has amended the original draft which was issued in December 2012 to include a fifth overseas test to apply in the year of death which would apply if the taxpayer would meet the third automatic overseas test for year X.

There is a danger that although P left the UK to take up residence abroad and has effectively established a home abroad and remained abroad for most of a tax year, if he still has a home in the UK and dies during the first full year of absence, his residence for tax purposes will revert to the UK.

***Example***

Bob, who has been UK resident for many years left the UK in March 2014 with the intention of settling permanently in Australia in retirement, but has not yet sold his home in the UK. Bob died in March 2015. By virtue of the provision in the automatic UK residence test he could then revert to UK residence for 2014/15, which could affect his financial and tax planning significantly. Having met one automatic UK test, we need to check whether Bob meets any of the automatic overseas tests (including the last), which would move Bob to the sufficient ties test.

Automatic overseas tests:

- P was resident in the UK for one or more of the three tax years preceding year X, but the number of days in year X spends in the UK is less than 16, and P does not die in year X. *NOT MET – BOB DIED IN THE YEAR*
- P was not resident in the UK for any of the 3 tax years preceding year X, and P spent less than 46 days in the UK in tax year X *NOT MET – BOB UK RESIDENT IN LAST 3 YEARS*
- P works full time overseas for year X, with no significant break in overseas work (as above), and the number of days in which P does more than 3 hours work in the UK is less than 31, and the number of days spent in the UK (other than deemed days - see below) is less than 91. (This test does not apply to international transport workers) *NOT MET – BOB IS RETIRED*

- P dies in year X, and P was not UK resident for either of the two tax years preceding X or P was not resident for the preceding tax year before X and the pre-preceding year was a split year by virtue of Case 1, 2 or 3, and P spent less than 46 days in the UK in year X. *NOT MET – BOB UK RESIDENT FOR LAST 3 YEARS*

As none of the automatic overseas tests are met, Bob is UK resident for 2014/15.

Sufficient ties test:

If P dies in year X, The Table applying where P has been UK resident in at least one of the previous years removes the minimum number of 15 days from the test applying where there are at least 4 ties.

In addition if P dies before 1 March in year X, all of the day counts in both Tables are reduced by deducting a time apportioned number of days representing the number of complete months in year X after P died, rounding part days up at .5 and above, and down otherwise.

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.

The 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.

Split year treatment

Split year treatment applies only to individuals, and applies when the individual is resident in the UK in year X, but his facts fall into one of five cases outlined in the legislation.

Cases 1 to 5

Case 1 – employee commencing work overseas

Case 2 – accompanying spouse

Case 3 – leaving the UK to live abroad

Case 4 – coming to live or work full time in the UK

Case 5 – starting to have a home in the UK

Additions in FB2013 include Case 6 and Case 7 and Case 8 which deal with detailed circumstances where certain conditions are met when an individual is not resident in previous year. The detail of these is not considered here.

Year of birth

It would seem that as the test looks simply at the tests on a year by year basis, rather than at a continuum of events that a quirk in the rules would make babies born in the UK to UK resident parents, but born very late in the tax year would not be UK resident in their year of birth. It is not known whether HMRC will address this issue in the forthcoming Finance Bill.

*Contributed by Rebecca Benneyworth*

## Payment for cancellation of share options

An employee (R) was made redundant in 2007. She had been previously granted four share options. Following her redundancy, her employer failed to comply with the share option agreements and instead made her a cash payment. HMRC issued a ruling that this was a benefit in connection with a failure to acquire securities and was taxable under ITEPA 2003 s 477. R appealed, contending that an HMRC guidance publication entitled Approved Company Securities Option Plans, issued in January 2008, indicated that the payment would not be taxable.

*Decision:*

The First-tier Tribunal dismissed her appeal. Sir Stephen Oliver observed that the HMRC publication was 'as illiterate and as potentially misleading as any official publication that we have come across'. However, the payment was clearly taxable under s 477.

**Comments -** ITEPA 2003 s 477 provides that the assignment of an 'employment-related securities option', or the receipt of a benefit in connection with such an option, gives rise to a charge to income tax under s 476. The First-tier Tribunal upheld HMRC's view that the payment which the appellant had received from her former employer gave rise to a charge within this provision. The case is also notable for Sir Stephen Oliver's unusually strong criticisms of an HMRC guidance publication, which the appellant had submitted in support of her belief that the payment would not be subject to income tax.

*Ms C Rawcliffe v HMRC TC02529*

## Interest retained by bank as security for a debt

An individual (C), who was resident in the UK, had agreed to buy a property (which had not yet been built) in Cyprus. To finance the purchase, he borrowed a large sum of money (in Swiss francs) from a Cyprus bank. He exchanged these for Cypriot pounds, which he deposited in an account with the same bank. He was credited with interest on this deposit account. He subsequently became dissatisfied with the delay in building the property, and stopped repaying the loan. The bank then froze the deposit account which he had opened. When HMRC discovered this, they issued discovery assessments charging tax on the interest which had been credited to the deposit account. C appealed, contending that he should not be taxed on the interest as he had never received it.

*Decision:*

The First-tier Tribunal rejected this contention and dismissed his appeal, holding that he was taxable on the interest under ITTOIA 2005 s 371.

**Comments** - ITTOIA 2005 s 371 provides that interest is taxable on the person 'receiving or entitled to' it. The First-tier Tribunal upheld HMRC's contention that the appellant was taxable as he had been entitled to the interest, even though he had not withdrawn it and the bank had subsequently frozen the account. The decision here is in line with the CA decision in Peracha v Miley [1990] STC 512. A topical case for current times.

*N Coxon v HMRC TC2530*

## Solicitor: interest on accounts in joint names

A solicitor (B) opened bank and building society accounts in the joint names of him and his wife, and subsequently opened further accounts in the joint names of him and one or more of his three children. In his tax returns, he initially declared only a proportion of the interest received on these joint accounts, treating the majority of the interest as accruing to his wife and children. Subsequently he did not declare any of the interest on his personal return, apportioning the whole of it between his wife and children. HMRC issued assessments for 1996/97 to 2009/10, and imposed penalties, on the basis that all the interest accruing on these joint accounts was taxable on B, as the person 'receiving or entitled to' the interest. B appealed, contending that he had transferred a beneficial interest in the accounts to his wife and children.

