Tolley®CPD

May 2013

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Personal Tax

Joint Accounts – Income Tax (Lecture P771 – 13.12 minutes)

Who is liable?

The general rule for income tax purposes is that the person liable to tax on interest arising in the tax year is the person receiving or entitled to the interest (ITTOIA 2005, s 371).

This general rule is subject to two exceptions:

- Joint held property held by spouses or civil partners – see below
- The 'settlements' anti-avoidance rules (ITTOIA 2005, Pt 5, Ch 5) – If caught by the rules, the settlor is taxed on the income of the settlement, even if he or she does not receive the income and is not entitled to it.

Spouses and civil partners

There are specific income tax rules dealing with jointly held property in the names of spouses or civil partners who live together (ITA 2007, s 836). The general rule is that the individuals are treated as beneficially entitled to the income in equal shares.

However, this '50:50 rule' is subject to certain exceptions, which are broadly as follows:

A Income to which neither of the individuals is beneficially entitled.

B Income subject to a declaration of unequal beneficial interests (see below).

C Partnership income (within ITTOIA 2005, Pt 9).

D Income from a commercial UK furnished holiday lettings business (within ITTOIA 2005, Pt 3, Ch 6).

DA Income from a commercial overseas furnished holiday lettings business in an EEA state (within ITTOIA 2005, Pt 3, Ch 6).

E Distributions from:

(a) Close company shares or securities to which one of the individuals is beneficially entitled to the exclusion of the other; or

(b) Such shares or securities to which the individuals are beneficially entitled in equal or unequal shares.

F Income to which one of the individuals is beneficially entitled so far as it is treated as a result of any other provision of the Income Tax Acts as—

(a) the income of the other individual, or

(b) the income of a third party.

'Form 17 rule'

If spouses or civil partners are beneficially entitled to both the income and the asset in unequal shares (e.g. 70:30), they may submit a joint declaration to HMRC to be taxed on the income according to their beneficial entitlement, instead of on a 50:50 basis. The declaration must be submitted to HMRC within 60 days of making it, and applies to income arising on or after the date of the declaration (ITA 2007, s 837). This is referred to in HMRC guidance as the 'form 17 rule'.

The above rules do not apply to joint accounts between spouses or civil partners if there are additional joint account holders, such as sons or daughters (TSEM9810).

Other account holders

Some points to note:

- Joint account holders who are not spouses or civil partners are liable to tax on the interest to which they are actually entitled. Bank or building society accounts in joint names are normally in joint ownership, i.e. the account holders are 'joint tenants' (in England and Wales). Each account holder is jointly entitled to all of the funds in the account, and interest is paid to the account holders jointly.
- Alternatively, accounts can be held in common ownership, ie as 'tenants in common' (in England and Wales). Each account holder is liable to interest on the share of the account that they own. However, HMRC considers that this will only 'exceptionally' be the case (SAIM2420).
- If one account holder (A) has provided all the funds in an account, but interest is shared 50:50 between A and B, in the absence of evidence that there has been a transfer of beneficial ownership of funds from A to B, HMRC may contend that there is a 'resulting trust', such that A is taxable on 100% of the interest (see TSEM9947).
- However, the presumption of a 'resulting trust' may be rebutted, such as where there is evidence of a transfer of beneficial ownership of funds from A to B, such as a gift or a loan, or there is an express trust.
- A joint account holder who has provided the funds in the account may produce a 'declaration of trust' stating how the interest should be divided. However, even if the right to income has been validly transferred, unless there is evidence that ownership of the underlying funds has been transferred, HMRC may argue that the settlements legislation applies (see below).

Is there a 'settlement'?

The settlements anti-avoidance legislation (ITTOIA 2005, Pt 5, Ch 5) can apply to joint accounts in certain circumstances involving family members. It broadly provides that where the settlor retains an interest in

a settlement, he or she is taxable on the income arising under the settlement (ITTOIA 2005, s 624). A 'settlement' includes, 'any disposition, trust, covenant, agreement, arrangement or transfer of assets'. The settlor retains an interest if there are circumstances in which the settlor (and/or spouse or civil partner) may benefit from the property and/or income of the settlement. The settlements provisions can also treat interest on accounts held by unmarried minor children as income of their parent(s), if the funds originated from the parent and the interest exceeds £100 per parent (ITTOIA 2005, s 629).

Family members

In *Bingham v Revenue & Customs* [2013] UKFTT 110 (TC), the taxpayer, Mr Bingham, opened a bank account many years previously in the joint names of himself and his wife. The funds were provided exclusively by Mr Bingham from his earnings as a solicitor. Mr and Mrs Bingham's three adult children were subsequently added as joint account holders; other accounts were also held in the joint names of Mr Bingham, his wife and children. HMRC assessed Mr Bingham on the basis that all of the interest on the joint bank accounts was assessable on him. Mr Bingham appealed.

The interest earned on the bank accounts had initially been apportioned according to the number of joint account holders (eg 20% each, for five joint account holders), but was subsequently apportioned between the account holders in varying amounts each year, to enable them to make use of their personal allowances and lower rate tax bands.

The tribunal held on the facts that the arrangement was a settlement, of which Mr Bingham was the ultimate settlor. He had retained an interest in the fund. The gifts necessarily involved an element of bounty, and as such were potentially caught by the settlement provisions. As the settlor, this rendered Mr Bingham accountable for the bank interest, under (what is now) ITTOIA 2005, s 619 *et seq*. He was therefore liable to income tax on the whole of the interest on the funds for some of the tax years assessed, although his appeal against extended time limit assessments for earlier years and penalty assessments was successful.

Conclusion

Particularly in the case of joint accounts between family members, whilst it is possible to give away a right to interest on the account, the settlements provisions must be considered. There should be clear evidence of a gift of the underlying capital as well. As the tribunal judge in *Bingham* commented:

"It is not by any means clear that there ever was any transfer of any part of the capital funds standing to the credit of the accounts either to Mrs Bingham or to the children. There has been an expression of intent on the part of Mr Bingham but that does not by itself operate to transfer a beneficial interest. Indeed the acts undertaken by Mr Bingham are actually inconsistent with a transfer of a beneficial interest in the fund. Mr Bingham remained as a signatory to the accounts; he retained even by his own account a 25% or 20% interest in the accounts (at different times) and *de facto* control was exercised over the accounts by virtue of the family discussions which would precede any substantial dealing with

the monies from time to time standing to the credit of the accounts. *None of this speaks of a transfer of a beneficial interest in the ownership of the fund by family members of which they could be said to have been deprived*" (emphasis added).

Contributed by Mark McLaughlin

Application to pay backdated class 3 NICs

The appellant was born in Dublin in 1928. He moved to the UK in December 1948 and paid UK national insurance contributions from January 1949 until July 1950. He then left the UK and worked in the Kenyan Police Force from August 1950 until 1963. In 1963, he moved to Australia, and he subsequently lived in the Irish Republic, the Isle of Man, and Gibraltar. In January 2009, he was allowed to pay backdated UK class 3 NICs for 1984/85 to 1992/93 (the years in which he had lived in the Irish Republic), thus qualifying for a reduced UK pension. He lodged an appeal to the First-tier Tribunal, contending that he should also be allowed to pay such contributions for the time he had spent in Kenya.

The First-tier Tribunal rejected this contention and dismissed his appeal, holding that he was not entitled to pay contributions for this period, because he had not met the requirements of the National Insurance (Residents & Persons Abroad) Regulations, SI 1948/1275, reg 5(2).

Decision:

The Upper Tribunal upheld this decision.

Comments - SI 1948/1275, reg 5 and SI 2001/1004, regs 48 and 145, lay down detailed requirements which must be fulfilled before someone who is resident outside the UK can be credited with UK NICs. The Upper Tribunal upheld the First-tier decision that the appellant (an Irishman who had lived for less than two years in the UK before emigrating to Kenya) was not entitled to pay backdated contributions for his period of service in the Kenyan police.

JA Garland v HMRC (Upper Tribunal)

Change of mind over Classes 2 and 4 NICs

HMRC now considers that Sleeping and inactive Limited Partners are—and have in the past been—liable to pay Class 2 National Insurance contributions (NICs) as self employed earners and Class 4 NICs in respect of their taxable profits. "Inactive Limited Partners" are Limited Partners who take no active part in running the business. This view represents a change from that previously held by HMRC and the Department for Work and Pensions.

What Happens Next

Sleeping or inactive Limited Partners who have not paid Class 2 or Class 4 NICs for a past period will not be required by HMRC to pay those contributions.

Payment of Class 2 NICs from 6 April 2013

HMRC now take the view that Sleeping and inactive Limited Partners are liable to pay Class 2 NICs because they are "gainfully employed" as self employed earners for the purposes of section 2(1)(b) of the Social Security Contributions and Benefits Act 1992 because: -

- "Employment" as defined in section 122 of the Social Security Contributions and Benefits Act 1992 includes business and section 1(1) of the Partnership Act 1890 provides that "Partnership is the relation which subsists between persons carrying on a business in common with a view of profit"; and
- Section 2(1)(b) of the Social Security Contributions and Benefits Act 1992 imposes no requirement that partners have to be active in the business.

Class 2 NICs is a weekly liability which will be due from 6 April 2013 unless a Sleeping or inactive Limited Partner is either under 16, over pension age, is granted the Small Earnings Exception, is a married woman or widow with reduced liability, or claims deferment on account of other employments.

It will therefore be necessary for Sleeping and inactive Limited Partners to check their Class 2 NICs position. Sleeping and inactive Limited Partners who are not already paying Class 2 NICs as a result of being self employed must advise HMRC of their self-employed status and arrange to pay NICs or seek exception/deferment, etc, according to their individual circumstances. Many Sleeping and inactive Limited Partners will qualify under one of these exceptions but there is a need to ensure that the appropriate action has been taken.

The application form for partners to register for Class 2 NICs and Self Assessment is available at: online.hmrc.gov.uk/shortforms/form/SA401?dept-name=&sub-dept-name=&location=40&origin=http://www.hmrc.gov.uk

Sleeping and inactive Limited Partners who are not already paying Class 2 NICs should register on form SA401. Such partners should record the nature of the business being carried out at box 15 on the form as either Sleeping Partner or inactive Limited Partner.

Further guidance in respect of Small Earnings Exception is available at: www.hmrc.gov.uk/working/intro/class2.htm

Further guidance in respect of Deferment is available at: www.hmrc.gov.uk/working/intro/employed-selfemployed.htm

Payment of Class 4 NICs from 6 April 2013

HMRC now take the view that Sleeping and inactive Limited Partners are liable to pay Class 4 NICs because: -

- in order for there to be a partnership for the purposes of the Partnership Act 1890 the persons making up the partnership (whether General, Sleeping or Limited Partners) will all be "carrying on a business in common with a view of profit"; and
- Section 15 of the Social Security Contributions and Benefits Act 1992 imposes no requirement that partners have to be active in the business.

Class 4 NICs is assessed annually but because HMRC has announced its revised view towards the end of 2012-13 tax year, Sleeping and inactive Limited Partners should account for Class 4 NICs liability, if any, for the 2013 -14 tax year of assessment and for subsequent tax years.

General guidance in respect of Class 4 NICs is available at:

www.hmrc.gov.uk/working/intro/class4.htm

Losses from earlier years, which have not yet been set against profits chargeable to Class 4 NIC, can be brought forward and set against Class 4 NICs profits from the same trade.

Further guidance in respect of losses in respect of Class 4 NICs is available In the National Insurance Manual and Helpsheet 220:

www.hmrc.gov.uk/manuals/nimmanual/NIM24610.htm;
www.hmrc.gov.uk/manuals/nimmanual/NIM24615.htm;

www.hmrc.gov.uk/helpsheets/hs220.pdf

Class 2 & 4 NICs paid for years prior to the 2013-14 tax year

Some Sleeping and inactive Limited Partners may have paid Class 2 and 4 NICs for past years. As these contributions will have been correctly paid in accordance with the law, HMRC considers that such payers will not be entitled to a refund of Class 2 NICs or to any Overpayment Relief in respect of Class 4 NICs.

