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Contents

Personal Tax

Part-surrender, complete disaster

The taxpayer took out life insurance policies issued by an Irish company while he was not resident in the UK. He later moved to the UK and surrendered part of the rights of his policies. Because he surrendered more than 5% of the annual allowance for the relevant tax year, the whole excess was a chargeable event. HMRC assessed the taxpayer to income tax at the basic rate as well as the higher rate because the policies were offshore. Furthermore, the largest policy was classed as a personal portfolio bond within ITTOIA 2005, s 515 to s 526. This resulted in the taxpayer being charged to tax each year as if there were an actual gain on an amount equal to 15% compounded of the premiums paid less the aggregate amount of any previous part-surrender gains, regardless of whether the policy produced an actual return of that amount.

The taxpayer appealed against the assessments, saying that the tax amounted to “judicial theft” and breached his human rights under the First Protocol of the European Convention of Human Rights, article 1. He also said that he had received bad professional advice and, had he understood the tax consequences of his actions, he would have surrendered the whole of the policies in a single year.

Decision:

The First-tier Tribunal expressed sympathy for the taxpayer, saying that he was “not the first appellant to come before this tribunal or its predecessors to complain of the workings of the chargeable event regime where large part-surrenders are made”. This did not mean that he was not liable to the tax, though. He may have received poor advice, but this did not absolve him from paying the tax that was correctly due. The tribunal added that it may be possible for him to seek compensation from his advisers, “but that was not a matter for the tribunal”.

With regard to the human rights argument, the tribunal said the taxpayer's complaint was “that the normal tax law should not be applied to him, on the ground that he has unintentionally put himself in a situation which has disadvantageous tax consequences as a result of bad advice and lack of knowledge of the applicable tax law”. It was not contrary to the European Convention on Human Rights to refuse to exempt a person from paying the tax in those circumstances. The taxpayer's appeal was dismissed.

The tribunal went on to comment on the part-surrender legislation, noting:

“the system of taxation of part-surrenders in excess of the 5% allowance is one which penalises the unwary or ill advised, often with quite disproportionate consequences as in this case. HMRC, and for that matter the insurance industry, have been aware of this major fault in the system for many years but have done nothing to correct it. In correspondence with the appellant's MP, the director of HMRC CT and VAT, Jim Harra, said '… the 5% rule … continues to be popular with many insurers and their investors. Proposals on a couple of occasions to abolish the 5% rule have not been pursued'. Quite apart from the odd notion that it is the rule's popularity with insurers that should allow the iniquitous effect of a large part-surrender to be visited on taxpayers, the reply completely misses the point.

The iniquitous effect of large part-surrenders can clearly be removed without affecting the operation of the 5% rule in those cases in which it was intended to apply as a relief. What is more, the rules for corresponding deficiency relief are in most cases a wholly inadequate remedy for the disproportionate consequences of a large part-surrender, even where they are not prima facie discriminatory."

Comments – This case is one of those unfortunate cases where advisors often overlook the draconian aspects of the law particularly when the area of the law is not frequently encountered. This is particularly true with Personal Portfolio Bonds which are the subject of an unfair and illogical tax charge. It is worth taking note of all the comments that were made by the Tribunal.

R Anderson v HMRC TC2555

Reduction in rate of class 2 NICs: whether retrospective

An individual (M) had lived and worked in the UK from 1960 to 1968, when he emigrated. He subsequently moved to Alderney. In 2009 he applied to make a backdated payment of class 2 national insurance contributions, to enable him to qualify for a UK pension. HMRC accepted his application, and M sent a cheque which HMRC accepted as payment of 12 years' contributions. M appealed to the FTT, contending that, when the weekly rate of class 2 contributions had been reduced from £6.55 to £2 in 2000, the reduction should be treated as having retrospective effect, so that the cheque which he had sent should be treated as payment of 24 years' contributions rather than 12 years' contributions.

Decision:

The FTT rejected this contention and dismissed M's appeal.