*Decision:*

The FTT upheld the assessments in principle. Judge Hacking found that B had intended 'to establish a jointly held fund accessible to all family members'. The fact that B had remained a signatory to the accounts was 'inconsistent with a transfer of a beneficial interest in the fund'. Accordingly, B remained liable 'to account to the revenue for the whole of the interest earned on the jointly held bank accounts'. Furthermore, even if

there had been a transfer of the beneficial interest, the transfer would have fallen within the 'settlement' provisions of ITTOIA 2005 ss 619, 620. (However, the tribunal allowed B's appeal against the assessments for 1996/97 to 2004/05 as they had been issued outside the normal time limits, and B had not acted negligently as he 'had an honestly held but incorrect belief that he was properly entitled to apportion the interest earned on the accounts according to what he believed were the relevant beneficial interests of his family members'. Judge Hacking also observed that 'enquiry by the Revenue into the underlying beneficial interests in jointly held bank accounts' appeared to be unusual, so that this was not 'a suitable case for the imposition of penalties'.)

**Comments -** ITTOIA 2005 s 371 provides that interest is taxable on the person 'receiving or entitled to it'. Where a married couple hold a joint bank account, HMRC normally accept that each should be taxed on 50% of the interest, even where the capital initially derived from the husband. The FTT upheld this treatment in Halpin v HMRC (TC02159). However, the solicitor in this case sought to apportion the whole of the bank interest to his wife and children, seeking to take advantage of the fact that they were not chargeable at the higher rate. HMRC seem to have viewed this as unduly provocative, and instead of apportioning the interest among the account-holders in equal shares, they decided that the solicitor was taxable on the whole of the interest. The FTT upheld HMRC's contention, holding that the solicitor was the person entitled to the interest, within s 371.

*AJ Bingham v HMRC TC2528*

# Capital Taxes

## Painting: whether a wasting asset

Executors sold a painting for £9,400,000. They declared the gain on their return, but subsequently sought to amend the return on the basis that the sale of the painting was exempt from CGT under TCGA 1992 s 45. HMRC issued a closure notice stating that CGT was chargeable on the disposal. The executors appealed, contending that the painting was 'plant' and was a wasting asset.

*Decision:*

The Upper Tribunal accepted this contention and allowed the appeal. Morgan J held that 'the painting satisfied the tests as to function and as to permanence in the established test as to the meaning of plant' and that TCGA 1992 s 44(1)(c) deemed it to be a wasting asset.

**Comments** - TCGA 1992 s 45 provides that, subject to certain conditions, 'no chargeable gain shall accrue on the disposal of ... an asset which is tangible movable property and which is a wasting asset'. At first sight, it might seem that a valuable painting would not be within the definition of a 'wasting asset'. However Morgan J accepted the executors' contention that the painting was a wasting asset, within the definition in TCGA 1992 s 44(1)(c). It seems likely that HMRC will seek to take this case to the Court of Appeal.

*Lord Howard of Henderskelfe's Executors v HMRC (Upper Tribunal)*

## Two IHT guidance updates **(Lecture P769 – 14.30 minutes)**

HMRC have recently updated their guidance in the Inheritance Tax Manual in relation to two important topics:

(i) the situs of specialty debts; and
(ii) the 'loss on sale' relief for land set out in S191 IHTA 1984.

<u>Specialty debts</u>

In essence, a specialty debt is a debt recorded in a deed. These are sometimes used in IHT planning for UK residents who are:

(i) non-UK domiciliaries; or
(ii) beneficiaries of an offshore trust.

The strategy is based on the long-accepted common law tradition that a deed created under seal is situated where the deed is kept (see *Gurney v Rawlins (1836)*). If the deed is situated abroad, the debt is an

overseas asset and therefore ranks as excluded property in the hands of a non-UK domiciliary. However, in an amendment announced on 23 January 2013 to Para IHTM27079, HMRC claim to have been advised that their previous interpretation was 'unlikely to be correct'. They go on to say that, in future, they will treat specialty debts like any other debt, ie. as situated where the debtor resides.

Where a debtor's country of residence is in the UK, this revised point of view will bring such debts within the scope of an IHT charge, even where the deed is situated abroad. It is feared that HMRC may also try and impose the new rule retrospectively, ie. on past transactions. For example, if a non-UK domiciled individual had previously transferred a specialty debt to an offshore settlement (and the debt is owed by a UK resident), it is possible that HMRC may argue that a chargeable transfer has taken place – at the time, the transaction would have been regarded as a non-event.

There is considerable doubt in the tax profession about HMRC's legal justification for their new position. In the words of one private client expert:

'This change took place without consultation or clear guidance as to why they reached a different conclusion from centuries of accepted legal practice and case law.'

Having said that, the speaker remembers the late Peter Twiddy, Assistant Director of what was then the Capital Taxes Office, expressing a view some years ago that the law was wrong (especially if the debt was secured over UK land) and contemplating taking a test case. Indeed, the feeling of IHT specialists at the Tax Bar is that the change has been in the offing for some time and that they would be surprised if a modern court upheld the 'old' rule that the debt is sited where the document happens to be.

<u>S191 IHTA 1984 relief</u>

Under S191 IHTA 1984, where:

(i) the personal representatives of a deceased individual (who are referred to in the legislation as 'the appropriate person');
(ii) sell an interest in land which was included in the deceased's estate;
(iii) within four years of the death;
(iv) for a price which is different from the land's probate value,

they can make a claim (using Form IHT38) to substitute the sale proceeds for the value of the land at the date of death.

It should be noted that the 'loss on sale' relief here does not operate in quite the same way as the relief for quoted shares found in S179 IHTA 1984. With quoted shares, it is necessary to compute the appropriate loss on the post-death sale of the shares and then deduct this loss from the value of the deceased's estate. The present provision, however, merely requires the substitution of the sale proceeds for the land's probate value and therefore might well be used where the land has *increased* in value rather than the reverse. Of course, one's initial thought is that no-one would wish to make such a claim because it would inflate the 40% IHT charge on the death estate. But what if the value of the estate fell below the IHT nil

rate band or the land was eligible for 100% relief? In that case, there would be no additional IHT on the increased value, but the person holding the land would have a higher base cost for CGT purposes.