Voluntary payments of Class 2 and 4 NICs for years prior to the 2013-14 tax year

There may be instances where some Sleeping and inactive Limited Partners may wish to pay Class 2 and 4 NICs for years prior to the 2013-14 tax year in order to qualify for, or improve, contributory benefits, for example the basic State Pension. HMRC, in conjunction with DWP, will provide details in the summer of the arrangements for the payment of Class 2 and 4 NICs in these circumstances.

PA Holdings

HMRC has announced that PA Holdings has withdrawn its appeal to the Supreme Court. The decision of the Court of Appeal [2011] EWCA Civ 1414 in favour of HMRC is therefore final.

Family pension plans (Lecture P773 – 6.16 minutes)

Employees are exempt from income tax on contributions paid into registered pension schemes by their employers (S308 ITEPA 2003). Where employer contributions are exempted by this provision, they are also excluded from being classified as earnings for NIC purposes.

In response to the introduction of the £50,000 annual allowance limit in 2011/12, arrangements known as family pension plans were developed in order to sidestep the FA 2011 rules for employees who would otherwise have to face an income tax charge on contributions in excess of the £50,000 limit.

Under this scheme, an employer pays pension contributions into a registered pension scheme for an employee's family member as part of that employee's flexible remuneration package. The effect is that the employee is still exempt from income tax and NICs on those employer contributions, ie. there is no benefit in kind charge. Furthermore, these contributions do not count towards the employee's £50,000 limit.

For 2013/14 onwards, the insertion of the words 'in respect of the employee' at the end of S308 ITEPA 2003 means that such contributions will no longer attract an income tax exemption. The NIC legislation is being similarly amended.

Contributed by Robert Jamieson

Yet more changes to tax relief for pensions (Lecture P774 – 7.51 minutes)

UK tax-relieved pension contributions are subject to two broad limits. The first one – the annual allowance – is the maximum amount of pension savings which can benefit from relief in any one tax year. The second limit – the lifetime allowance – is the maximum amount of tax-allowable pension savings which can be built up over a working lifetime. If the pension fund is worth more than the lifetime allowance when benefits are first taken, a tax charge is payable on the excess.

Following an announcement by the Chancellor in his Autumn Statement, changes have been made to the pension contribution legislation for 2014/15 onwards:

(i) the annual allowance, which is currently £50,000, is to be cut to £40,000; and

(ii) the lifetime allowance is being reduced, on this occasion from £1,500,000 to £1,250,000.

There are no changes to the carry-forward rules for pension contributions and so, if pension savings for a tax year are less than the annual allowance, any unused allowance for the previous three years can be carried forward to the current year. Unused allowances from 2011/12 to 2013/14 can be carried forward to 2014/15 based on the £50,000 limit. Because the limit will become £40,000 in 2014/15, an individual can carry forward for 2015/16 up to £50,000 of unused allowances from 2012/13 and 2013/14 and up to £40,000 from 2014/15.

HMRC have indicated that, for defined contribution schemes, the lifetime allowance limit is based on the size of the individual's pension pot. For a defined benefit scheme, the figure is calculated by multiplying the amount of the pension by 20. In other words, a £1,250,000 lifetime allowance is equal to a pension of £62,500 per annum (this assumes that no tax-free lump sum has been taken).

With effect from 6 April 2014, the draft legislation provides for transitional protection known as 'fixed protection 2014' against the lifetime allowance charge for those who do not have any of the existing protections, ie:

(i) primary protection under Para 7 Sch 36 FA 2004;

(ii) enhanced protection under Para 12 Sch 36 FA 2004; or

(iii) fixed protection under Para 14 Sch 18 FA 2011.

This is designed to work in the same way as the existing fixed protection rules brought in last year when the lifetime allowance was lowered to its present level of £1,500,000.

Contributed by Robert Jamieson

Capital Taxes

Whether house used as principal private residence

A woman lived in a house (AR) which she owned jointly with her husband. She also owned a flat and a second house (ER), both of which had been let to tenants. In August 2007, she separated from her husband and moved into the flat. In March 2008, she advertised ER for sale. In April 2008, after her tenants had moved out, she moved into ER and began redecorating it. In November 2008, she moved back into AR with her husband. In January 2009, she sold ER. HMRC issued an assessment charging CGT on the gain. She appealed, contending that ER had been her principal private residence from April to November 2008.

Decision:

The First-tier Tribunal rejected this contention and dismissed her appeal, observing that she had already advertised ER for sale before she began living there. Judge Aleksander found that 'she never intended to live permanently at (ER); it was always only ever going to be a temporary home, and therefore it was never her residence'.

Comments - The house did not qualify for private residence relief because the appellant had advertised it for sale before she temporarily moved into it. The PPR relief is a common relief but it is crucial that the property meets the conditions for the relief to apply. This case is yet another in which the taxpayer has not considered the quality of the occupancy and this was insufficient for the Tribunal to accept that it had the appropriate degree of permanancy.

Mrs S Bradley v HMRC TC2560

Floating rate notes stripped of interest: profit on sale

An individual (H) purchased certain floating rate notes, marketed by a bank and described as 'flexi-notes', which had been stripped of interest for a certain period. At the end of the period, H sold the notes, making a total profit of £8.6m. HMRC issued amendments to H's self-assessment, treating the profits which he had made on the sale of the notes as discounts, which were chargeable to income tax under what is now ITTOIA 2005 s 381. H appealed, contending that the flexi-notes were qualifying corporate bonds and that his profits were capital rather than income.

Decision:

The FTT rejected this contention and dismissed H's appeal, applying the principles laid down by the HL in the 1921 case of National Provident Institution v Brown (8 TC 57). Sir Stephen Oliver observed that the marketing brochure which advertised the notes 'stresses that the product was designed to give an enhanced after-tax return significantly in excess of interest on fixed-term deposits. Moreover, the brochure offers the flexi-note package as a suitable investment for individuals and their trustees. The trustees would, if there were competing claims between income and capital beneficiaries, be bound to treat the profit on the discount, or a large part of it, as income.'

Comments - The FTT upheld HMRC's view that the profit on the sale of the 'flexi-notes' was a discount which was within the charge to income tax, applying the principles laid down in National Provident Institution v Brown.

M Healey v HMRC TC2591

Loss claim: purchase price of discounted securities

A barrister (B) acquired six loan notes from a company (O) for their face value of £500,000. The notes carried the right of early redemption for the first 14 days at their issue price or very slightly less. After 14 days, they were redeemable at the noteholder's option for 5% of the issue price (i.e. £25,000). B granted a call option over the notes to a trust, of which he was the settlor, the life tenant and one of the trustees. This trust exercised the call option, received £499,500 from O, and was substituted for O as the issuer of the notes. On the same day, B gave the notes to a second trust, of which he was the settlor and a trustee (but was not the life tenant), so that at the end of 2002/03, the first trust held £499,500 while the second trust held the loan notes, which could be redeemed for £25,000. In 2004, B submitted an amendment to his 2002/03 tax return, claiming that the loan notes were 'relevant discounted securities', and that he had incurred a loss of £475,000 on his transactions in them. HMRC began an enquiry and rejected the claim. B appealed, contending inter alia that his reason for putting his assets into a trust was not tax avoidance, but was 'to avoid potential creditors'.

Decision:

The FTT dismissed his appeal. Judge Mosedale observed that, if B's only concern had been asset protection, he could have transferred the £500,000 directly into a trust, and found that 'the loan notes transactions were undertaken solely for tax avoidance reasons'. She found that O 'did not require a loan of £500,000' and its 'grant of the call option and its issue of the loan notes was done solely to facilitate (B's) tax avoidance scheme'. Furthermore, 'the main purpose of the 14-day redemption clause was tax avoidance and in particular to establish that the loan notes were issued at full value. The scheme was pre-planned and the dramatic drop in value from £499,500 to £25,000 on day 15 was engineered on the face of the documents.' There had been a series of transactions, under which B had transferred money to a family trust. Viewed realistically, B had acquired the notes for £25,000 and had not made a loss on them.

Comments - The appellant in this case has been singled out for criticism by Margaret Hodge in her role as Chairman of the Public Accounts Committee. The decision is in line with the previous decisions in A Berry v HMRC ([2011] STC 1057) and R Audley v HMRC ([2011] SFTD 597), but the case is likely to reopen the public debate about tax avoidance.

GR Bretten QC v HMRC TC2604

Loss wiped out

Land Securities entered into a series of transactions between March and September 2003, disposing of nine shares it had acquired in 1969. The main purpose was to establish a capital loss amounting to £200m, relying on the identification rules in TCGA 1992, s 106 (repealed by FA 2006). HMRC disallowed the claim saying that the value shifting provisions in s 30 applied.

The taxpayer appealed to the First-tier Tribunal, which dismissed the appeal.

Decision:

The Upper Tribunal said on the facts the relevant acquisition date for s 30(9) was September 2003, not when they were originally acquired in 1969. This meant the disposal had in effect taken place before the acquisition. Section 30(5) required an increase to be made to the loss on the disposal to eliminate the loss claimed by the taxpayer.

The taxpayer's appeal was dismissed.

Comments - HMRC's director general for business tax, Jim Harra, described the scheme as “flagrant tax avoidance that provided finance to a FTSE 100 company that appeared cheap because the UK taxpayer was expected to pick up a £60m bill”. He noted that this was the department's “eighth consecutive success in court against tax avoidance, sending a clear message that indulging in tax avoidance is now a very high risk and expensive strategy, because HMRC will continue to challenge avoidance at every turn”.

Land Securities plc v CRC, Upper Tribunal

Administration

Not late

The trustee of a settlement appealed against a late filing penalty in respect of the 2010/11 return. He said that he posted the return on 26 October at a post office. HMRC claimed they had not received the return until 2 November.

The First-tier Tribunal referred to Interpretation Act 1978, s 7 and decided that a first class letter would "in the ordinary course of post" be delivered on the next day. In any event, a letter posted on 26 October would ordinarily arrive by 28 October.

Decision:

The tribunal concluded that, because HMRC could not prove to the contrary, for example, they produced no date-stamped letter, no log of receipts and no statement from the supervisor of the receiving office, the return was received on 28 October. On this basis, it was not late and no penalty was due.

The taxpayer's appeal was allowed.

The trustee of the DE Britton Settlement TC2524

Which tax needs to be paid to keep TTP arrangement?

The taxpayer entered into a time-to-pay arrangement with HMRC to pay his self-assessment tax liabilities. He did not keep up the payments due under the plan and, as a result, HMRC cancelled it and began recovery proceedings. They also issued a surcharge for late payment.

The taxpayer explained that he was experiencing cashflow problems because he was having to provide his companies, QUK and Quattro Holdings, with the cash to enable them to pay their PAYE, VAT and corporation tax liabilities.

Decision:

The First-tier Tribunal said that inability to pay tax was not a reasonable excuse in itself but that "the reasons why a person is unable to pay can constitute a reasonable excuse". In this instance, the taxpayer had a choice of whether to comply with the agreement or fund his companies. He decided on the latter because he thought it would be "imprudent to neglect QUK's position". Were the business to fail, this would have affected not only himself and his employees, but also HMRC in terms of tax loss.

The tribunal said he would have been "well advised" to have explained the situation with regard to the companies to HMRC and asked for an extension to the time-to-pay agreement. Despite not doing so, the tribunal judge concluded that the taxpayer had a reasonable excuse for non-payment because he used the funds he had to support his companies and enable them to meet their tax liabilities.

The taxpayer's appeal was allowed.

Comments – The taxpayer in this case was arguably caught between a rock and a hard place in that he did not have the funds to meet all of the tax liabilities that were relevant. He did the best in the circumstances but as the tribunal said he would have been “well advised” to have explained the situation with regard to the companies to HMRC and asked for an extension to the time-to-pay agreement. The Tribunal however reached what appears to be a fair result.

T James TC2527

Employer deducting tax at basic rate

A doctor (G) began working for a NHS trust in 2010. The trust did not deduct tax in accordance with the code issued by HMRC, but only deducted tax at the basic rate. After G submitted his 2010/11 tax return, HMRC discovered that there had been an underpayment of more than £6,000. HMRC failed to make a direction under the Income Tax (PAYE) Regulations, SI 2003/2682, reg 72 or 81, but issued a closure notice requiring G to pay the tax. G appealed, contending that the underpayment was the fault of his employer and the tax should be collected by adjusting his PAYE code.