Comments - Not surprisingly, the FTT upheld HMRC's contention that the significant reduction in the rates of class 2 NICs which took place in 2000 did not have retrospective effect, so that anyone wishing to make backdated contributions for previous years has to do so at the rates which were in force at the relevant time.

C Murfitt v HMRC TC2684

Introduction of 98% tax rate: whether a breach of European Convention on Human Rights

In May 2011 the Hungarian Parliament enacted legislation which provided that payments of severance pay exceeding 2,000,000 Hungarian forints, paid to public sector workers after 1 January 2010, should be taxed at 98%.

In NKM v Hungary (ECHR Case 66529/11), a woman, who had been made redundant from her post in the civil service in May 2011, lodged an application with the European Court of Human Rights.

Decision:

The ECHR held that the legislation was a breach of Article 1 of the First Protocol of the European Convention on Human Rights, finding that it was disproportionate and had deprived the applicant 'of the larger part of a statutorily guaranteed, acquired right'. It awarded the applicant damages of €11,000 and costs of €6,000.

Comments - The ECHR held that the Hungarian legislation which imposed a tax rate of 98% on certain types of income contravened the European Convention on Human Rights. (Older readers may remember that the UK had a 98% tax rate on some investment income in the late 1970s, when Lord Healey was Chancellor of the Exchequer.) This case is included as a reminder and as an illustration of how things change with the passage of time.

Tax planning for non-domiciliary: whether accountant negligent

The controlling shareholders of a clothing company sold their shares for £22m in early 2005. The sale gave rise to significant CGT liability. One of the shareholders (M) had been born in Iran, although he had moved to the UK at the age of 12. He subsequently took proceedings against the accountants who had acted for him in relation to the sale, contending that they should have taken steps to take advantage of his non-UK domicile and should have taken advice from an appropriate specialist.

Decision:

The QB reviewed the evidence in detail, accepted this contention and gave judgment for M. Silber J found that M 'would have sought advice from a non-dom specialist very speedily as he was determined to ascertain ways of eliminating or reducing his CGT liability if he thought there were or might be potentially significant tax advantages for him as a non-dom'. He held that M should have been advised to take advantage of a 'bearer warrant scheme' under which he could have transferred the shares outside the UK before December 2004, when such schemes were blocked by TCGA 1992 s 275A.

Comments - From an accountant's perspective, this is a worrying decision. Some accountancy firms have recently faced public criticism for allegedly promoting tax avoidance. However, in this case, Silber J held that an accountancy firm had been negligent in failing to advise a client to adopt a specific avoidance scheme, even though that scheme was subsequently blocked by anti-avoidance legislation. It seems difficult to reconcile some of Silber J's reasoning with previous judicial observations, such as those of Lord Scarman in Furniss v Dawson [1984] STC 153 and those of Harman J in Cancer Research Campaign v Ernest Brown & Co [1997] STC 1425. It is not yet known whether the accountants intend to appeal to the CA, although such an appeal would seem to have a reasonably good prospect of success. In the meantime, the lesson of the case seems to be that an accountant should not be afraid to seek advice from an appropriate specialist.

See also the comment 'The adviser's duty to alert his client to a tax savings opportunity' (Patrick Cannon) Tax Journal dated 14 June 2013, p 9.

Mehjoo v Harben Barker (and related appeal) (QB)

Lifetime Allowance Protection Regime - Condoc

A consultation document has been published about the detail and implementation of an individual protection regime to accompany the reduction in the pensions lifetime allowance (LTA) from £1.5m to £1.25m from 6 April 2014.

Fixed protection

Fixed protection 2014 (FP14) will entitle an individual to an LTA of £1.5m. Any new pension saving made on or after 6 April 2014 is likely to lead to the loss of FP14. Individuals must apply for FP14 before 6 April 2014. This means that individuals with FP14 are likely to need to opt out of active membership of all tax relieved pensions schemes if they want to maintain this protection.