In *Stonor v CIR (2001)*, HMRC succeeded with their contention that such a claim was invalid on the ground that, although the legislation did not specifically disallow a S191 IHTA 1984 claim where the land has increased in value, it is essential for 'the appropriate person' to make the claim. Given that this term means the person liable to pay the IHT on the land, it follows that, if there is *no* IHT on the land, there cannot be an appropriate person. And, if there is no appropriate person, there cannot be a claim. But what if there is *some* IHT on the land so that the previous argument becomes irrelevant? It is this point which HMRC have recently dealt with by amending the Inheritance Tax Manual. In Para IHTM33026, it now says that all such claims will be refused because it is HMRC's opinion that the purpose of S191 IHTA 1984 is to provide relief from IHT (eg. where there is a loss) – the legislation is not there to increase the charge.

*Contributed by Robert Jamieson*

# Administration

## RTI – Update April 2013 (Lecture P770 – 7.58 minutes)

Commencement date

Business have now received their RTI mandate, and as a result most businesses will be required to commence RTI from the first payroll run on or after 6 April 2013.

Where an employer runs payroll before 6 April for payment on or after 6 April, this payroll run (the first of 2013/14, and therefore either week 1 or month 1) will not be subject to RTI. The next payroll run will be the first under RTI – week 2 or month 2 – at which point the cumulative figures for the year (including week 1) will also be filed thus bringing the year up to date.

Payroll out of sync

Where the payroll has been run with incorrect tax months or weeks, it may be necessary for the employer to make an adjustment to get things onto the correct footing.

The tax week or month used for the payroll run should reflect the payment date and not the date that the payroll is run. So a monthly payroll run on 31 March for payment on 7th of April is a month 1 not a month 12 payroll. Where you or your client has this out of sync so that March 31 was treated as month 12, you will need to skip a week or month to get it onto the correct footing for RTI. March 31 should be run as month 1, and the first payroll run to be affected by RTI would be April 30 (paid on May 7) which would be month 2.

Alternatively, your client might prefer to make payment before 6th of month, but this would also accelerate the PAYE and NIC liability, which is possibly why they pay early in the tax month in the first place.

Whichever way you go about it, you will have to align the tax weeks and months with the date of payment with effect from 6 April 2013.

EPS nil payment returns

There has been quite a bit of incorrect information about filing of EPS nil payment returns. These are used to indicate that no payments have been made to employees in a particular tax month, and not to indicate that no tax or NIC is due. If employees have been paid and no tax or NIC arises on the payment, this will be clear to HMRC from the FPS filed. There is no need to file an additional EPS to state that no tax or NIC is due.

The EPS nil payment is filed between 6th and 19th of the following month to indicate that the preceding tax month contained no payments to employees.

Inactivity reports

The EPS function can also be used to indicate that one or more future months will be inactive – that is no payments will be made to employees in those months. This saves filing multiple EPS's for nil payments. Note that as an inactivity report, the EPS must be filed during the preceding tax month, giving details of future tax months which will be inactive.

If the employer changes plans and makes a payment to employees during a period when an inactivity report has already been filed, simply filing the FPS will "undo" the inactivity report and the employer can file FPS's or further EPS's for subsequent months.

Special easement – March 2013 announcement

As a result of intensive lobbying by the professional bodies and business groups, HMRC announced a relaxation to the "on or before" rules in later March 2013.

The easement runs until 5 October and allows employers with less than 50 staff to report payments to employees on their normal payroll run, or by 5th of the following month at the latest. This effectively allows those employers who were facing moving from monthly payroll to weekly payroll to remain on the same payroll interval until October, during which time a permanent solution to the issue of reporting on or before for smaller employers is identified.

The main employers benefitting from this extra relaxation are employers giving weekly advances to monthly paid staff (which would otherwise have to be reported weekly) and employers paying staff on the day they have worked who were permitted by an easement announced in December to move to weekly reporting. Where they currently report monthly they will be able to remain on monthly reporting until a permanent solution is found.

Annual schemes

Annual schemes have been in existence for some years, but under RTI will become particularly useful, especially for very small companies with a single director. By registering a scheme as an annual scheme, under RTI the employer will have to state in which month the payment is to be made. The employer will then file an FPS for that month only, and will not be required to file EPS nil returns or inactivity reports for the remaining month of the year.

Clearly this presents a significant time and administrative saving, so schemes will probably be set up as annual to save time and effort. This is done by telephoning the employer payment helpline and providing the Accounts office reference.

Year end 2012/13

Some software packages will require the 2012/13 year end to be run before the first FPS of 2013/14 can be submitted. Where this is the case, it is a requirement of the software, and not of HMRC's systems. However, those employers using HMRC's Basic PAYE Tools will find that they must run year end 2012/13 before they download and install the RTI enabled version.

Quarterly payment

The option for quarterly payment by small employers is still available under RTI. Employers do not need to register for quarterly payment, as HMRC's computer swill be able to monitor the amounts payable per the FPSW's filed and will therefore know that the employer qualifies for quarterly.

*Contributed by Rebecca Benneyworth*

## PAYE payment allocations **(Lecture B770 – 13.53 minutes)**

The current penalty regime for late payments (FA 2009, Sch 56) applies (among other taxes) to PAYE deductions with effect from 6 April 2010. An employer is in default if HMRC does not receive payment by the due date (i.e. broadly the 19th of the month following the end of the month/quarter to which it relates, or 22nd of the following month if payment is made electronically). However:

- There is no penalty for the first default in the tax year (FA 2009, Sch 56, para 6(3)); and
- Following *Agar Ltd v Revenue & Customs* [2011] UKFTT 773 (TC), no penalty can be charged in respect of PAYE deductions for month 12 of a tax year. This is on the basis that a penalty notice is specifically stated to apply to a particular tax year. Payment for month 12 is due on the 19th (or 22nd) April, which falls in the following tax year. A late payment for month 12 therefore represents the first default in the next tax year.

*Appeals, reductions, suspensions, reasonable excuse*

Late payment penalties are subject to an appeal procedure. HMRC may also reduce a penalty due to 'special circumstances' if appropriate. Penalties may be suspended if an employer has a 'time to pay' agreement in place with HMRC before the deductions fall due, which is not broken. Furthermore, a penalty

liability does not arise if there is a 'reasonable excuse' for the failure. However, if the excuse has ceased, payment must be made without unreasonable delay thereafter.