Decision:

The FTT allowed his appeal. Judge Hellier held that the effect of TMA 1970 s 59B and SI 2003/2682 reg 185 was that, where HMRC had not made a direction under reg 72 or reg 81, 'the amount of tax which is to be treated as having been deducted from (G's) income is the amount which the employer was liable to deduct from the relevant payments, not the amount actually deducted'.

Comments - TMA 1970 s 59B provides that in arriving at the liability of a taxpayer for a tax year, a deduction is made for tax deducted at source in respect of that year. SI 2003/2682 reg 185 provides that the amount deducted at source is taken to include tax which the employer should have deducted but did not. In this case, HMRC seems to have overlooked the requirements of reg 185 and the need for them to make a direction under reg 72 or reg 81 before seeking to collect tax from an employee.

Dr A Gayen v HMRC TC2556

Impact of absenteeism

The taxpayer company had suffered financially since 2007 and failed to keep up with its PAYE liabilities. HMRC suggested that the company contact the business payment support service, but it was unable to help. Part of the problem was a bad debt which the company was trying to recover, but it also had an unusually high amount of employee absenteeism which caused a lot of disruption to the company's business and impacted on its cashflow.

HMRC imposed penalties for late payment of PAYE tax and National Insurance. The company appealed.

Decision:

The First-tier Tribunal noted that the company was in a specialised industry with specialised employees. If the workers were ill, it delayed completion of some contracts. It was not easy for the company to find replacement workers with the same skills. The company had taken steps to improve the business and tried to pay its tax bills. It was unfortunate that the business payment support service refused to help.

Overall, the tribunal concluded that the company had reasonable excuse for late payment. It had exercised due diligence and was no longer in default. The absence of vital workers had contributed significantly to the company's cashflow.

The taxpayer's appeal was allowed.

Comments – The decision is self-explanatory.

I D Machinery TC2590

Prudent employer

The taxpayer appealed against a penalty imposed for the late filing of its end-of-year employer return form P35. The company's agent filed the return on 3 May 2012 and received an email from HMRC stating it had been successfully filed. This was a generic email sent for live and test submissions.

On receipt of the penalty notice, the agent contacted HMRC and was told the return had been a test submission. He resubmitted it immediately.

Decision:

The First-tier Tribunal was satisfied that the taxpayer believed the return had been filed on time. It had been submitted in good time and acknowledged by HMRC. The company had not been told that it was defective in any way. The tribunal said the taxpayer's actions "were those of a prudent employer conscious of his responsibilities under the taxes acts".

The taxpayer's appeal was allowed and the penalty cancelled.

Comments – Again the comments are self-explanatory. When the taxpayer does its best in the circumstances the Tribunal acts in a way that can be seen to be fair. The taxpayer believed the return had been filed on time. It had been submitted in good time and acknowledged by HMRC. It had no reason to believe there was any deficiency.

Wayne Watkins Oil Burner Services Ltd TC2610

Whether HMRC should share costs of unsuccessful appeal

The decision follows on from the decision in Eclipse Film Partners No. 35 LLP v HMRC (No. 4), [2012] SFTD 823, where a limited liability partnership (E) entered into a complex series of transactions in relation to the licensing and distribution of film rights. The partners made substantial claims to tax relief under ICTA 1988 s 353. HMRC began an enquiry into E's tax return for 2006/07, and subsequently issued a closure notice, determining that E had not been carrying on a trade, so that the partners were not entitled to the tax relief which they had claimed.

The First-tier Tribunal reviewed the evidence in detail and dismissed E's appeal against this decision, holding that its activities amounted to a 'non-trade business', within ITTOIA 2005 s 609. Prior to this hearing, E had applied for a direction that HMRC should pay half the costs of preparing material for the hearing of the appeal. Following the dismissal of E's appeal on the substantive issue, HMRC appealed to the Upper Tribunal against the costs direction, contending that since the partnership had opted out of the 'costs-sharing regime' under SI 2009/273, rule 10, the First-tier Tribunal had exceeded its jurisdiction in ruling that it should pay half of the partnership's costs.

Decision:

The Upper Tribunal accepted this contention and allowed HMRC's appeal. Judge Berner held that the First-tier Tribunal had 'no power to direct the sharing of costs of complying with directions, except in exercise of its power to award wasted costs or in the case where a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings. The only case where the FTT would have full power to order costs sharing is in a case categorised as complex where the taxpayer had not opted out.'

Comments - SI 2009/273 provides that, in cases which are categorised as complex, an appellant has the right to opt out of the 'costs sharing' regime. The Upper Tribunal upheld HMRC's contention that, since the appellant here had chosen to do so, HMRC could not be required to share its costs. See the commentary at Simon's Taxes, para A5.501. The implication of this case is that an appellant needs to assess the prospects of success with care before deciding whether to opt out of the 'costs sharing' regime. If the appeal is successful, it will have been worthwhile to opt out of the 'costs sharing' regime. If, as here, the appeal is unsuccessful, it will have been in the appellant's interests to remain within the 'costs sharing' regime.

HMRC v Eclipse Film Partners No. 35 LLP (No. 5) (Upper Tribunal)

Late appeals

HMRC formed the opinion that a publican (F) had failed to operate PAYE on some payments to employees. In August 2009, it issued notices of determination. F did not appeal, and in October 2010 HMRC issued a statutory demand. Subsequently, F applied to lodge a late appeal against the determinations.

Decision:

The First-tier Tribunal (Judge Porter) rejected the application, but the Upper Tribunal remitted the case to a different judge for reconsideration. Judge Berner held that the First-tier Tribunal had 'directed its attention almost exclusively to the question whether (F) had a reasonable excuse for failing to make an appeal within the proper time limits', when it should also 'have considered the merits of the proposed appeal'.

Comments - TMA 1970 s 49 deals with late appeals. TMA 1970 s 49(5) provides that one of the conditions for the admission of a late appeal is that 'there was reasonable excuse for not giving the notice before the relevant time limit'. On the face of the legislation, this would appear to justify Judge Porter's decision to refuse the application. However, Judge Berner overturned Judge Porter's decision and remitted the case to a different judge for reconsideration, to take into account the merits of the proposed appeal.

D O'Flaherty v HMRC (Upper Tribunal)

Recent Compliance developments

HMRC have recently issued two documents which reveal an interesting picture about the activities of the department. The first is called 'Levelling the tax playing field' which is then described as a 'Compliance progress report'. The second is called 'No safe havens' and is subtitled 'Our offshore evasion strategy 2013 and beyond'.

These reports continue some interesting details about the current attitude towards compliance. In particular, it highlights the increasing sophistication of HMRC and the focus on trying to limit the ability of UK individuals to use offshore structures to avoid tax in this jurisdiction.

The headline in 'Levelling the tax playing field' is the statistic that in in 2011/12, HMRC collected £16.7bn of additional compliance revenues, which is an increase of £2.8bn over the previous year. HMRC has also won more than 50 avoidance cases and initiated more than 30 changes to tax law since 2010 closing down numerous avoidance loopholes. They have prosecuted more than 1,560 individuals since 2010 with a 91% success rate.

Looking beyond the headlines the following statistics are provided:

- HMRC have launched 40 specialist taskforces since May 2011, investigating more than 5,500 businesses and individuals and bringing in more than £60 million in additional revenue and instigating 40 criminal investigations
- HMRC have received 8,000 disclosures over nine disclosure campaigns, securing around £100 million from voluntary disclosures
- 3,000 evaders have been put into the Managing Deliberate Defaulters programme

- £500 million has been brought in by the High Net Worth Unit who deal with the UK's 5,600 wealthiest individuals (typically those with at least £20 million in wealth). The affluent team, who deal with the next tier of 500,000 affluent individuals down have brought in £98 million since 2010

- £14.8bn in additional compliance revenues have been collected from large businesses

The report then goes on to explain the anti-avoidance strategy:

- Preventing avoidance to the outset where possible
    - Developing effective legislation thereby minimising opportunities for avoidance
    - Influencing behaviour of taxpayers, promoters, agents, intermediaries and all persons facilitating avoidance by sending out clear messages
    - Disrupting the business model of promoters
    - Operating an effective disclosure regime
    - Publicising success in tackling avoidance and warning of the financial and other risks involved
    - Working with other jurisdictions to strengthen international tax standards
    - Putting in special processes to deal with large business and high net worth individuals
- Detecting it early were it persists
    - DOTAS
    - Intelligence on avoidance schemes through other methods (such as pressuring taxpayers to provide information)
    - Effective risk assessment of taxpayer returns and other information
- Countering it effectively through legislative change or challenge by HMRC, supported by the Litigation and Settlement Strategy

Turning to the document on offshore evasion shows how much HMRC see this is a fundamental plank in their attempts to stem tax evasion. Again there are some interesting statistics:

- The forecast revenue from the UK Swiss agreement is £5 bn of which £340 million has already been collected

- The forecast revenue from the Isle of Man, Jersey and Guernsey agreements is £1 bn.

- There have been 4,000 registrations under the Liechtenstein Disclosure Facility and this is expected to generate £3 bn. The largest single settlement under the LDF if £11 million

As with onshore evasion, HMRC declare their intentions are to ensure:

- There are no jurisdictions where UK taxpayers feel safe to hide their income and assets from HMRC
- Would-be offshore evaders realise that the balance of risk is against them
- Offshore evaders voluntarily pay the tax due
- Those who do not come forward are detected and fact vigorously enforced sanctions

They are attempting to achieve this by:

- Reducing the opportunities to evade offshore by international agreements and other multilateral action
- Increasing the likelihood that evaders are caught
- Strengthening the severity of the punishment

Here is an example of a case which HMRC has worked:

Roderick Smith and Stephen Howarth owned a business together. Goldlogic Control Systems, their business, worked with a wide range of customers across Europe. Smith and Howarth were aware of HMRC campaigns to tackle offshore evasion; indeed, given the chance to come clean in an offshore disclosure campaign, Smith came forward and disclosed one of his 12 offshore accounts. They didn't tell their accountant and felt they had done enough to get HMRC off their backs. Time passed and they enjoyed a lavish lifestyle, splashing the hundreds of thousands of pounds they had evaded on luxury cars and holidays. But HMRC was alerted by the German tax authority that they had significant business activities that they had not been declaring. HMRC investigators uncovered a complex web of accounts across five shell companies registered in other jurisdictions, created solely for the purpose of tax fraud. The two men were prosecuted – both facing jail sentences of at least a year, and confiscation ordered by the Court to recover the tax and interest evaded totalling £500,000. They must pay within 24 months or their jail sentences will be doubled.

Both documents mention repeatedly the use of technology and data gathering systems as being pivotal in the success that HMRC are having in tackling avoidance. This is a reference to a system called 'Connect' which is an astonishing piece of software. It was designed by BAE Systems and cost £45 million but it is thought to have brought in £1.4 bn of additional revenue since its introduction in 2010. It has won awards.

Connect is an appropriate name. It effectively mines the databases held by HMRC to connect pieces of information about an individual. HMRC has one of the biggest databases in the world. It creates 'spider's webs' of all the connecting factors and HMRC argue that a skilled investigator can detect patterns of concealment from the mazes that the system produces.

There are some 3,000 Connect analysts and around three-quarters of HMRC enquiries now made use of the system. It uses a mathematical technique known as social network analysis that ploughs through disparate, previously unrelated information to detect otherwise invisible networks of relationships. It automates analysis that would once have taken months, if it could have been done at all.

It is not only used to spot anomalies on an individual basis. The following example is given:

Take inheritance tax, where HMRC receives about 300,000 paper returns every year. Around 200,000 of those come from estates claiming to be below the taxpaying threshold. To identify high-risk case among a vast number of returns our experts have developed a single risk code that sifts more than 50 million lines of data, to spout where estates might have been falsely submitting as exempt utilising information on property transactions, company ownerships, loans, bank accounts, employment history and self-assessment that had previously been unmanageable. This single code detects returns that are likely to be false, and why, which has enabled us to step up our compliance strategy on non-taxpaying estates – raising an additional £26 million in the first year of operation.

Without sounding too 'Big Brother is Watching Us', it is important not to underestimate the effect of such technology. Of course, there is also the possibility that incorrect connections can be made which can then lead to a huge mountain for advisors to scale to convince HMRC that their client is innocent!