Individual protection

Individual protection 2014 (IP14) will give individuals a personalised LTA based on the value of their pension savings at 5 April 2014 (up to £1.5m). It will allow individuals to continue pension saving after 5 April 2014, while protecting tax relieved pension savings that have accrued up to that date (up to £1.5m). Individuals will have three years from 6 April 2014 to apply for IP14.

The option of IP14 would therefore be of benefit to those who want to continue saving in their pension scheme, albeit with a lower LTA than with FP14, and will be subject to LTA charges on the additional savings. Individuals will be able to apply for both FP14 and IP14, subject to meeting the eligibility conditions.

Eligibility

Individuals will be able to apply for IP14, if:

- they have pension savings of greater than £1.25m at 5 April 2014; and
- they do not have either primary or enhanced protection.

This means that any individual will be able to apply for IP14, including those with FP12 (£1.8m) or those applying for FP14, providing that on 5 April 2014 they have pension savings in excess of £1.25m and they do not have either primary or enhanced protection.

It is proposed that, for an individual with IP14, the pensions tax legislation should be read as if their personalised LTA was substituted for the standard LTA. This will work in a similar way as it does for those with fixed protection, where the standard LTA is replaced with £1.8m for those with FP12 and £1.5m for those with FP14.

Examples

Bart applies for IP14 and has total pension savings at 5 April 2014 of £1.35m. Bart will have a personalised LTA of £1.35m and he is treated as having a standard LTA of £1.35m for tax purposes.

Catherine applies for IP14 and has total pension savings of £1.6m at 5 April 2014. Catherine will have a personalised LTA of £1.5m and she is treated as having a standard LTA of £1.5m for tax purposes.

Lump sum
It is proposed that an individual with IP14 would be entitled to take up to 25% of their pension fund as a tax free lump sum, but subject to an overall maximum of 25% of their personalised LTA. Therefore, an individual with IP14 and a personalised LTA of £1.4m will (subject to their scheme rules) be able to take up to £350,000 as a tax free lump sum.

Further contributions
Unlike fixed protection, under IP14 there will be no restriction on further contributions or accruing additional pension benefits/rights on or after 6 April 2014. It would therefore not normally be possible for an individual to lose IP14

LTA Charge
Where an individual has IP14 and a benefit crystallisation event occurs on or after 6 April 2014, then if the total amount of their LTA used up including the amount crystallised by the BCE exceeds their personalised LTA, the excess will be subject to the LTA charge in the usual way. That is, a charge of 55% will apply to the excess if it is taken as a lump sum, or a charge of 25% will apply to the excess if it is taken as pension income.

For individuals with IP14 who are members of defined benefit schemes, this means that any increase in their promised pension benefits after 5 April 2014 (for example, due to an increase in their pensionable pay or their number of years of service) will be subject to the LTA charge when the benefits are taken.

For individuals in defined contribution schemes, any new contributions or investment growth in the fund value on or after 6 April 2014 will be subject to the LTA charge when the individual takes their benefits.

Example
Neeta has pension savings of £1.32 million on 5 April 2014. Neeta applies for IP14 and has a personalised LTA of £1.32 million. All her pension savings are in a defined contribution scheme. After 5 April 2014 Neeta contributes a further £40,000 to her pension savings. In addition, through investment growth, her fund increases by a further £160,000 by the time she takes her pension benefits. When Neeta takes her benefits, her BCEs total is £1.52m. This is £200,000 greater than her personalised LTA of £1.32m, and therefore this excess of £200,000 is subject to the LTA charge.

Application
To apply for IP14, an individual will have to have a valuation of their pension savings from all their pension schemes as at 5 April 2014. Since they will not have this information before 6 April 2014, they will not be able to apply for IP14 before that date. The window for applying for IP14 will need to be longer than for fixed protection.

The Government is therefore considering a three year window for applications for IP14. That is, applications for IP14 Interaction with Fixed Protection must be received by HMRC by 5 April 2017.

Individuals who want to apply for FP14 will have to do so before 6 April 2014.