Inability to pay is not a 'special circumstance' for the purposes of a special reduction in penalties, and an insufficiency of funds is not a 'reasonable excuse' unless it is attributable to events outside the employer's control (FA 2009, Sch 56, paras 9, 10, 13, 16).

Legislation

In the case of failure to make PAYE payments, the relevant penalty provisions are as follows (FA 2009, Sch 56, paras 6(4)-(7), 7, 8):

> **"6**
>
> (4) If P makes 1, 2 or 3 defaults during the tax year, the amount of the penalty is 1% of the amount of the tax comprised in the total of those defaults.
>
> (5) If P makes 4, 5 or 6 defaults during the tax year, the amount of the penalty is 2% of the amount of the tax comprised in the total of those defaults.
>
> (6) If P makes 7, 8 or 9 defaults during the tax year, the amount of the penalty is 3% of the amount of the tax comprised in the total of those defaults.
>
> (7) If P makes 10 or more defaults during the tax year, the amount of the penalty is 4% of the amount of the tax comprised in the total of those defaults.
>
> **7**
>
> If any amount of the tax is unpaid after the end of the period of 6 months beginning with the penalty date, P is liable to a penalty of 5% of that amount.
>
> **8**
>
> If any amount of the tax is unpaid after the end of the period of 12 months beginning with the penalty date, P is liable to a penalty of 5% of that amount."

Payment allocations

In *AJM Mansell Ltd v Revenue & Customs* [2012] UKFTT 602 (TC), the employer company (a pharmacy) appealed against a penalty for late payment of PAYE and Class 1 NIC deductions for 2010/11. The tribunal had to consider (among other issues) whether the company's payments had been correctly allocated by HMRC, and whether HMRC had any obligation to allocate payments in a way which was more favourable to

the company, and/or to advise the company that a different method of allocation would be more favourable.

On the first issue (i.e. whether the company's payments had been correctly allocated by HMRC), the tribunal noted that the common law allows the company to appropriate its PAYE and NIC payments in any way it chooses, *as long as it does so before the money changes hands*. However, the tribunal found as a fact that the company had allocated its payments to the debt arising for the previous month.

On the second issue (i.e. whether HMRC had an obligation to allocate differently and/or to advise the company to allocate in a more favourable manner), as the tribunal had found that the company allocated its payments to the previous month, HMRC had no power to reallocate them. The tribunal added:

> "It is clear that under the alternative "current month" allocation procedure the company would be in default for Month 1. It cannot be part of the duty of a public body to advise employers not to comply with their legal obligation for one month, and instead allocate payments to the PAYE debts of a later month, in order that the company can avoid a penalty. We entirely reject the submission that HMRC acted unfairly."

Overall, the tribunal rejected the company's arguments on the above issues, and also on a third issue, i.e. that the company had a reasonable excuse for late payment. The company's appeal was dismissed, and the penalty confirmed.

<u>A different outcome</u>

However, in *Kelcey and Hall Solicitors v Revenue & Customs* [2012] UKFTT 662 (TC), the appellant appealed against a PAYE late payment penalty for 2010-11. Due to defaults by clients, the appellant did not have the money to discharge the PAYE liability for April 2010. The appellant's normal procedure was to discharge PAYE liabilities early in the month following payment of the salaries. Hence the PAYE liability in respect of the May salaries was paid on 8 June 2010. However, because the PAYE liability for April had been missed due to lack of funds, the payment made on 8 June 2010 was allocated to April in respect of the April salaries. This had the knock-on effect that every month effectively became late.

The tribunal found that the appellant had been misled by an "apparent relaxed attitude" in telephone conversations with HMRC staff, who had failed to advise that the new penalty regime was being rigorously applied from 2010-11. The tribunal also referred to the following guidance in HMRC's Debt Management and Banking Manual (at DMBM210105):

> "Where exceptionally you feel the customer's allocation would not be in their best interests, for example because a different debt is about to be enforced, you can suggest to the customer that it would be in their best interests to allocate differently"

The tribunal found that this was a case where HMRC's guidance should have been followed. The tribunal decided that by the time of a conversation with HMRC staff relating to the late payment for month 5, the HMRC staff should either have known that the new regime was being immediately enforced, or they should have suggested a different payment allocation in accordance with DMBM210105. The tribunal therefore found that there were special circumstances in the case. The appellant's appeal was therefore allowed in part, i.e. in respect of the penalty for month 5 onwards.

*Contributed by Mark McLaughlin*

## 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*

## Admissible evidence

The case of B & D Foulser v HMRC (Upper Tribunal) 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)*

## 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 byb 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*

## 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*

## Inefficiency delays payment

The taxpayer incurred a capital gain on the disposal of a property which he owned jointly with his brother. The purchaser did not have the money to pay immediately but expected to realise income from other developments to enable him to pay for it. They entered into a loan agreement for £600,000 and completion took place in July 2010. The taxpayer included the gain in his 2010/11 self-assessment return. The tax due on 31 January 2012 was £38,736.

On 9 February, he visited his tax office to discuss the tax, saying he was unable to pay it because the purchaser had not paid. The taxpayer provided information for a time-to-pay arrangement with HMRC. On 22 March, HMRC told him that his application for time to pay had been refused and that the tax was due on 2 April. He borrowed the money to pay the tax, but his cheque for the tax did not clear until 12 April so HMRC imposed a late payment penalty.

The taxpayer appealed, saying he had reasonable excuse for the late payment.

*Decision:*

The First-tier Tribunal said the taxpayer could reasonably expect the Revenue to have responded to his time-to-pay application within two weeks of his contacting the tax office. Had it done so, he would have had time to pay the tax in time not to have incurred the penalty.

The taxpayer's appeal was allowed.

**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*

# Business Taxation

## The Samadian case - end of home as a self-employed business base? (Lecture B768 – 10.00 minutes)

*Why is this case important?*

In what could become a landmark decision in the interpretation of the term 'wholly and exclusively' in relation to business expenditure, Dr Samadian has lost his prolonged dispute with HMRC over his business mileage claims in relation to the 2003/04 to 2006/07 tax years. Samadian v RCC [2013] UKFTT 115 (TC); ICTA 1988, s 74 (for the tax years up to 2004/05); ITTOIA 2005, s 34 (for the 2005/06 tax year onwards)

The Tribunal panel acknowledged Dr Samadian had a dedicated office in his home which was necessary for his professional activity. However, the panel found that there was a dual purpose to Dr Samadian's travel between his home and the private hospitals and therefore no deduction could be made for these expenses. Drawing on the principles of *Mallalieu v Drummond*, it was decided that the private purpose of the journey was to maintain a home which is geographically separate to the private hospitals. Mallalieu v Drummond [1983] STC 665.