Contributed by Ros Martin

The General Anti-Abuse Rule

The General Anti-Abuse Rule (GAAR) is one part of the Government's approach to managing the risk of tax avoidance. It has been introduced to strengthen HM Revenue & Customs' (HMRC's) anti-avoidance strategy and help HMRC tackle abusive avoidance. The GAAR legislation defines what are, for its purposes, tax arrangements that are abusive.

But just because something isn't covered by the GAAR doesn't mean it won't be tackled in another way. HMRC will continue to tackle tax avoidance using existing anti-avoidance methods as well as the GAAR, where appropriate.

The GAAR applies to the following taxes:

- Income Tax
- Corporation Tax (including amounts chargeable or treated as Corporation Tax)
- Capital Gains Tax
- Inheritance Tax
- Petroleum Revenue Tax
- Stamp Duty Land Tax
- Annual Tax on Enveloped Dwellings

An independent advisory panel has been set up to give opinions on specific cases and approve the GAAR guidance.

There is a significant amount of guidance amounting to over 200 pages already on the HMRC website. You can download the current guidance:

- Parts A, B and C: Purpose and status of the guidance, Summary of what the GAAR is designed to achieve and how it operates to achieve it, and Specific points (PDF 160K)
- Part D: Examples (PDF 435K)
- Part E: GAAR procedure (PDF 160K)

RTI: Forms P45 And P46 For 2012/13

HMRC has confirmed that employers who have operated RTI from 6 April 2013 should not submit forms P45/P46 for employees who started or left during 2012/13. Any forms submitted will result in an error code 7818 stating 'This PAYE In Year Movement submission cannot be accepted as the employer has been invited to join RTI'.

If there are any outstanding P45/P46 forms relevant to 2012/13 employees, the following action should be taken:

Leavers:
Instead of submitting P45s enter the leaving date on the employee's 2012/13 P14. If 2012/13 P35 and P14s have been submitted without a leaving date then no further action is necessary.
The employee should not be included on the first Full Payment Submission (FPS) or Employer Alignment Submission (EAS). The employment will then be automatically ceased at 5 April 2013 following HMRC's processing of the first FPS or EAS.
Revised P14s should not be submitted.

Starters:
Include details of the employee in the EAS and/or first FPS and either show a date of starting of 6 April or leave this field blank

Employers who are not submitting PAYE in real time you should continue to submit forms P45/P46 to HMRC up to the date of joining.
(www.hmrc.gov.uk/news/rti-submitting-p4546.htm)

RTI: Starter Declarations From 6 April 2013

HMRC has amended the guidance on the PAYE starter process to help increase accuracy for individuals with a P45 and more than one job. In such cases, instead of selecting statement C and operating tax code BR, the employer should select statement B and operate the tax code on the P45 - unless the tax code on the P45 is BR, 0T or D prefix - in which case statement C would still apply.

Individuals without a P45, or with an old P45, will continue to complete the starter declaration to confirm their employment situation.

This is effective from 6 April 2013.
(www.hmrc.gov.uk/news/rti-starter-dec.htm)

Real Time Information and National Insurance number Verification Requests (NVRs)

HMRC has responded to complaints by employers that they are receiving rejections for NVRs. According to HMRC, these rejections are correct and are being made because the employer is sending the request before they have made their first Full Payment Submission (FPS).

HMRC's guidance 'Making sure you use the correct National Insurance number' clarifies this: 'You cannot send an NVR until you have started to send PAYE information in real time - wait two weeks after sending your first FPS before sending an NVR.'
Some employers also believe that all employees must have a National Insurance number for when they submit their RTI returns.

HMRC states that there will be occasions where a National Insurance number isn't available (for instance, when an employee is under 16 years old). In these cases, employers must leave the National Insurance number field blank for that employee. A 'dummy' National Insurance number should not be used.

What is essential is that, when a National Insurance number forms part of a real time PAYE submission, it is correct.
(www.hmrc.gov.uk/news/rti-nvr.htm)

Revised Form P85

Form P85: leaving the UK has been updated to take account of changes in the residence rules which are effective from 6 April 2013
(www.hmrc.gov.uk/cnr/p85.pdf)

New Expenses and Benefits Online Forms

HMRC has developed two new 'Online end of year Expenses and Benefits forms' for employers (with an equivalent form for agents).

New online forms available from April 2013
Employers can still choose to use their own payroll software to report expenses and benefits if it provides this function. The online forms are alternatives. However, employers who currently use HMRC's Basic PAYE Tools to run payroll will need to consider alternative methods for completing end of year forms - P11D, P9D and P11D(b) - as the tools will not provide this facility from 2012-13 onwards.

The new forms are
'No Return of Class 1A National Insurance contributions' - used to report that no P11Ds or P11D(b) are due

'Notification of payrolled benefits' - used to notify HMRC in advance that they will be sending P11Ds online that include all expenses and benefits provided to employees that have been fully payrolled
(www.hmrc.gov.uk/payerti/exb/onlineforms.htm)

Not too late

The taxpayer submitted a paper tax return for 2006/07 to HMRC in February 2008. The return was unsolicited and showed a profit. A second 2006/07 return, along with the form for 2007/08, was submitted on her behalf by her adviser in January 2011. The second 2006/07 return showed a loss. The taxpayer said her advisers had filed the return, not realising a return had already been submitted.

She said her previous advisers had lost her papers and, as a result, the returns filed by the new advisers used estimated figures. She wanted to carry forward the losses shown on the second return to 2007/08, but HMRC said this was not possible because that return had been filed outside the time limit under TMA 1970, s 9ZA for amending the first 2006/07 return.

Decision:

The First-tier Tribunal noted that HMRC did not dispute that the taxpayer could, by filing the second return, amend the first. The department's objection was mainly that the time limit for making an amendment had passed. On that basis, the tribunal found that the time limit was not applicable, because the original 2006/07 return had been filed voluntarily, ie not under s 8. The taxpayer was entitled to carry forward the loss from 2006/07.

With regard to the 2007/08 return, the taxpayer had freely admitted that the figures were estimated. The tribunal was satisfied that the figures submitted by the taxpayer were reasonable and based on professionally prepared accounts. It was not “persuaded by HMRC's reasons for rejecting these accounts as a basis for calculating figures” for the taxpayer's return.

The tribunal concluded that the figures provided on the return were more reliable than those calculated by HMRC.

The taxpayer's appeal was allowed.

Comments – This case is interesting as it highlights the fact that the normal time limts will not apply in the circumstances that the return was filed voluntarily

F Weerasinghe TC2542

Business Taxation

Buying or leasing a car in 2012/13 and 2013/14 (Lecture B771 – 7.06 minutes)

Writing down allowance

The normal WDA of 18% per annum reduces to 8% for cars with CO2 emissions in excess of 160 g/km, which then go in the special rate pool.

For expenditure from 1 April 2013 this level reduces to 130 g/km, so careful timing may be needed.

On a sale of a car within the special rate pool, or indeed within the general pool, there is still the oddity that on a sale of the car (even if it is the only item in the pool) there is no balancing allowance on the excess of the tax WDV over the sale proceeds except in the following circumstances:

- the trade ceases
- the owner is a sole trader or partner with the asset having some private use as then each car is kept separate in the capital allowances computation

Tax relief on leasing a car

The rental payments are subject to a disallowance of a fixed 15% where CO2 emissions exceed 160 g/km. That reduces to 130 g/km for leases commencing from 1 April 2013 (6 April for sole trader or partner), so the timing of any new car leases can be important.

Capital allowances on qualecs

The 100% FYA is claimable where the CO2 emissions do not exceed 110 g/km. That level reduces to 95 g/km from 1 April 2013, with 100% FYA planned to end completely on 31 March 2015. The reduction to 95 g/km eliminates cars such as the Mini Cooper 1.6D and BMW 320d Efficient Dynamics so careful planning on the timing of the purchase of a QUALEC is essential.

The Stop and Start technology now results in several desirable models qualifying for 100% FYA. In testing, the Stop and Start system has reduced fuel consumption by 10% for city driving, 6% in a standard combined cycle and up to 15% in heavy traffic.

Examples of QUALECS within the reduced limit of 95 g/km:

model	List price	Likely discount	CO_2emissions g/km	0- 60 secs
Chevrolet 1.3 vcdi 95 eco	£12,795	£1,000	95	12.5
Volt Hatchback 1.4 Range Extender	£34,995	nil	27	9.0
Citroen C3 1.6e-HDi Airdream VTR	£15,490	£1,900	93	11.5
Fiat 500 0.9 Twinair s/s	£11,660	£250	95	12.2
Ford Fiesta 1.6 TDCi 95 Edge Econetic	£14,445	£1,900	87	12.9
Kia Rio EcoDynamics 1	£11,895	£700	85	14.9
Lexus CT 200h SE-I	£23,750	£850	94	11.5
Nissan Micra 1.2 DIG-S Visia	£11,150	£700	95	11.3
Renault Clio 1.5 dC1 88 Expr. Eco	£12,450	£1,500	94	12.7

Seat Ibiza 1.2 TDi 75 SE Copa Ecomotve	£14,440	£1,950	92	13.9
Smart ForTwo Coupe 0.8 cdi Pulse	£10,400	£300	86	16.8
Toyota Auris 1.8 VVT-I HSD	£20,550	£1,500	93	11.4
Vauxhall Corsa 1.3 CDTi 95 ecolex	£14,340	£650	94	11.5
VW Polo 1.2 TDI 75 Bluemotion	£14,995	£950	91	15.6

Contributed by Gerry Hart

New Anti-Avoidance : Loans by Close Companies (Lecture B772 – 10.56 minutes)

Introduction

The Finance Bill contains provisions to tighten up the rules on the s.455 CTA 2010 charges relating to loans to participators in close companies. This anti-avoidance legislation involves a broadening of the definition of 'loans to participators' to:

- Include loans to certain partnerships and trustees
- Bring transfers of value other than loans into the scope of the charge; and
- Prevent "bed & breakfasting" of loans.

Loans to partnerships and trustees

Where a close company makes **a loan or advance on/after 20 March 2013**, s.455 CTA 2010 is now extended to apply if the loan is to:

1. Trustees, where one or more of the trustees, or actual or potential beneficiaries of the settlement, is a participator in the company (or an associate of such a participator); or
2. An LLP or other partnership, one or more of the partners in which is an individual who is a participator in the company (or their associate).

There will be exceptions to the extended scope of the charge, for example for loans made in the ordinary course of a credit business. The provisions giving relief for loans written off or repaid will apply in the normal way.

Other Transfers of value

HMRC is concerned that the s.455 rules are being avoided by transferring value to participators in other ways. This could include, for example, a situation where

- an LLP is formed by the participator and the close company;
- the close company makes a contribution to the LLP, or leaves profits undrawn in the LLP;
- amounts are then drawn down from the LLP by the participator that are not loans or advances made by the company to the participator.

This sort of arrangement means that the participator will have an overdrawn capital account in the LLP, funded by the corporate member.

Part 10 of CTA 2010 is therefore amended to catch arrangements where value is extracted from a close company and the benefit is conferred (directly or indirectly) on a participator (or their associate). A s.455 charge will arise on the value extracted (at the normal 25% rate) where the arrangement

- is not already subject to a s.455 charge; and
- is not chargeable as income of the participator.

Note that there appears to be no restriction on the tem "benefit" in the new legislation (s.464A), so it could be interpreted very widely by HMRC.

This change has effect in relation to **arrangements to which a close company becomes a party on or after 20 March 2013**. Relief will be available if the value is returned by the participator for no consideration.

"Bed and breakfasting" of loans

It is not uncommon to find that, just before the 9 month corporation tax payment date, a participator repays an outstanding loan to the company (perhaps by means of a short-term loan from a third party). Relief from the s.455 payment is therefore available under s.458 CTA 2010. Once the deadline has passed, the company re-lends the money to the participator a few days later (so that he may repay the third party loan).

This is of course all perfectly legal and seems to be an easy way around the cash flow issues associated with s.455 payments. Up until now, HMRC's response to such 'artificial' repayment arrangements (in the Enquiry Manual at EM8565) has been to refer the matter to its Anti-avoidance Group, who will then consider whether the arrangement can be attacked under *Ramsey* principles (i.e. a series of pre-ordained transactions, at least one of which is inserted for the avoidance of tax). It seems that such challenges are relatively rare and tend to be pursued only where there are relatively large amounts involved.