They will need to stop contributing to any money purchase arrangement and ensure that benefits in any defined benefits arrangement will not increase above a set level from this date.

Contributed by Tony Jenkins

Capital Taxes

CGT avoidance scheme: acquisition cost of shares

An individual (M) entered into an avoidance scheme, intended to create a large tax loss, in 2006. He exercised an option to buy some shares in a trading company (S) for a nominal price of £6m. This nominal price was payable to a discretionary trust of which M was the principal beneficiary, and whose assets consisted mainly of that debt. Accordingly, the economic effect of the scheme was to transfer almost £6m of M's assets into that discretionary trust. A few days later, M sold the shares for £552. On his 2005/06 tax return, he claimed that he had made a tax loss of £5,999,448 on the transaction, which would be available for offset against his income (under ICTA 1988 s 574). HMRC issued an amendment rejecting the claim.

Decision:

The First-tier Tribunal substantially dismissed M's appeal. Judge Hellier observed that TCGA 1992 s 38(1) provided that there should be a deduction for consideration given 'wholly or exclusively for the acquisition of the asset'. On the evidence and in the context of the scheme, M had not paid £6m wholly and exclusively for the shares in S. He held that the only sum given wholly and exclusively for those shares was their redemption value of £600. That was their acquisition cost for tax purposes, so that M had only made a loss of £48, rather than the amount claimed.

Comments - This is the latest in a line of recent cases in which the First-tier Tribunal has held that a scheme intended to produce a tax loss does not have the result advertised by its promoters. The tribunal observed that the economic reality of the scheme was to transfer a substantial sum of money into a discretionary trust. Therefore, the £6m which was the subject of the scheme was not paid wholly or exclusively for the acquisition of shares, and did not produce the tax loss which the scheme's promoters had claimed.

J Myers v HMRC (and related appeals) TC2703

CGT avoidance scheme: No commercial purpose

Abbeyland, the taxpayer, was a property development, investment and letting business. In anticipation of a large capital gain arising on the sale of one of its properties in 2004, it used a capital redemption policy which enabled the company to realise a capital loss of £1.6m that could be set against current or future gains. Abbeyland acknowledged that the transaction had been undertaken solely to avoid tax.

HMRC disallowed the loss on the transaction. Abbeyland appealed.

Decision:

The First-tier Tribunal noted that the scheme was similar to the one used in Drummond v CIR [2009] STC 2206 where the taxpayer had bought and sold second-hand life insurance policies.

The Court of Appeal dismissed the taxpayer's appeal in that case, and the tribunal said there was no reason to distinguish Abbeyland's transaction from that in Drummond.

The assets used in each scheme were similar and the aim of TCGA 1992, s 8 was to ensure that the capital gains tax rules applied equivalently for the purpose of corporation tax, and that s 37 should apply identically for individuals and companies.

The tribunal judge, Peter Kempster said: “The acquisition and subsequent disposal of the bonds were solely for the purposes of a tax avoidance scheme, all the steps of which were preordained, with no commercial motive or effect.”

The taxpayer's appeal was dismissed.

Comments - HMRC have published a press release stating they have “already recovered tax, interest and penalties of £250m from cases closely resembling the scheme used by Abbeyland Ltd” and that this is the department's “12th win in the courts against avoidance” in 2013.

Abbeyland Ltd V HMRC TC2693

The meaning of ‘business’ for CGT and IHT purposes (Lecture P782 – 19.54 minutes)

The CGT angle

Ramsay v HMRC (2013) is an appeal by the taxpayer (Mrs R) which has recently been heard by the Upper Tribunal. The point at issue was whether a residential property in Belfast, divided into 10 rental flats, constituted a business for CGT purposes, and in particular whether Mrs R’s arrangement fell within S162 TCGA 1992 (which deals with the transfer of a business to a company in exchange for shares).