Potentially the decision has a wide interpretation across all professional self-employed activity where the business-owner undertakes substantive work at home, but who also has another business base at which he delivers his expertise on a regular basis.

There are a large number of cases which stand behind this test case.

*Facts of the case*

*Dr Samadian's professional activities*

As a geriatrician, Dr Samadian specialises in the health care of elderly people.

He is employed full time for the Epsom and St Helier NHS Trust at two hospitals in South London: the St Helier and the Nelson. He has a permanent NHS office with full administrative support, including a secretary.

In addition, Dr Samadian holds weekly out-patient sessions at two private hospitals: St Anthony's in Cheam and Parkside in Wimbledon. His NHS secretary acts as his secretary for him in his private practice in her spare time.

Letters are typically sent to his dedicated office at his home in Sutton, either direct or via his NHS office. Telephone calls are made to his home office, his mobile, his private secretary or his NHS office, whilst emails are usually sent to his professional email address which he accesses at home.

After receiving a referral, Dr Samadian will embark upon a 'fact finding' consultation at one of his scheduled sessions at the private hospitals, at the patient's own home or an alternative care location.

Out-patient consulting rooms are hired for a three hour duration for the scheduled sessions, with other doctors using the rooms on a similar restricted basis for the rest of the time.

More often than not, the rooms contain:

- a desk
- a chair
- a couch
- a screen
- a blood pressure monitor
- a hospital computer (which Dr Samadian does not have access to)

If he receives any test results or other correspondence at either of the private hospitals, it is placed in a shared pigeon hole for all other doctors with surnames starting with 'S'.

Having usually conducted the initial 45-60 minute consultation without any administrative support at the two private hospitals, Dr Samadian then prepares a treatment plan in his home office and continues to monitor and care for the patient, liaising with the patient's GP and family as necessary.

If patients are admitted to hospital, those patients remain under the care of Dr Samadian and he reviews their condition during his ward rounds six evenings a week at St Anthony's.

**The home office**

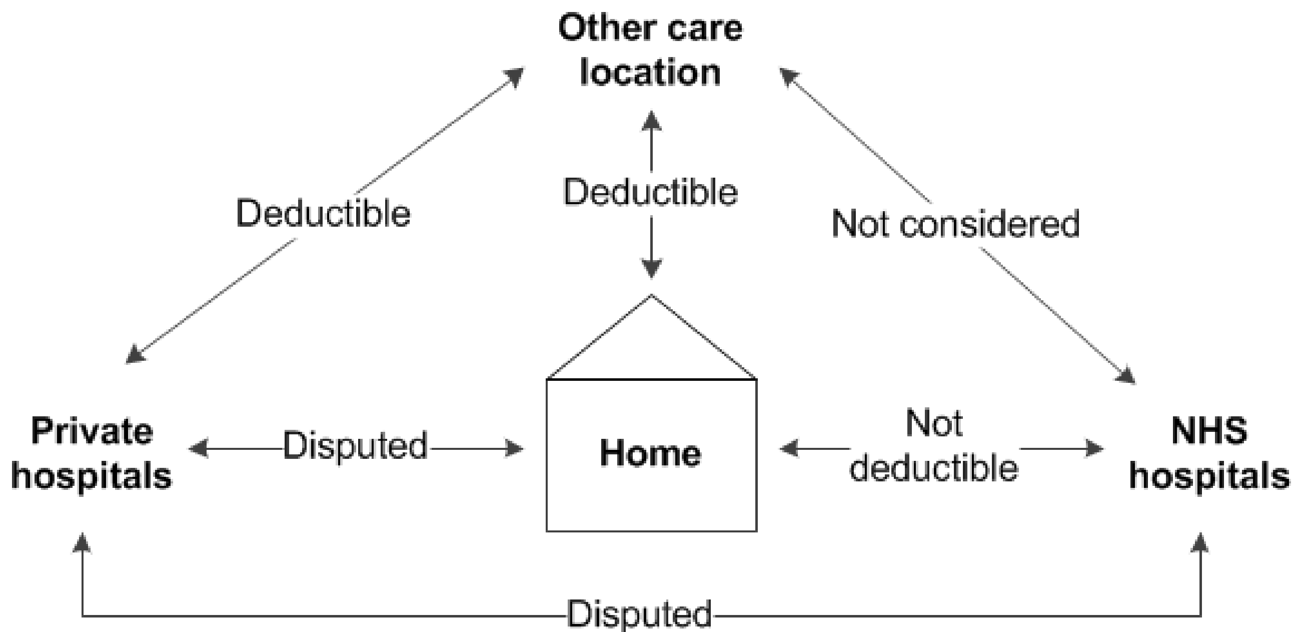
His home office contains:

- a desk
- a chair
- a medical library
- computer facilities
- a filing cabinet
- prescription pads
- basic medical equipment including a stethoscope, an ophthalmoscope, an auroscope and patella hammer within a doctors bag for patient examinations
- patient clinical records
- business records

Dr Samadian does not examine patients in his home office, although all business correspondence with his patients and GPs shows his home address.

**The mileage claim**

The areas of agreement and dispute between HMRC and Dr Samadian as to whether the expenses of his journeys are deductible are summarised in the diagram below:




'Other care locations' are care locations outside of Dr Samadian's usual routine. This includes patients' homes and care facilities other than the four hospitals mentioned above.

**Arguments**

**The case for the appellant**

In his trial submissions and presentations before the Tribunal, Mr Howard on behalf of Dr Samadian, argued extensively on the meaning and interpretation of the term 'business base'. Samadian v RCC [2013] UKFTT 115 (TC) at paras 54-58.

In summary, Mr Howard's argument was that the business base should be regarded as the place from which a business is run and not, as put forward by HMRC, the place where the professional services, or part of them, are carried out.