Going forwards, this type of short-term repayment arrangement to avoid s.455 charges will be caught by new statutory rules. Relief under s.458 will not be given where

- > £5,000 of the repayment is reversed within 30 days; **or**
- the **loan** is > £15,000 and there is an intention to make a new payment at any time

This amendment has effect in relation to repayments and return payments (re-advancements) made on or after 20 March 2013.

Other points to note

There are two additional developments worth highlighting.

Review of loans to participators rules:
The 2013 Budget included a statement that the government will carry out a review of the close company loans to participators rules and will issue a consultation document on the review later in 2013.

Exemption from beneficial loans rules:
While discussing loans made by small companies, it is worth reminding readers that avoiding s.455 charges by repaying loans in time will not help to avoid income tax charges under the beneficial loan rules, where less than the Official Rate of Interest (currently 4%) is paid on the loan. Such benefits are exempt, though, if the loan does not exceed £5,000 at any point in the tax year.

In the March 2013 Budget, the Chancellor announced that this threshold is being doubled to £10,000 from **April 2014**.

Contributed by Kevin Read

Director loan accounts – ideas and solutions (Lecture B773 – 7.59 minutes)

As stated above Finance Bill 2013 seeks to counter repayment of director loans either just before the year end or just before the 9 month point (when the tax falls due) when the loan is re-borrowed. This is achieved in two ways:

New section 464C(1)

This prevents relief under section 458 CTA 2010 from applying where in a 30 day period there is both a repayment of a loan and a further advance to the debtor (or an associate of the debtor) of sums totalling £5,000 or more.

Any relief due to the company will be restricted by deducting the lower of the total repayment and the new advances made in the 30 day period. (section 464C(4))

This is the slightly less aggressive form of restriction of the two proposed but it is possible that both of the new restrictions will bite and the director will be seeking a solution which fits both.

New section 464C(2)

This restriction applies if immediately before the repayment is made, the loan account stands at a balance due to the company of £15,000 or more. Here, the restriction applies to discount any further borrowing ("at any time after the repayment is made") where :

(a) any person intended that the new loan would be made, or

(b) arrangements had been made for the new loan to be advanced.

Relief (if any is due) should be restricted by the lower of the amount repaid and the additional drawing.

This is a more difficult restriction to deal with as the legislation does not set a time limit; intention is subjective, and in a challenge the taxpayer would have to satisfy HMRC that there was no such intention. If the evidence of the previous years' behaviour is examined, this might lead a tribunal to believe that such an intention was formed, based on the facts of earlier years.

Effective dates

Both restrictions apply to loan repayments and subsequent re-borrowing made from 20 March 2013.

Solutions

S 464C(1) restriction.

Where a loan is repaid by a director, and the repayment is in excess of £5,000, then no further drawing should be made on the loan account for a period of at least 30 days. In fact, drawing less than £5,000 will not trigger the restriction, but it is probably safer to leave a 30 day window for clarity. Normally, the dates of the repayment and the further advance will fall either side of the year end of the company, or either side of the due date for the tax if the loan was advanced during the previous accounting period.

S 464C(2) restriction

Dealing with the restriction in s464C(2) is more challenging. If the loan account ever reaches a balance of £15,000 then it may be very difficult to stay outside of the restriction, because even if the loan is reduced to below £15,000 before the year end to stay outside the provisions, the requirement for re-drawing to be disallowed at any time after the repayment was made means that this restriction can continue to apply even where further interim repayments have been made.

It will, of course, be more difficult to rule on the intention to re-draw against the loan account where there is an extended period of time between the repayments and re-drawing, but technically the legislation can apply at any point in time.

Relief for taxable repayments

Where the repayment of the loan takes the form of a payment which is taxable (to income tax) on the loan beneficiary, the restrictions in S464C(4) do not apply, and the repayment will count for the purposes of relief under s 458 CTA 2009. (New S464C(5)).

This seems to present the most viable solution for many directors, and indeed means that many small companies will not be troubled by these changes. Where the loan account is cleared by salary and/or dividend then the "repayment" takes a form that is chargeable to income tax; this means that the "repayment" is recognised for the purpose of relief under s 458 CTA 2010.

Conclusion

As described above, most small companies running director loan accounts and clearing them by salary and dividend will not have a problem with this legislation, as the repayment takes a taxable form.

Where, however, a client makes a cash payment to clear his loan account (possibly supported by short term borrowings) then it is likely that the restrictions will present relief. Where repayments of less than £5,000 at a time are made to circumvent s 464C(1), this will not be effective, as subs. 1 provides for a series of repayments totalling £5,000 or more.

As described above, avoiding the restrictions in subs. 2 will be challenging if the director has regularly repaid and re-borrowed in previous years. It might well be easier on all concerned if the company accepted responsibility for the s 455 tax and paid it over.

Contributed by Rebecca Benneyworth

Revised guidance on repairs and renewals of assets **(Lecture P772 – 13.37 minutes)**

Later this year HMRC will be publishing expanded guidance on repairs aimed at Tax Professionals. This guidance will replace the existing guidance in the Business Income Manual at BIM35330 and BIM35450 to BIM35470.

The guidance follows a logical pattern:

BIM46901 Overview
BIM46905 Role of accountancy
BIM46910 What is a repair: the 'entirety'
BIM46915 What is a repair: improvements
BIM46920 What is a repair: different materials
BIM46925 What is a repair: changing technology
BIM46930 What is a repair: Notional repairs
BIM46935 What is a repair: effect of a change of ownership
BIM46945 What is a repair: Assets on which capital allowances given
BIM46950 What is a repair: Character of the Asset
BIM46990 Renewals basis – Expenditure before 2013

There is a significant increase in the detail with each of the areas and extends the guidance previously given with many examples demonstrating the detail. You would be well advised to scrutinise the new chapters which focus on different materials, changing technology and notional repairs together with the examples. These have been updated to reflect current developments and a number of recent tribunal cases such as the recent case involving the retarmacing of a roadway which did not result in any improvement.

One of the key aspects in this new guidance is the scrapping of the renewals basis.

Scrapping of the renewals basis

The tax legislation provides for a deduction for the cost of renewing "trade tools" (see ITTOIA 2005, s 68). Strictly, the legislation applies only to small items such as hammers, chisels and so on, but by concession the relief has been extended to any items of plant and machinery.

The allowance works on the basis that you cannot have a deduction for the first purchase of an item of plant, so when fitting out a new rental property, there is no deduction for buying, say, a cooker. When the cooker needs replacing, however, the cost of the replacement can be claimed as a "renewal".

The renewals allowance applies to any trader, but it is particularly useful for landlords of residential accommodation as capital allowances are not available.

Prior to April 2013, the landlord of a furnished property has always had a choice: he could claim the renewals allowance, or he could claim a "wear and tear" allowance calculated as 10% of the rent he receives. Wherever possible the 10% wear and tear allowance is generally claimed.

If the property was not fully furnished (eg kitchen appliances only), then the wear and tear allowance is not available. The renewals basis would be the only option for a partly furnished property.

At BIM46990 HMRC state that the renewals basis will not apply to expenditure on replacing plant and machinery which is incurred:

(a) on or after 6 April 2013, for the purposes of income tax; and

(b) on or after 1 April 2013, for the purposes of corporation tax.

The strict statutory allowance for "trade tools" will remain but this is unlikely to be much help for landlords.

From April 2013, the only relief available to residential landlords will therefore be the wear and tear allowance, and this can only be claimed for fully furnished properties, so landlords of unfurnished residential accommodation will not be able to claim any relief at all for replacing such items as cookers, fridges, dishwashers, and so on.

NICs on payments from EBT

An employee benefit trust made payments to certain employees in 2003/04. HMRC issued a ruling that class 1 NICs were due on the payments.

Decision:
The Upper Tribunal upheld HMRC's ruling, disapproving the Special Commissioners' decision in Channel 5 TV Group Ltd v Morehead, [2003] STC (SCD) 327, and holding that the essential feature of a gratuity was 'that it is a token of thanks for the services provided directly and personally to the donor'. A voluntary payment 'by a third party who has received an indirect benefit from the provision of the employee's services' did not amount to a gratuity.

Comments - The Upper Tribunal allowed HMRC's appeal against the First-tier Tribunal (FTT) decision, and specifically disapproved the Special Commissioners' decision in Channel 5 TV Group Ltd v Morehead.

HMRC v Knowledgepoint 360 Group Ltd (Upper Tribunal)

Resurfacing of caravan park: revenue expenditure

A partnership operated a caravan park. It claimed a deduction for the cost of resurfacing part of the park, replacing the previous grass surface with a hardcore surface. HMRC rejected the claim on the basis that the expenditure was capital.

Decision:

The FTT allowed the partnership's appeal. Judge Reid held that the work had not resulted in any improvement to the park, observing that the new surface had less aesthetic appeal, was not suitable as a recreational area for children, and had generated customer complaints. He held that the expenditure should be treated as revenue rather than capital.

Comments - The FTT accepted the partnership's contention that the cost of resurfacing part of the caravan park was an allowable deduction, and rejected HMRC's view that it should be treated as capital expenditure.

Cairnsmill Caravan Park v HMRC TC2580

Film production partnership: loss claim

A partnership was formed in 2001 to produce a film. In its first accounting period, ending on 5 April 2002, it claimed to have made a loss of £1.9m. Its return claimed significant deductions for 'deferred amounts' payable to members of the cast and production crew.

HMRC began an enquiry and formed the opinion that these amounts were not properly deductible in the period ending 5 April 2002.

It issued an amendment disallowing these amounts and reducing the loss to £597k. The partnership appealed.

Decision:

The First-tier Tribunal reviewed the evidence in detail and dismissed the appeal. Sir Stephen Oliver observed that 'expenditure incurred on the production of a film is deductible as soon as there is an unconditional obligation to pay it'. In the present case, the financial statement which the partnership had submitted 'failed to comply with generally accepted accounting practice in the UK'. It 'should have been corrected to remove the provision for deferred payments to cast and crew before being used as a starting point for the calculation of the taxable profit or loss of the partnership'. At the time the financial statement was signed, the 'deferred cast and crew amounts' were unascertainable, and the partnership had not yet incurred the expenditure it had claimed.

Comments - There have been several high-profile cases concerning claims to loss relief by partnerships in the film industry. The First-tier Tribunal upheld HMRC's contention that the partnership's claim was excessive, because its accounts failed to comply with generally accepted accounting practice, and anticipated expenditure which had not yet been incurred.

Alchemist (Devil's Gate) Film Partnership v HMRC TC2573

Purchase and sale of film rights: whether trading

A bank marketed a tax avoidance scheme whereby, in a complex series of transactions, a film company (GF) sold the rights in two films to a hedge fund manager (D) for a nominal price of £21.9m. D was only required to pay £4.8m of this, as the balance of £17.1m was lent to him by a company associated with GF. Later on the same day, D assigned the rights to GD (another company associated with GF) for £881k. D claimed the difference as a trading loss. HMRC rejected the claim on the basis that D was not trading, and that the aim of the transactions was not to make profits but to 'generate artificial tax losses for the participants'. D appealed, contending that he was carrying on a trade of acquiring and exploiting film distribution rights.

Decision:

The First-tier Tribunal rejected this contention and dismissed D's appeal, holding that D was not carrying on a trade. Judge Blewitt held that 'the sole purpose of the scheme, and therefore the sole purpose of (D's) participation therein, was to shelter his taxable income'.

Comments - There was a great deal of money at stake in this case, as similar schemes have been used by other wealthy individuals seeking to claim loss relief. HMRC was so pleased to win this case that it issued a press release on 1 March, before the Tribunal Centre had released the official decision. Jim Harra of HMRC commented that 'this is another film scheme which has delivered none of the tax benefits promised by the promoter. Mr Degorce put in nearly £5m of his own money, including £1.6m which went into the promoter's pocket, but all he has come away with is an HMRC enquiry and an appearance before a tax tribunal.'