Mrs R conducted various activities at the property, but, in 2012, the First-Tier Tribunal held that these activities were ‘normal and incidental to the owning of an investment property’.
They arose by necessity when someone such as Mrs R owns a property which is let out as flats. Accordingly, the property was merely an investment and Mrs R was *not* carrying on a business. Rollover relief under S162 TCGA 1992 did not apply.

At the later hearing, the Upper Tribunal went through the various authorities regarding the meaning of ‘business’. Berner J noted that there was no statutory definition of the word and that it should therefore be afforded a ‘broad meaning’ for CGT purposes.

One would have thought that the facts found by the First-Tier Tribunal represented a serious obstacle in this appeal. However, the Upper Tribunal decided that the court at first instance had made an error of law.
The relevant question was whether Mrs R’s activities constituted a business, but the First-Tier Tribunal had considered whether she was carrying on a trade (which is a very different matter).

Furthermore, the First-Tier Tribunal had not assessed appropriately the degree of activity undertaken by Mrs R. They stated that her activities were undertaken in order to maintain and enhance an existing investment property and thereby improve the available returns through increased rents. Berner J in the Upper Tribunal did not agree. The questions which he posed in this regard were:

(i) Did Mrs R's activities represent an occupation or function pursued with reasonable or recognisable continuity?

(ii) Did Mrs R's activities have 'a certain amount of substance' in terms of turnover?

(iii) Were Mrs R's activities conducted in a regular manner and on sound and recognised business principles?

(iv) Were Mrs R's activities of a kind commonly made by those who seek to profit from them?

By answering all these questions in the affirmative, the judge concluded that Mrs R *was* carrying on a business and so relief under S162 TCGA 1992 was held to be in point.

It is thought that this is the first case which has had to consider the meaning of 'business' for CGT purposes. This is surprising, given that the CGT legislation has now been in place for nearly 50 years. The word can also be important in the context of IHT, and in particular business property relief where it is again not defined.

The IHT angle

Earlier this year, the First-Tier Tribunal heard the case of *David Zetland Settlement v HMRC (2013)*. In this dispute, the trustees of a settlement owned commercial properties which were let on a normal commercial basis. The issue was whether the trustees were conducting a business for the purposes of business property relief because, if they were not, the settled property would be subject to a 10-year anniversary charge under S64 IHTA 1984 in the absence of an entitlement to 100% business property relief. The value of the trust assets was in excess of £6,000,000.

The relevant test in these circumstances is found in S105(3) IHTA 1984 which allows a deduction for business property relief unless the business 'consists wholly or mainly of one or more of the following, that is to say, dealing in securities, stocks or shares, land or buildings or making or holding investments'.

The case report confirms that the trustees dealt with the general management of the trust properties and were assisted by various staff members. There was an impressive list of services provided to the tenants – certainly more extensive than those which had been undertaken by Mrs R in *Ramsay v HMRC (2013)*.

There were a number of full-time and part-time staff involved, including a porter, a general handyman, a property manager, an in-house solicitor and two secretaries. There were internet services, cleaning services and 24-hour security as well as a café, a gym and a hairdressing salon (although these latter operations were not run by the trustees).

Despite all this, the Tribunal considered that these factors were insufficient 'to tip the balance in favour of obtaining business property relief'. HMRC's argument, which was accepted by the First-Tier Tribunal, was that the trustees' main activity was the making or holding of investments.

It is difficult to reconcile this decision with that of the Upper Tribunal in *Ramsay v HMRC (2013)* and the difference cannot be explained by the fact that one case related to CGT and the other to IHT. Although the underlying legislation is different, the question was the same: was there a business or was there merely an investment? Both cases needed to consider the nature of a 'business', for which there was no definition under either code.

Contributed by Robert Jamieson

Furnished holiday lettings and services provided (Lecture P783 – 19.59 minutes)

Judgment was handed down on 28 January 2013 by the Upper Tribunal in the business property relief case of *HMRC v Pawson (2013)*. Henderson J reversed the decision of the First-Tier Tribunal and allowed HMRC's appeal.