Drawing parallels to the *Horton* case (which the taxpayer won), he highlighted the transient nature and limited facilities available to Dr Samadian at the two private hospitals, comparing it favourably to Mr Horton, who entered into contracts at his home, kept his tools there and carried out his office work there. For a summary of the *Horton* case, see BIM37620. Horton v Young 47 TC 60.

Mr Howard argued the travel between the NHS hospitals and the private hospitals was allowable because there was no non-business element to the journeys.

## The case for the respondent

Ms Sukul for HMRC expressed the more simplified view that the cost of travelling between the home and a place of work was generally not allowable, as the journeys could not be regarded as wholly and exclusively for business.

She argued that the private hospitals were Dr Samadian's business base because this is where he saw and examined his patients.

As far as the journeys between the NHS hospitals and the private hospitals were concerned, Ms Sukul argued that these were essentially commuting between a non-business location and a business location.

## The Tribunal decision

In coming to their decision, the Tribunal first considered whether the facts could be distinguished from *Horton*. On finding that they could, the Tribunal then considered whether the Dr Samadian's mileage expenses were allowable under general principles. Horton v Young 47 TC 60 (subscription sensitive)

The facts could be distinguished from *Horton* on the basis that Dr Samadian had a pattern of regular and predictable attendance at the private hospitals in order to perform significant professional functions as a clinician. Therefore the Tribunal considered the private hospitals to be 'places of business' and so Dr Samadian could not be said to be an itinerant worker in the same way as Mr Horton. Samadian v RCC [2013] UKFTT 115 (TC) at para 83.

The Tribunal then reviewed the case law on self-employed business travel expenses in order to apply general principles to Dr Samadian's facts and concluded that no previous judgments had looked at business mileage in the context of the principles of the *Mallalieu* case.

The *Mallalieu* case centred around a claim for a deduction for the cost of the professional clothing of a barrister. The claim failed as there was found to be a dual purpose in the expenditure: the taxpayer needed to wear clothes for warmth and decency as well as for business purposes. The Tribunal in *Samadian* noted that, "although [Mallalieu] had no conscious motive for incurring the expenditure which was not a business motive, the facts were such that there must necessarily have been a non-business motive in her mind as well." Samadian v RCC [2013] UKFTT 115 (TC) at para 51.

The Tribunal found the *Mallalieu* ruling "important and helpful in clarifying the distinction between 'object' or 'motive' on the one hand and 'effect' on the other, and in making clear that a court may look behind the conscious motive of a taxpayer where the facts are such that an unconscious object should also be inferred." Samadian v RCC [2013] UKFTT 115 (TC) at para 52.

Whilst it accepted that Dr Samadian had a place of business at home, the Tribunal believed there must have been a "mixed object" in the travel between home and the private hospitals because part of the object of the journeys must "inescapably" be to maintain a home in a location which was separate from the private hospitals. Samadian v RCC [2013] UKFTT 115 (TC) at paras 92-94.

The journeys between the NHS hospitals and the private hospitals are also regarded as not deductible by the Tribunal on the grounds that "the object of the travel is to put the Appellant into a position where he can carry on his business away from his place of employment; the travel is not an integral part of the business itself". Samadian v RCC [2013] UKFTT 115 (TC) at para 96.

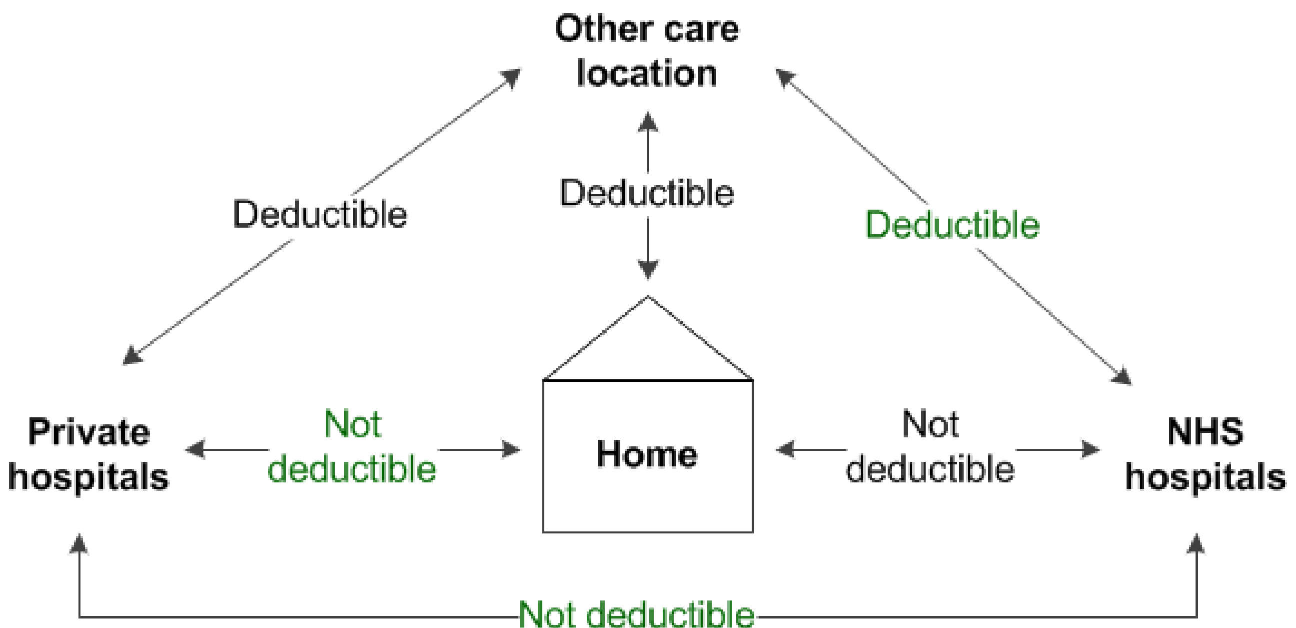
The Tribunal accepted that the following journeys were allowable:

- travel between private hospitals or other private practice destinations (eg from a private hospital to a clinic or from a private hospital to see a private patient in their own home or care home)

- emergency call outs starting at the home, but going towards a non-habitual destination, such as a patient in their own home or care home. Emergency call outs to private hospitals or other venues attended in an habitual fashion are not allowable

Samadian v RCC [2013] UKFTT 115 (TC) at para 100

Incorporating the Tribunal's decision into the previous diagram, the tax treatment of Dr Samadian's journeys is as follows:




The decision on the tax treatment of the journeys between the NHS hospitals and other care locations is surprising, as it appears from the facts that the Tribunal was not asked to consider this point. Samadian v RCC [2013] UKFTT 115 (TC) at para 21.