P Degorce v HMRC TC2593

Helpful debt

Mr and Mrs E owned the taxpayer property management company. It leased business premises to M, a company also owned by Mr and Mrs E. Company M fell into financial difficulties in June 2003 and, in December 2003, it went into receivership owing the taxpayer rent.

The company claimed bad debt relief under TA 1988, s 74 in its tax return. HMRC refused the claim on the basis that the taxpayer had allowed rent to accrue during the period M had been in financial difficulty and then had written off the arrears for motives unrelated to the business.

Decision:

The First-tier Tribunal said that for s 74 relief to be allowed, the taxpayer's purpose in not collecting the debt had to be for its own business purposes. In this instance, the directors of M had allowed the rent payments to fall behind to give the company time to recover, in the hope that it would be able to pay the outstanding rent later. This could only be interpreted as “a predominant intention to benefit” M at the expense of the taxpayer.

The taxpayer's appeal was dismissed.

Comments – One of the most fundamental rules in the taxation is the determination of the profits an central to this whether the expense has been incurred wholly and exclusively for the purpose of the trade. In this case the question arose over the identity of the organisation for whom the expense had been incurred.

Sere Properties Ltd TC2429

Travel costs not allowable

The taxpayer worked as a toolmaker at a Jaguar plant in the Midlands in 2003/04. For the period 6 April to 1 November, he said he was employed by a Dutch company at Jaguar, although he subsequently claimed to have been employed by an agent. With effect from 1 November, the taxpayer registered as self-employed.

HMRC concluded that the taxpayer was self-employed throughout 2003/04. They said he had not declared profits of £36,015 and assessed him to tax. The taxpayer appealed. He maintained he had been an employee until 1 November, but insisted that if the assessment stood, commuting expenses of about £11,000 should be allowed against the profits.

The taxpayer was unable to provide payslips for the period he claimed he was an employee. There was no contract of employment, nor did his role change after he registered as self-employed. Further, HMRC had no record of him being subject to PAYE.

Decision:

On these grounds, the First-tier Tribunal concluded he was self-employed for the whole of 2003/04.

As to the taxpayer's claim that his travelling expenses be allowed against his profits, the tribunal said the Jaguar plant was the taxpayer's base of operations and consequently, referring to the decision Newsom v Robertson 33 TC 452, they were not exclusively for the purpose of his trade.

The taxpayer's appeal was dismissed.

Comments – The treatment of travelling expenses is a key aspect of the determination of the taxable income. There are different rules for the allowability of the travelling expenses incurred depending upon whether the person in question is employed or self-employed. Therefore it is important to determine if the point is in question as to whether the individual is employed or self-employed. The Tribunal determined that the individual. Last month’s notes dealt with the Samadien case which reviewed in detail the rules for travel expenses in detail. You would be well advised to examine that case.

L Meynell-Smith TC2531

Novation of interest rate swaps

FA 2002 replaced the tax regime applying to 'interest rate swaps' previously contained in FA 1994. The new regime applied to companies for their first accounting period ending after 1 October 2002

A company (BW) had entered into an 'interest rate swap' for commercial reasons. In August 2003, when it was subject to the FA 2002 regime, it novated the swap to an associated company (BF), which was not yet within that regime, for a premium of £91m. In its next return, it treated this premium as outside the scope of tax. HMRC issued an amendment charging tax on it, and BW appealed.

Decision:

The FTT dismissed the appeal, holding that FA 2002 Sch 26 para 28 did not apply. Judge Nowlan held that BF 'cannot have inherited liabilities under a transaction effected at a time when the required statutory provision that normally achieved that result did not apply it', and that 'parliament cannot have intended para 28 to apply so as to let one company drop out of charge without the other inheriting the liability'.

Comments - The FTT upheld HMRC's view that the premium which the company had received was chargeable to corporation tax. As E&Y's Mike Gibson has observed (see 'In brief', Tax Journal, dated 19 April 2013): 'This is an interesting case that should be considered in situations where a transaction gives rise to unequal tax treatment'.

Bristol & West PLC v HMRC TC2630

Business Records Checks – the initial phone call

There has been much discussion in the profession about the recent re-launch of Business Record Checks (BRCs). Under the revised approach, the starting point is that the business receives a letter saying that

- the business will receive a short phone call (maximum 15 minutes) on or after a specified date,
- the purpose of which is to ascertain whether HMRC needs to arrange a visit to check that the statutory records being kept are adequate.

The letter goes on to say that, subsequent to the call, HMRC may, rather than arrange a visit, ask its Business Education Support Team to offer to help the business improve its record-keeping.

Factsheet TH/FS1 (*Keeping records for business – what you need to know*) is included with the letter.

Readers may be interested in what happened when an unincorporated business recently received one of these phone calls from HMRC (made on the date specified in the letter). It is a very straightforward business as far as record-keeping goes (e.g. relatively few transactions and no cash receipts) and the call lasted less than 5 minutes.

The questions asked (not quoted verbatim here) were:

Preliminary questions

1. On a scale of 1 to 9, how familiar are you with record-keeping requirements for tax purposes? ('1': not at all; '9' understand them fully.)
2. On a scale of 1 to 9, do you struggle to understand official documentation and notices? ('1': completely; '9' not at all)

Business specific questions

1. How long have you been running your business – more than or less than 2 years?
2. Do you write up your business records yourself?
3. Approximately how many sales do you make each month? Possible answers included 1-10, 11-100, etc.
4. Approximately what proportion of your sales is in cash? (0, 1/3, ½, 100%)
5. How often do you write up your sales records? (Weekly, monthly, quarterly, annually.)
6. Approximately how many purchases do you make each month? (1-10, etc.)
7. Approximately what proportion of your purchases is in cash? (0, 1/3, ½, 100%.)
8. How often do you write up your records of purchases (Weekly, monthly, quarterly, annually.)
9. Can you easily identify what part of your expenditure is for personal use?

Having answered these questions, the business owner was told that he seemed to have adequate record-keeping, that no visit was necessary and that this would be put in writing shortly.

It is perhaps surprising that the following questions, among others, do not form part of the questionnaire:

- Do you keep hand-written or computerised accounting records?
- Do you use sequential invoicing?
- Do you have a separate business bank account that only contains business receipts and payments?

It seems that unrepresented taxpayers who can say that they have few cash transactions, write their books up regularly and can identify personal expenditure are likely to be regarded as "low risk" under this 'tick-box' approach to compliance.

Repayments of amounts wrongly paid as VAT

Four companies, which acted for VAT purposes as the representative members of large groups which carried on business as retailers, had accounted for VAT on amounts which were subsequently accepted not to be due, and had received substantial repayments, together with statutory interest. They treated these repayments as outside the scope of corporation tax. HMRC issued amendments to their self-assessments, charging corporation tax on the repayments, and the companies appealed. The First-tier Tribunal (FTT) dismissed the appeals, holding that 'the VAT repayments received by each of the appellants were trading receipts' and that 'the interest payments are chargeable to corporation tax under Case III of Schedule D'.

Decision:

The Upper Tribunal (UT) upheld this decision. Asplin J observed that 'without the trade which gave rise to the overpayment of VAT, no payment would be made by HMRC'. Accordingly, the VAT repayments arose from the trade.

Comments - The UT upheld the FTT decision that the repayments of sums which the companies had originally paid to HMRC as VAT were chargeable to corporation tax.

Shop Direct Group v HMRC (and related appeals) (Upper Tribunal)

Annual SDLT charge and CGT exposure of high value residential property owned by non-natural persons **(Lecture P775 – 8.48 minutes)**

We now have all of the details, with several important changes being made to the original proposals.

The following tax charges apply, all with the aim of stopping high-value UK residential property being held in envelopes:

- ♦ ***15% rate of SDLT on acquisition*** from 21 March 2012 costing at least £2 million by non-natural persons whether UK resident or not; the rate is 7% for acquisition by a natural person

- ***An annual SDLT charge*** from 1 April 2013 on such high value residential property
- ***The application of CGT*** to gains from 6 April 2013 on such property by non-natural persons (important change - this applies whether non-resident or resident)

Main aspects of the 15% acquisition charge and the annual SDLT charge

These apply to UK residential dwellings held by a non-natural person with a value of at least £2m. They do not apply to non-residential or commercial property.

The annual charge applies to corporate owners, collective investment trusts, and partnerships with a corporate member, whether UK resident or not. The definition of a non-natural person does not include a trust (this is a change from the original proposals) or of course an individual. Properties held by companies in a nominee capacity are not subject to the annual charge.

There are linked transactions rules for SDLT, but this is not the case for the 15% acquisition charge. This means that where several properties are purchased from the same vendor for £2m + in total, but each is worth less than £2m, there is no exposure to the 15% charge. There are however anti-fragmentation rules which serve to amalgamate various legal interests acquired in a single dwelling.

There is a range of valuable exemptions available, many of which have been added after the consultation period:

- **property development businesses** where the property is not occupied by a connected person (the previous proposal that the business had to have been carried on for at least 2 years has been dropped)
- **property rental businesses**, subject to the same requirement about connected persons
- **property trading businesses**, subject to the same requirement about connected persons
- **properties open to the public** at least 28 days a year and run as a business
- **employee accommodation**, provided the occupier is not too closely connected with the company
- **most dwellings owned by charities**
- **farmhouses occupied by a working farmer**
- **diplomatic and publicly owned properties**
- **property that is conditionally exempt from IHT**

As a new provision where the purchaser is within any of the exemptions above, the 15% SDLT rate on acquisition is reduced to 7%. This is subject to the proviso that the exemption conditions are complied with for at least 3 years after the transaction

The charge is based on the property value assessed at five-yearly intervals from 1 April 2013. Where the property interest was already in existence on 1 April 2012 it will be the value at that date which is used. This earlier valuation date for existing owners has been chosen so that valuations can be undertaken before the charge applies.

Valuations will be subject to checking by the Valuation Office Agency (VOA). The use of a professional valuation will reduce the chance of the need for the VOA to make an internal inspection of the property, and the VOA will offer a pre-return valuation checking service to property owners.

The annual charge is as below and the rates will be indexed in April each year (commencing 1 April 2014) in line with CPI in September of the previous year.

Property value	*£2m - £5m*	*to £10m*	*to £20m*	*over £20m*
Annual charge	*£15,000*	*£35,000*	*£70,000*	*£140,000*

The due date for payment of the charge is 15 days after the commencement of the period of account. For existing owners this will be by 15 April each year, though for the first year of operation the return is due by 1 October 2013 with payment due by 31 October.

If a property is valued within 10% of a band threshold an application can be made to HMRC for a pre-return banding check (PRBC), via a form which will be downloadable from 1 June.

Main aspects of the CGT charge

The CGT charge on disposal applies where the annual SDLT charge is relevant. Partnerships are treated as transparent, so that any resident or non-resident non-natural member of a partnership disposing of a property within the charge is apportioned their share of the gain.

The charge applies to the disposal or part disposal of relevant UK residential property and it also applies to gains accruing on a disposal, whatever the form of disposal. Thus the charge applies to the disposal of shares or interests in securities in a property owning company where more than 50% of the value of assets is derived from UK residential property.

The charge only applies to the gain from the start date of 6 April 2013, unlike originally intended, so rebasing applies. That is good news, but not the extension to a UK resident company. This is claimed to be on the grounds of consistency. It means that instead of paying tax at 21% to 24% on the gain the resident company will face a CGT charge at 28%.

The same exemptions apply as for the annual SDLT charge, so in practice many disposals will be exempt from this CGT charge.

For marginal disposals over £2m there is a tapering relief similar to that applying to chattels. The chargeable amount is the lower of the full gain and the difference between the consideration and the threshold amount for that disposal, multiplied by 5/3.

Contributed by Gerry Hart

VAT

Date of supply

The taxpayer, a limited company, acquired the freehold interest in a hotel and converted it into four properties, which it then sold as zero-rated dwellings.

HMRC decided they should have been standard rated because they were sold as holiday homes, and raised an assessment to collect the VAT.

The taxpayer appealed. The original planning permission decreed that the properties should be classed as holiday accommodation and as such could not be used by the owners for the first three months of the year. Later, this restriction was removed. As a result, the taxpayer argued that the buildings were eligible for zero rating.