The dispute concerned a holiday cottage near Aldeburgh in Suffolk which was owned as to one-quarter by the deceased (Mrs P). Mrs P's personal representatives argued that the bungalow, which was regular rented out and which could accommodate up to 11 people, qualified for business property relief. HMRC refused to accept this claim and their reasoning had a familiar ring: the property was, in reality, an investment – regardless of how it may have been treated for income tax purposes – and Mrs P had done nothing more by way of the provision of services than would be consistent with the protection of a family investment.

There were no particularly unusual features about the facts of the case, but the First-Tier Tribunal's decision was that they considered the letting of a holiday cottage to holidaymakers to be what they called 'a serious undertaking earnestly pursued' and so they held that it represented a business for the purposes of the relief. The test which they propounded was that an intelligent businessman would, in this context, regard the ownership of a holiday letting property as a business rather than an investment – it was far too active an operation to fall under the latter heading. The constant need to find new tenants and to provide services over and above those which were necessary for the bare upkeep of the property would cause it to be regarded as a business asset to be exploited.

On appeal, the Upper Tribunal held that the lower court had erred in law in concluding that an ordinary businessman would consider Mrs P's letting business as *not* being one which was mainly investment. This was on the basis that the weight of judicial authority forcibly implied that, for any business in which the principal activity was the deriving of income from the occupation of land, the starting-point would be that the business is mainly an investment one.
Only at the far end of the spectrum of possible letting operations, where the business involves the provision of very extensive services, will the investment element be overridden.

This latest decision seems to turn on Henderson J's primary proposition that 'the owning and holding of land in order to obtain an income from it is generally to be characterised as an investment activity'. With respect, this cannot be correct: surely it must depend on the *purpose* for which the land is owned and held. Does not a farmer or an hotelier own and hold land to obtain income from it? Would Henderson J argue that they are investors rather than traders?

One is left to wonder whether holiday lettings can ever qualify for business property relief. HMRC's current practice is routinely to refuse a claim for relief whatever the facts, although this stance is not really supported by the instructions set out in Para IHTM25278 of the Inheritance Tax Manual which reads:

'In the past, we have thought that business property relief would normally be available where:

(i) the lettings were short-term; and

(ii) the owner, either himself or through an agent such as a relative, was substantially involved with the holidaymakers in terms of their activities on and from the premises.

Recent advice from Solicitor's Office has caused us to reconsider our approach and it may well be that some cases that might have previously qualified should not have done so. In particular, we will be looking more closely at the level and type of services rather than who provided them.'

The key sentence in that extract is the last one.

The present position is that the family will go to the Court of Appeal as long as they can be assured that no costs will fall on them personally. A fighting fund has been set up by their accountants (see 'Taxation' dated 7 February 2013), but leave for the appeal has been refused. However, a final oral application on this point will be heard by the Court of Appeal on 2 October 2013.

The decision in the *Pawson* case has caused advisers to refocus on the services which should be provided in a holiday property if the owner is to stand a reasonable chance of qualifying for business property relief in connection with his rental accommodation.

Lettings should ideally be for short periods, ie. a week or a fortnight, and the holidaymakers should find that their rental payment entitles them to all of the following:

(i) a fully furnished property;

(ii) the provision of bed linen, towels etc;

(iii) satellite television;

(iv) wifi;

(v) a welcome pack consisting of one day's supply of food and drink in the fridge;

(vi) a 'meet and greet' service;

(vii) detailed information about things to do, places to visit and recommended local restaurants, pubs and shops;

(viii) if relevant, the provision of a parking permit;

(ix) the availability of a cleaning service; and

(x) an undertaking that any problems arising during their stay with be dealt with by either the owner or the letting agent.

It is difficult to see how this differs in any significant way from the level of services provided at most hotels.

Contributed by Robert Jamieson

APR on Farmhouses (Lecture P784 – 11.40 minutes)

The relief

100% APR on that part of a transfer of value of owner-occupied agricultural property in the EEA which is attributable to agricultural value is clearly valuable. On let farmland it is also 100% for tenancies dated from 1 September 1995. Otherwise it is 50% except where the successor tenant takes occupation as a result of the death of the previous tenant.