The rationale for the decision seems to be that, unlike the journeys between the NHS hospitals and the private hospitals, the other care location is not a business base. Samadian v RCC [2013] UKFTT 115 (TC) at para 100.

However, anecdotal evidence suggests that HMRC normally argues that these types of journeys would not be deductible.

**Comment**

**Unconscious objects - a magic bullet for HMRC?**

The decision sought to apply the principle of *Mallalieu* to business mileage expenses but at the same time preserve the precedent of *Horton*. It appears that the key factor was that the private hospitals were held to be places of business (whereas the off-site workplaces were not places of business in *Horton*) and that even though the Dr Samadian's home was a place of business, there was an unconscious objective in the travel in that he needed to go home at night.

Under the rationale given in the judgment, it is difficult to see how any home to business travel expense could ever be allowable - surely everyone's unconscious objective is to go home (even if the home is the only business base and significant work is performed after returning home)? Although *Horton* was heard 13 years before *Mallalieu*, it seems that even Mr Horton would not have won his case under this test.

The Tribunal recognised that the world is becoming more mobile and that previous judgments need to be analysed carefully in order to apply the precedents to the modern world. With ever-increasing numbers of people now able to work to a greater or lesser extent from home, HMRC is facing a number of claims for business expenses on the basis that the home is the location of the business. The income tax and Class 4 national insurance at stake on a macro level will be significant. One has to wonder whether the Tribunal has just made the perfect argument for HMRC to limit the deductibility of business expenses in the 21st Century. Samadian v RCC [2013] UKFTT 115 (TC) at para 71.

**'To the job' travel**

It seems sensible for the travel between the NHS hospitals and the private hospitals to be disallowed. The Tribunal has imported the principles of 'on the job' and 'to the job' travel from ITEPA 2003 and it is logical that travel between a place which is not a business base and a place which is a business base would have the characteristics of ordinary commuting. See the Business travel and subsistence expenses guidance note for more on the concept of 'on the job' and 'to the job' travel.

### What next?

The decision was released on 28 January 2013 and Dr Samadian has 56 days to appeal. It is understood that Dr Samadian will appeal, however it may be some time before we know whether the appeal has been accepted.

It remains to be seen whether HMRC will wait to see whether an appeal is forthcoming or will immediately attempt to settle the huge backlog of cases which have built up whilst the outcome of this case has been awaited.

### What do you need to do?

The *Samadian* case could have a major impact on the deductibility of the expenses of business mileage for self-employed professionals.

However, it is best to hold fire on any review of clients until we know the final outcome of the case. Having said that, you may wish to bear in mind the judgment during preparation of 2012/13 Tax Returns, perhaps by:

- including disclosure notes on the white space of the Return in order to limit the potential for discovery
- warning the client that his business mileage claims may be affected by the outcome of this case, and
- keeping a list of the potentially affected clients in order to speed up a review should Dr Samadian lose the appeal

Also, if HMRC opens a compliance check into the business mileage of one of your self-employed clients on the basis that the business is not carried on from home, it may be a good idea to advise the Officer of the *Samadian* case and ask that your client's compliance check be held until the outcome of that case has been decided. This prevents costs building up for both sides.

*Produced by Tolley in partnership with Guy Smith of Abbey Tax*

## 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 of 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 perfection.

*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*

## 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

## Patent box: reduced CT rate for profits from patents (Lecture B769 – 13.46 minutes)

From 1 April 2013 companies of any size can elect into the Patent Box regime, which allows qualifying companies to be taxed at a reduced rate of 10% on profits from patents and other intellectual property, referred to in the legislation as "relevant IP profits". The full Patent Box benefits are being phased in over five years up to 2017.

In order to be able to make the election, the company must have undertaken qualifying development by making a significant contribution to the creation or development of a patented invention, or a product incorporating the item.

The company then has to identify the profits that can benefit from the Patent Box regime. The first step is to identify how much of the company's total gross income includes "relevant IP income" (RIPI), which is income derived from its qualifying patents.

RIPI includes income from sales of patented items, licence fees from rights granted by the company out of its qualifying patents, amounts received from the sale of rights, and compensation, damages, insurance proceeds in respect of qualifying patents.

A company can choose between two routes to calculate how much of its profits derive from qualifying income. It can either apportion its total profits according to the ratio of RIPI to total gross income, or apportion expenses between streams of income to arrive at a profit derived from its RIPI stream.

Having calculated this profit, which should exclude any additional deduction for R&D expenditure, there are two further stages before completing the calculation.

The first is to remove a routine return on certain specified expenses, leaving "Qualifying Residual Profit" ("QRP"). The purpose of this deduction is to eliminate the return on certain items that might be expected if there were no special IP related to the products. This adjustment is calculated as 10% of capital allowances, premises costs, personnel costs, professional services, and certain other services costs which are set out in CTA 2010, s 357CJ.

Finally, a notional marketing royalty for use of the assets is removed from the QRP. For companies with QRP of less than £3m, a small claims treatment reduces QRP by 25%. The resulting profit is called Relevant IP Profits (RP) which can then benefit from the Patent Box.

The Patent Box RP is taxed at 10%, which is achieved by including a further deduction before applying the company's normal corporation tax rate.

If the Patent Box RP produces a negative figure there is no change to the company's normal corporation tax computation. However, the negative RP must reduce other RP of the company derived from a different trade, of other group companies, or future RP of the company or other group companies.

The legislation includes anti-avoidance provisions to stop commercially irrelevant patented items being included in a product to enable income to qualify under the Patent Box regime. Also, in certain circumstances RP in the first four years for which the company qualifies may be reduced by additional deemed R&D expenditure where the actual R&D expenditure is less than 75% of the average R&D expenditure over the four years immediately prior to electing into the Patent Box.

The new Patent Box regime will be very attractive to any company which is actively involved in developing or producing patented products, but these companies will have to ensure that they have appropriate accounting records to extract data enabling them to carry out the required calculations.