Decision:

The First-tier Tribunal said that VAT arose when a taxable supply was made. In this instance, the supply was made when the leases were granted. It would be “fanciful” to say this could be varied because of a subsequent amendment to the planning permission. “It would enable … a tax planning exercise to be pursued ex post facto, to the substantial benefit of the taxpayer.” The leases supplied were subject to VAT at the standard rate.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: “It would cause major problems to the credibility of the VAT system if changes in circumstances were allowed to change retrospectively the liability of a supply made many months or years earlier. The key issue is to consider the relevant circumstances that apply at the time of the supply and this will determine the rate of VAT to be charged on the sale.”

Northside Management Ltd TC2319

Retractable fire curtains

A company (C) manufactured retractable fire curtains. HMRC issued a ruling that supplies of these curtains were standard-rated. C appealed, contending that they should be treated as building materials, within VATA 1994 Sch 8 Group 5 Note 22.

Decision:

The FTT accepted this contention and allowed the appeal. Judge Sadler held that 'fire curtains are an established and fully accepted method of providing fire safety and fire protection in dwellings in which such features are required to be incorporated or where it may be prudent to incorporate them'.

Comments - The FTT upheld the company's contention that its retractable fire curtains qualified as 'building materials' within VATA 1994 Sch 8 Group 5 Note 22.

Coopers Fire Ltd v HMRC TC2570

Wall insulation

A company (S) manufactured a gel product which it called 'Stormdry'. HMRC issued a ruling that the supplies of the product were standard-rated. S appealed, contending that the product qualified for the reduced rate of VAT under VATA 1994 Sch 7A Group 2.

Decision:

The First-tier Tribunal allowed the appeal in principle, finding that the product functioned as insulation and qualified as 'energy-saving materials' within the definition in Group 2 Note 1. (However, the tribunal noted that S would still have to account for VAT on its sales, as the reduced rate only applied to the installation of such materials.)

Comments - VATA 1994 Sch 7A Group 2 provides that the installation of 'energy-saving materials' qualifies for the reduced rate of VAT. The First-tier Tribunal accepted the company's contention that the product which it manufactured qualified as an 'energy-saving material' within Group 2 Note 1.

Safeguard Europe Ltd v HMRC TC2543

Training centre constructed by charity

A charity was formed 'for the advancement of education in water, outdoor and indoor activities for young people generally'. It arranged for the construction of a training centre on a site which it owned on the River Thames. HMRC issued a ruling that the construction of the centre was standard-rated, and the charity appealed, contending that it qualified for zero-rating.

Decision:

The FTT accepted this contention and allowed the appeal. Judge Sadler held that the charity was not carrying on a business, and that the building was used solely for a relevant charitable purpose.

Comments - The FTT upheld the company's contention that the training centre was intended for use solely for a relevant charitable purpose, so that its construction qualified for zero-rating. Judge Sadler specifically rejected HMRC's view that the centre was to be used in the course or furtherance of a business (which would have disqualified it from zero-rating).

Longridge On The Thames v HMRC TC2574

Associated persons

The European Commission applied to the CJEU for a ruling that, by permitting non-taxable persons to be members of a VAT group, Ireland had failed to comply with its obligations under art 11 of Directive 2006/112/EC.

Decision:

The CJEU rejected the Commission's contentions, holding that 'it is not apparent from the wording of Article 11 of the VAT Directive that non-taxable persons cannot be included in a VAT group'. The CJEU also observed that it was arguable that the inclusion of non-taxable persons in VAT groups 'contributes to administrative simplification both for the group and for the tax authorities and makes it possible to avoid certain abuses'.

Comments - As observed by Lee Squires and Fiona Bantock (page 26): 'While this judgment applies to the case against Ireland, it is expected that the CJEU will come to the same conclusion in the cases against the UK (C-86/11, judgment due on 25 April) and other Member States. The UK should therefore not have to amend its rules allowing holding companies (often non-taxable persons) to join VAT groups and consequently recover input VAT. It should also lead to more consistent treatment of VAT groups throughout the EU.'

European Commission v Ireland (CJEU Case C-85/11)

VAT: whether recipient of a supply may appeal

The Scottish case of Earlsferry Thistle Golf Club v HMRC (TC02602 — 25 March) concerned a Scottish golf club (E) which did not own a golf course, but paid another club (G) an annual fee for the right to use G's course at specific times. Following the CJEU decision in HMRC v Canterbury Hockey Club, E submitted a repayment claim, on the grounds that the fees charged by G should have been treated as exempt from VAT. HMRC rejected the claim, but made a repayment to G, which in turn made a repayment to E. In 2011, following the FTT decision in HMRC v Bridport & West Dorset Golf Club Ltd, E submitted a further claim. HMRC again rejected the claim and E lodged an appeal with the FTT, contending that there was an appealable matter, within VATA 1994 s 83(1)(b). HMRC applied for the appeal to be struck out.

Decision:

The FTT dismissed HMRC's application. Judge Ruthven Gemmell observed that the UT had referred the case of HMRC v Bridport & West Dorset Golf Club Ltd to the CJEU, and directed that E's appeal should be stood over pending the CJEU decision in that case.

Comments - In the early years of VAT, the VAT Tribunal reached conflicting decisions on the question of whether the recipient of a supply has the right to lodge an appeal. In Payton [1974] VATTR 140, the VAT Tribunal held that the purchaser of goods which had wrongly been treated as standard-rated did not have the right to appeal. However, this decision was not followed in the subsequent case of Williams & Glyn's Bank Ltd [1974] VATTR 262, where the VAT Tribunal held that the recipient of a supply did have

the right of appeal against a ruling that the supplies were taxable. Following the Williams & Glyn's case, HMRC has generally accepted that the tribunal can entertain appeals by recipients of supplies, although a notable exception was the case of Canterbury Hockey Club (VTD 19086), where Sir Stephen Oliver dismissed HMRC's application for the appeals to be struck out (and where the substantive appeal was subsequently referred to the CJEU). In the Earlsferry case, HMRC departed from its usual practice and applied for an appeal to be struck out. The FTT rejected HMRC's application and directed that the appeal should be stood over, pending the CJEU decision in the Bridport & West Dorset Golf Club case.

Bad debt relief: insurance payments

A firm of solicitors which provided legal services in respect of insurance claims claimed bad debt relief in respect of the full amounts which insurance companies had declined to pay. HMRC issued an assessment on the basis that relief was only available for the VAT fraction of the debt, as in AW Mawer & Co v C & E Commrs, [1986] VATTR 87.

Decision:

The Court of Session (CS) unanimously upheld the assessment (reversing the Upper Tribunal decision and restoring the FTT decision). The CS held that 'the proper construction of (VATA 1994 s 36) is the construction for which HMRC contends. The refund to which the taxpayer is entitled is stipulated in s 36(2) as the "amount of VAT chargeable by reference to the outstanding amount". The words "outstanding amount" are defined in subsection (3) by reference to the amount of the "consideration", or the extent to which the "consideration" has been written off. But as (VATA 1994 s 19) makes plain, the "consideration" is an amount inclusive of VAT.' The CS also observed that the solicitors had 'provided a taxable service for which they received partial payment of the consideration'. There was no reason why 'they should not be responsible, in the normal way, for the proportionate amount of VAT on the part consideration which they received'.

Comments – The CS has restored what had been the generally accepted VAT treatment of bad debts, prior to the UT decision in this case in 2011, and has upheld HMRC's view that only the VAT fraction of the bad debt can be reclaimed.

HMRC v Simpson & Marwick (CS)

Avoiding a default surcharge **(Lecture B774 – 15.45 minutes)**

Default surcharge – background

A taxpayer can commit two possible offences in relation to submitting his VAT returns – submit the return late and pay some (or all) of the tax late. We'll not consider the issue of whether the figures on the return are correct – that's a separate issue.

The good news is that a default surcharge is only based on the tax unpaid by the due date of the return.

So if I submit my June 2013 return online on 15 August 2013 (it should be submitted by 7 August i.e. one calendar month after the end of the period plus seven extra days for online filing) but somehow manage to pay the tax on time, then I have committed an offence, but will not get an actual penalty.

In summary, this is how the system works:

- First offence (either late return or late payment) – HMRC will send a surcharge liability notice to the taxpayer – a repeat offence in the next 12 months will lead to a penalty. In the case of a small business (annual sales of £150,000 or less), they get a polite letter on the first offence, asking if they need any help with their VAT accounting, and the surcharge liability notice for offence two (HMRC Notice 700/50, para. 3.2).
- Second offence – a 2% penalty will apply to any tax unpaid by the due date. Note the words 'due date' – one day late means that according to the letter of the law you are still liable to a penalty. The positive point for a smaller business is that no penalty is applied on either the 2% or 5% penalties if the tax involved is less than £400.
- Third offence – 5% penalty
- Fourth offence – 10% penalty
- Fifth and subsequent offences – 15% penalty

Note: if any offence is committed within the 12-month window of the surcharge liability notice (including a late return) then the period is extended by a further 12 months from the date of the offence.

Example

Here is the VAT return record of Mike the builder:

- He submitted his October 2011 return late and received a default surcharge liability notice from HMRC (his annual turnover exceeds £150,000 so he did not get the polite letter).
- He then submitted his January 2012 and April 2012 returns on time, but made a late payment of £20,500 for July 2012.
- He was also late in October 2012 (VAT due was £7,500) and again in January 2013 (VAT due was £3,500).

Solution

- Having submitted his October 2010 return late, Mike needed to be on time and fully compliant with the next four VAT returns up to and including the period ending 31 October 2011 – he did not achieve this goal.
- The default in July 2011 attracts the initial 2% penalty of £410 (£20,500 × 2%)
- The next period attracts a 5% penalty of £375 (£7,500 × 5%). However, good news on this one – because the total penalty is less than £400, and it is relevant to the 5% penalty period, then no penalty is issued.
- The penalty for January 2012 is also less than £400 (£3,500 × 10% = £350) but this penalty is applied because we are no longer in either the 2% or 5% period – hence the £400 *de minimis* situation does not apply.

Note - although the 5% penalty was waived in October 2011, it does not mean that the next default attracts only a 5% penalty – the next period still suffers a 10% rate.

Part payments and reasonable excuse

If Mike had telephoned me when he was about to pay his VAT late for July 2012 due to cash flow problems, I would have advised him to pay at least £501 on time. This would leave the unpaid tax by the due date at £19,999 and because the 2% penalty is now less than £400 (just!), the surcharge is waived.

The point when most advisers will get in on the act with this subject is when a client has received a default surcharge penalty and wants you to consider escape routes to see if it can be withdrawn. However, don't forget that any taxpayer faced with a surcharge penalty has committed at least two offences in the last 12 months, so a 'reasonable excuse' to avoid a penalty needs to be strong and persuasive.

What is a reasonable excuse? Lack of funds or reliance on another person to perform a task are not reasonable excuses – only emergency type situations like computer breakdowns, illness, bereavement or a one-off cash flow problem caused by a major customer (normally reliable) not paying his dues and causing an unexpected cash flow problem (although courts have been somewhat inconsistent with this issue over the years).

The other possible escape route is to consider the issue of 'proportionality' – this could be relevant when a very high surcharge has been charged to a taxpayer.

The Enersys case – opportunity or false dawn?

The tribunal case which first gave taxpayers hope that a surcharge could be withdrawn on the basis of 'proportionality' (excessive amount for the offence committed) related to *Enersys Holdings UK Ltd* (TC00335). The appeal concerned a default surcharge penalty of £131,000, caused by the fact that the taxpayer submitted and paid a VAT return one day late. The business was subject to a 5% default surcharge. The judge withdrew the surcharge and allowed the taxpayer's appeal on the basis that it was 'wholly disproportionate' to the offence committed.

HMRC did not appeal the Enersys case and instead took the view that they would consider each case on its merits. The key point with any decision made by the First Tier Tribunal is that it is not legally binding on all other situations that appear to be identical.

The key thing with the 'proportionality' argument is that it is an all or nothing situation – so either the penalty is maintained in full or withdrawn in its entirety. And in reality, the view of one person (or judge) will be very different to that of another.