The property must either have been occupied by the transferor (this includes occupation by a company he controls) for the purposes of agriculture throughout at least the two years immediately before the transfer; or owned by the transferor for at least the seven years immediately before the transfer and occupied (by him or another person) for the purposes of agriculture throughout that period.

Agricultural property includes land, woodlands, farm buildings, cottages etc, provided the woodland and buildings are ancillary to, and occupied together with, the agricultural land. That basic definition gives particular opportunities and also concerns when looking at farmhouses

Particular aspects on farmhouses

HMRC reckon to review all cases where there is a farming business of less than 20 acres or where the farmhouse is valuable and the acreage comparatively small (say less than 100 acres).

In Higginson v IRC SpC 337 it was decided that existence of a farmhouse with farmland going with it (rather than the other way round) means not a farmhouse.

In Antrobus v IRC SpC 336 (won by the taxpayer) it was held that five principles apply to pass the test of being a character appropriate to a farmhouse:

- history of the property
- comparable evidence
- house is, and was historically, the farmhouse connected to the agricultural land
- there was a farming business (profitability a factor, but not decisive)
- “man in street” approach

In Rosser v IRC SpC 368 (won by HMRC) further confusion arose in terms of being able to advise with the required level of certainty, and the character test from Section 115(2) IHTA1984 became under review.

Peter Twiddy is on record at a conference in stating that the following eight considerations should be applied, through the eyes of an educated rural layman:

- is the farmhouse of a character appropriate in size, content and layout to the agricultural land?
- is the farmhouse of a character appropriate in size, content and layout to the agricultural activities being conducted on the land?
- within the agricultural unit, does the land predominate?
- for how long has the land and house been associated, and is there a history of agricultural production?
- is this a house with land, or farmland with a farmhouse which is of an appropriate character?
- the "elephant test"
- all other relevant factors
- consider the matter in the round

The Land Tribunal subsequently had to decide what the agricultural value of the agricultural property was in the Antrobus case. As a basic rule a discount of 30% from open market value applies, being "what a working farmer would pay for it". The Tribunal made the following statements, which could be of wide importance:

- a lifestyle buyer could not usually occupy a property as a farmhouse
- a farmhouse was not only the place in which a farmer lives in order to farm the land – it must also be occupied by the farmer in order to farm the land on a day to day basis (Personal representatives of Rosemary Antrobus, deceased v Peter Twiddy)

Accordingly, on that basis most houses that are the management centres of fiscal farming operations cease to be farmhouses for APR purposes whether or not they are of a character appropriate to the farm.

In Annand and Others v HMRC SpC 565 the Commissioner came to the following conclusion as a review of the legal principles:

- A farmhouse is a dwelling for the farmer from which the farm is managed.
- The farmer of the land is the person who farms it on a day-to-day basis rather than the person who is in overall control of the agricultural business conducted on the land.
- The status of the occupier of the premises is not the test - the proper criterion is the purpose of the occupation.
- If the premises are extravagantly large for the purpose for which they are being used, or if they have been constructed upon some more elaborate and expensive scale, it may be that, notwithstanding the purpose of occupation, they should be treated as having been converted into something much more grand.

The decision as to whether a building is a farmhouse is a matter of fact to be decided on the circumstances of each case and must be judged in accordance with ordinary ideas and what is appropriate in size, content and layout, taken in conjunction with the farm buildings and the particular area of land being farmed.

Farmhouse of appropriate character to 16.29 acres of agricultural land? – Exors of Dennis Golding, deceased v HMRC TC01211

The farm was purchased in 1940, and subsequently the buildings were modernised and extended. The farmhouse was integral to the land farmed, but from the 1990s the farm income was not sufficient to live off.