*Contributed by Paul Howard*

# VAT

## Sales promotion scheme

A company (L) operated a sales promotion scheme, known as the 'Nectar scheme', which was intended to reward regular customers. Under the scheme, customers who purchased goods from certain retailers received 'loyalty points' which they could use to acquire further goods or services from other specified suppliers. L paid the suppliers for these goods or services, and reclaimed input tax. HMRC rejected the claim on the basis that the goods and services had been supplied to the individual customers, rather than L. The CA unanimously allowed L's appeal, applying the principles laid down in C&E Commrs v Redrow Group PLC, but the HL referred the case to the CJEU. The CJEU held that 'payments made by the operator of the scheme concerned to redeemers who supply loyalty rewards to customers' must be regarded 'as being the consideration, paid by a third party, for a supply of goods to those customers or, as the case may be, a supply of services to them. It is, however, for the referring court to determine whether those payments also include the consideration for a supply of services corresponding to a separate service.'

*Decision:*

Following the CJEU decision, the Supreme Court upheld the CA decision in favour of L (by a 3:2 majority, Lord Carnwath and Lord Wilson dissenting). Lord Reed held that 'VAT should be chargeable on (L's) taxable supplies only after deduction of the VAT borne by (L's) necessary costs'. This included 'the cost of securing that goods and services are provided to collectors in exchange for their points: that is to say, the payments made by (L) to the redeemers'. Therefore L 'should be authorised to deduct from the VAT for which it is accountable the VAT charged by the redeemers, so that it accounts for VAT only on the added value for which it is responsible. Only in that way will VAT be completely neutral as regards (L)'.

**Comments -** The Supreme Court (by a 3:2 majority) upheld the CA decision that the company was entitled to credit for the disputed input tax, but afforded both sides 'an opportunity to make written submissions on the form of order to be made'. The majority of the Supreme Court held that the CJEU decision had not fully addressed the relatively unusual facts of this case, and expressed the view that the House of Lords' decision to refer the case to the CJEU had been unnecessary and mistaken.

*HMRC v Aimia Coalition Loyalty UK Ltd (aka Loyalty Management Ltd) (Supreme Court)*

## 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)*

## 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. 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*

## Not a special investment fund

Wheels Common Investment Fund Trustees operated a multi-employer pension scheme on behalf of the Ford Motor Company. Capital International provided fund management services to Wheels and accounted for VAT on those supplies on the basis that Wheels did not qualify for exemption under VATA 1994, Sch 9 group 5.

After the European Court of Justice's decision in JP Morgan Fleming Claverhouse Investment Trust plc v HMRC (C-363/05) [2008] STC 1180, Capital submitted a repayment claim on the ground that its supplies qualified for exemption under EC law.

HMRC rejected the claim. Wheels appealed, saying that it qualified as “special investment funds” within article 135(1)(g) of EC Directive 2006/112/EC.

The First-tier Tribunal referred the case to the European Court of Justice (ECJ) for a ruling to determine whether the reference to “special investment fund” in article 135(1)(g) was “capable of including an occupational pension scheme established by an employer that is intended to provide pension benefits to employees and/or a common investment fund in which the assets of several such pension schemes are pooled for investment purposes”.

*Decision:*

The ECJ ruled that that such funds were not special investment funds within the meaning of article 135(1)(g). A retirement pension scheme was not open to the public and was in effect a benefit available only to employees of the sponsoring company. Furthermore, the members of the pension scheme did not bear the risk from the management of the fund. The pension they received depended on their length of service and salary, rather than the investment performance.

The court concluded that the investment management services provided to the appellant companies were not exempt from VAT.

**Comments -** Joanne Segars of the National Association of Pension Funds (NAPF) said the ruling was “deeply disappointing”. She added, “pension funds were set up to be vehicles that are free from tax, and they should not be paying these VAT charges”. Noting that the European Commission is reviewing the VAT Directive, Ms Segars said the NAPF would make “strong representations as to why the management of pension funds should be VAT exempt” and would “be taking this matter up with the commission as a matter of urgency”.

Grant Thornton's Lorraine Parkin explained that fund management services in respect of other collective investment vehicles, such as unit trusts, did benefit from VAT exemption, but that the ECJ concluded that “an occupational scheme is, in fact, not open to the public but constitutes an employment-related benefit that employers grant only to their employees” and could not be regarded as special investment funds.

She said "a significant amount of money was riding on this judgment". Had the taxpayer been successful, "it may have been possible for schemes to have claimed substantial sums, via the fund managers, to recoup the VAT previously charged by them. This ruling means that this will no longer be possible, which is no doubt a blow to many funds but probably has HM Treasury breathing a sigh of relief."

*Wheels Common Investment Fund Trustees Ltd v HMRC (and related appeals) Case C-424/11, ECJ, 7 March 2013*

## No retrospection

The taxpayer owned a stable block which he converted into a house for himself and his family. It was next to a larger property owned by his parents. Initially, planning permission was granted on the basis that the stable was not to be used as a separate residential unit but was to be ancillary to the larger property. Three years later, in 2010, the planning authority issued a new permission which excluded the "ancillary occupation" condition and described the property as a "separate dwelling".

In light of this, the taxpayer claimed repayment of the VAT incurred on the conversion. HMRC refused the claim, saying the original planning permission referred to "ancillary occupation" and this disqualified the build from a refund under VATA 1994, Sch 8 group 5 note 2(c).

*Decision:*

The First-tier Tribunal noted that all the conversion work had been carried out before the ancillary occupation condition was removed. It did not accept the taxpayer's proposition that the new version of the planning permission should be treated as retrospective for the purpose of obtaining VAT relief. The 2010 permission did not purport to correct errors in the earlier version of the permission, which was "valid and enforceable at all relevant times".

The taxpayer's appeal was dismissed.

**Comments -** Neil Warren, independent VAT consultant, said: "There seem to be a lot of tribunal appeals on the DIY scheme, most of which are won by HMRC."

He referred to another case where a taxpayer made an inaccurate DIY claim because of some of the finer details in the legislation. The claim was rejected and the taxpayer was "asked to defend himself by HMRC in relation to a potential 'careless error' penalty. This seems very harsh and it is hoped was a one-off situation."

*Morgan Arthur TC2398*