The chairman in the Enersys case considered four key questions in deciding whether a surcharge is excessive and a proportionality issue could apply:

Key issues to consider with 'proportionality' and default surcharges

(1) whether the default was "innocent" or "deliberate";

(2) the number of days of the default;

(3) the absolute amount of the penalty, about which the judge in the Enersys case said "The absence of an upper limit may be justifiable upon the basis that it is a necessary consequence of a tax-geared penalty, though in my view there must come a time, even in the case of a large company, when that justification breaks down";

(4) the "inexact correlation of turnover and penalty";

In the case of Enersys, the taxpayer was late on a 5% surcharge period, mainly because of confusion over the date when the VAT was due for payment – it was only one day late. Another important factor was that the tax due in this particular period was unusually high for the taxpayer – a 5% surcharge in any other VAT period would have produced a penalty that was far lower than £131,000.

Other cases since Enersys……

So where are we now? Let me consider two other post-Enersys cases, one produced a victory for HMRC and one for the taxpayer.

Eastwell Manor (TC1155):

- Business was a luxury hotel – and paid its September 2010 VAT return one day late
- HMRC issued a default surcharge of £18,454 (a 15% penalty)
- The taxpayer knew the payment was due by Friday 5th November rather than Monday 8th November.

The taxpayer lost this case – the tribunal noted that by being on a 15% surcharge (the maximum), the company already had a long history of non-compliance. The director was aware that he could have asked for time to pay before the tax was due (which would almost certainly have been granted for one day) and that a part-payment would have reduced the penalty. He knew that by making the BACs transfer on Thursday 4th November, it would not arrive in HMRC's bank account until Monday 8th November i.e. late.

Quote from Tribunal chairman: "This is not a small business. The turnover is around £5m most years, so the penalty is less than 1% of the turnover. There are 150 staff. While turnover is not necessarily a reflection of business size, on the facts of this case, the penalty is not disproportionate to the size of the business."

Total Technology (Engineering) Ltd (TC1323)

- Default surcharge of £4,260 was charged in relation to 5% surcharge period – however, the 2% surcharge period had produced a zero penalty (less than £400 and waived as explained above), so this was the first penalty charged to a generally compliant business
- The payment in question was one day late
- Company profits were about £50,000 a year.

Quote from Tribunal chairman: "We found a penalty of over £4,000 to be extremely high for a small company with annual profits of around £50,000.

"The penalty was not only harsh but plainly unfair. In coming to our conclusion we noted in particular the lack of correlation between the single day of delay and the quantum of the penalty; the relationship between that quantum and the Company's profits; the sudden jump in surcharge from zero to over £4,000 and the Company's generally good compliance record both before and since this default period."

The final word......appeal with Total Technology case – and HMRC win

As explained above, Total Technology (Engineering) Ltd persuaded the tribunal that a £4,000 default surcharge was disproportionate on the basis that it represented about 15% of the company's annual net profit. However, HMRC appealed the verdict to the Upper Tier Tribunal [2012] UKUT418(TCC) – and won the case!

The Upper Tribunal concluded that although the result for the taxpayer might be seen as 'harsh', it could not be seen as 'plainly unfair'.

The outcome of this case really means that unless a default surcharge is 'plainly unfair' (perhaps because of unusual factors such as the seasonal issue in the Enersys case), then a case based on proportionality issues is unlikely to succeed.

The priority for any business should be to submit its returns and payments on time, and to ensure that if payment cannot be made by the due date, an approach should be made to HMRCs Business Payment Support Services (before the deadline date) to request a time-to-pay arrangement. The other way to avoid or reverse a default surcharge is if the taxpayer had a 'reasonable excuse' for being late with the return or payment.

Contributed by Neil Warren

VAT registration and TOGC issues **(Lecture B775 – 20.56 minutes)**

In recent months, there have been a range of VAT tribunal cases (won by the taxpayer in some cases) in relation to both VAT registration and TOGC (transfer of a going concern) issues.

This session considers the cases in question because they have practical messages.

As an opening challenge, think of the priorities for a business buying or taking over an existing entity:

- If a TOGC outcome is evident, the buyer will not pay VAT on the purchase of the assets from the seller (including goodwill) – the proceeds will be outside the scope of VAT. It is important that the buyer does not incorrectly pay VAT where a TOGC applies because HMRC have the power to disallow any input tax he claims (no taxable supply).

- If a TOGC outcome is not evident, the buyer will get his own VAT registration threshold – but taking over an existing business means he will need to treat the taxable sales of the seller as his own sales i.e. usually meaning he needs to VAT register and account for output tax from his first day of trading.

MARK YOUNG T/A THE ST HELENS (TC2371) – no supply of assets needed for TOGC to apply

A restaurant owned by Mr Young traded as a limited company (Bonne Bouchee Ltd) and ceased to trade on 5 February 2009. It did not have any assets or ability to pay creditors or, in fact, liquidators fees. It had traded at a loss and needed to cease trading as it was insolvent. With effect from 14 February 2009, Mr Young reopened the restaurant as a sole trader – however, there was no transfer of any assets, goodwill, stock etc from the previous business because the latter owned no assets of any value.

The taxpayer claimed that he did not need to become VAT registered on 14 February 2009 (on the basis that he felt he had no need to take account of the turnover of the previous business) and that he was entitled to wait until his annual sales exceeded £67,000 (the registration threshold at the time) before he needed to register i.e. effectively on 1 September 2009. HMRC argued (successfully) that the legislation at VATA1994, s49, did not require there to be a business sale between the previous and new owners to create a TOGC situation – the fact that the new owner was stepping into an existing business with premises, trading name, facilities to trade in the same kind of business etc was sufficient. The wording in s49 states: 'where a business or part of a business carried on by a taxable person is transferred to another person as a going concern' i.e. not the sale of a business but the transfer of a business.

Comment

This decision gives cause for concern about the VAT position when a business is deemed to be 'new' or whether it is being 'taken over' from an existing person. Think about a caterer who takes over the catering function at a golf club because the previous owner has left. He has never met the previous owner, has no knowledge of his annual sales (presumably) 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, then he will need to treat the situation as a TOGC – and could be liable to become VAT registered on his first day of trading. .

BRENDA MASSEY (TC2520) – restaurant taken over as a going concern

Mrs Massey owned the freehold of a property and for many years, one floor was rented out to a tenant (Mr Piggott) who traded as a restaurant. Mr Piggott left the premises on 13 June 2009 (taking advantage of a break clause in the lease) and Mrs Massey reluctantly took over trading as a new entity on 24 June 2009. A payment of £6,000 was made to Mr Piggott, which the tribunal determined was for the net worth of fixtures and fittings on the premises.

The taxpayer claimed she had not taken over a business as a going concern – there was no payment for goodwill or stock and that she was therefore entitled to a registration threshold – in the case of a TOGC arrangement, the buyer must take into account the seller's turnover and treat this as his own as far as the limit is concerned (s49(1), VATA1994).

The tribunal concluded that the business was taken over as a going concern – the key point was that the new owners had everything in place to operate a business when they started trading, apart from consumable stock. Mrs Massey should therefore have registered for VAT on 24 June 2009 i.e. her first day of trading.

Comment:

With a VAT rate of 20%, the opportunity to make £79,000 of VAT free sales before having to register is a big incentive for a business owner trading with the general public i.e. such as a restaurant. The tribunal dismissed all of the factors put forward by the taxpayer as to why a TOGC was not evident – in reality, it started as a restaurant under Mr Piggott and continued as a restaurant under the ownership of Mrs Massey and therefore the argument of substance over form made it clearly a TOGC arrangement.

CHRISTOPHER AND COLIN SUMMERS (TC2267) – was there a separate partnership agreement in place?

The Summers family owned two businesses – one was selling ice creams (T/A Super Whippy) and one was involved in catering (T/A Full Monty Catering), Neither business was VAT registered because their sales figures were less than the VAT threshold – however, HMRC felt that the two entities comprised the same partners (father and son – Colin and Christopher Summers) with a turnover exceeding the VAT limit for the partnership whereas the partners claimed that Christopher's wife Tina was a partner in the ice cream business, and had invested £24,000 of capital to illustrate her involvement.

A point highlighted by the tribunal is that the Partnership Act 1890 does not require a formal partnership agreement to be in place between the partners, only for a business to be carried on by more than one person with a view to common profit. This statement dealt with the problem that the partnership tax returns and accounts for the ice cream business only showed the two partners (not Tina) although the business accountant admitted that this had been an error on his part and should not therefore be relevant to the case.

The taxpayer appeal was successful on the basis that Tina (with an oral agreement rather than any legal document in writing although there was a written memorandum of understanding in place that she was a partner) was a partner in the ice cream business following her £24,000 investment i.e. creating two legal entities trading below the VAT threshold.

Comment:

VAT registration is determined by the taxable sales of each legal entity – rather than each different business. The taxpayer was very fortunate that the tribunal accepted there was a second partnership in the absence of any clear written partnership agreement or accounts/tax returns that showed Tina as a partner. Advisers need to make sure paperwork and contracts are clear about the legal entity that is relevant to any business and that accounts and tax returns are then consistent with the entity in question.

ROBERT WELLS (TC2172) – late registration penalty reduced to nil

The taxpayer (an artist) should have registered for VAT in 2007 – the end result being a belated VAT registration for the period from 1 January 2007 to 31 October 2010 and VAT arrears bill of £24,218. HMRC issued a penalty of £1,905 as a result of the late registration and this was the subject of the appeal.

The taxpayer argued (successfully) that the end result of the late VAT registration was that he had overpaid income tax and Class 4 NI, but the overpaid tax of £2,593 relevant to 2006/07 tax year was time barred because a claim had to be made before 5 April 2011. He felt that the VAT penalty should be reduced to nil because he was already out of pocket with the loss of income tax and NI. The tribunal agreed with him, recognising that HMRC were still enjoying a net tax windfall of £600 (£2,593 less £1,905) even if the late notification penalty was reduced to zero as a result of the 2006/07 tax overpayment being time barred. To quote from the case report:

“A situation where a fault on a taxpayer’s part, such as his failure to notify liability to be registered for VAT, has both given rise to a penalty and caused an irrecoverable overpayment of tax on his profits, may in our view be an occasion where it could be ‘proper’ to abate the penalty.”

Comment:

This is an interesting case where different taxes have overlapped. The tribunal recognised the adverse income tax and NI outcome for the taxpayer as a result of the late VAT registration, and felt it was wrong to penalise him again for the same error. A common sense outcome was achieved.

JAMES HILLIS (TC2611) – late registration penalty reduced to zero

A solicitor (sole trader) was late registering for VAT by more than 12 months, and HMRC invoked a 10% late registration penalty, the minimum allowed by the legislation in the case of an unprompted disclosure:

- A minimum 0% penalty applies - late registration is less than 12 months
- A minimum 10% penalty applies - late period exceeds 12 months

The tribunal decided that a strict application of the legislation was not in accordance with the intention of the legislation, which is to penalise taxpayers who make serious errors. The taxpayer had made a mistake by not realising he should have been VAT registered at an earlier date (he was 13 months late with his notification) - the penalty of £2,502 was reduced to zero.

"The penalty regime is not intended for tax payers who make a genuine mistake on their liability and disclose their mistake to HMRC. This intention can be discerned from the wording of the legislation which enables a reduction of the penalty to a nil amount where the notification of liability is made within 12 months and the availability of a reasonable excuse for non-deliberate failures. The report on proceedings of the HC Committee stage of the Finance Bill 2008 emphasised that tax payers who have made genuine mistakes should not be deterred by fear of penalties from coming forward and regularising their affairs. Further the 12 month threshold for unprompted disclosures whilst introducing certainty was not set

in stone. The HC Committee envisaged that there would be a margin of appreciation for those taxpayers outside the 12 month limit who have made an honest mistake, albeit in the form of a reasonable excuse. The Tribunal considers that the HC Committee's reference to a reasonable excuse encompassed special circumstances, particularly as an honest mistake on the law could not as a rule constituted a reasonable excuse."

Comment:

Somewhat strangely, the tribunal noted the fact that the taxpayer was only able to collect £18,000 of the VAT owed from his late registration from customers (in his case the Legal Services Commission), out of a total amount of £25,000, effectively meaning he had been penalised by £7,000 already. Many retailer businesses that are late registering have no opportunity to reclaim any tax from customers, so this was an unusual approach. The outcome introduces a shade of grey into a topic (VAT registration) that is usually black and white because the legislation is clearly based on dates and deadlines.

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