The claim that the farmhouse was of an appropriate character to 16.29 acres of farmland was accepted by the tribunal on the following grounds:

- From the photos provided the state and condition of the property was such that it could only be acceptable as a farmhouse
- The kitchen was "spartan at best"
- There was no electricity in any of the bedrooms
- The bathroom was downstairs, which would be convenient for a farm worker
- An educated rural layman would regard the house as a farmhouse
- The lack of substantial profit was not surprising given the age of the deceased, but did not mean that the farmhouse was not "character appropriate"
- Nobody would purchase the working farm for any other purpose than to farm

The latest case on farmhouses is HMRC v Trustee of William Hanson 1957 Settlement UKUT0224. The farmhouse owned by the trust was occupied by the son of the settlor until the settlor's death. A claim for APR on the death was rejected by HMRC but they lost before the FTT and appealed to the UTT.

The settlor had lived in the house until 1978 when he and his wife had moved next door into a newly refurbished property. His eldest son moved into the farmhouse. This was a traditional route for the family, but no legal documentation supported the move which was simply a 'gentleman's agreement'.

HMRC argued that both occupation and ownership of land and farmhouse must be present before the farmhouse qualifies for APR, whereas in this case only ownership was present for the deceased. The family argued that the farmhouse was occupied by the person farming the land on a day to day basis and that should be enough to qualify.

The FTT held that the effect of Section 115(2) IHTA 1984 was that 'cottages, farm buildings and farmhouses must be of a character appropriate to agricultural land or pasture in the same occupation, but it is not required that the cottages, farm buildings and farmhouses should be in the same ownership as the agricultural land or pasture'. This was contrary to the Rosser decision.

The UTT accepted that there must be some nexus between the farmhouse and the agricultural land. The wording of Section 115(2) makes such a nexus explicit for woodland, but is silent in the parallel wording for farmhouses and other buildings.

HMRC had argued that if ownership is ignored in the test for nexus then an estate could be in a position to benefit from APR notwithstanding that it included no agricultural land whatsoever. Whilst the tribunal found this to be true, it did not undermine the purpose of the legislation.

The UTT agreed with the trustee that it is appropriate to look at the situation on the ground in order to establish the reality of the farming unit. A single farming unit is likely to be in a single occupation; hence occupation can be taken as a reliable touchstone for identifying 'the property' referred to in the relevant limb of Section 115. This reading was consistent with the scheme of the legislation and made a more natural construction than HMRC's. Whilst common occupation would not always and necessarily constitute a sufficient nexus, it did so here and the appeal of HMRC was dismissed.

Contributed by Gerry Hart

Scope of *Hastings-Bass* confirmed by Supreme Court (Lecture P785 – 13.37 minutes)

Pitt v HMRC; Futter v HMRC [2013] UKSC 26

The so-called *Hastings-Bass* rule, dating from a 1975 case, has been used by those having discretionary control over assets to unwind transactions that have had negative consequences of which they were not aware at the time of taking the decision to act. Over the years more and more cases have been brought seeking to use this doctrine, including where unexpected tax charges have arisen on beneficiaries. The doctrine has therefore become a bit of a 'Get Out of Jail Free' card for trustees over the years.

In the original 1975 case, the Court of Appeal held that it would not interfere with the exercise of a trustee's discretion, even if the transaction did not achieve the full effect that was intended, **unless** "...it is clear that the trustee would not have acted as he did

a) had he not taken into account considerations that he should not have taken into account, or
b) had he not failed to take into account considerations that he ought to have taken into account."

An example of where the trustees of a settlement subsequently used this doctrine successfully is the 2005 *Sieff* case, in which trustees appointed large amounts of chattels out of a discretionary trust, having been advised that no CGT charges need arise as gift relief claims under s.260 TCGA 1992 could be made jointly with the beneficiaries. The advice had overlooked the fact that gift relief is not available when appointments are made in the 3 months following any 10-year anniversary of the trust's creation; the appointments were made in such a 3-month period.

HMRC have pursued similar cases through the courts in recent years, with more success. The Supreme Court has recently reached a verdict in two important cases, the facts and history of which are as follows.

In *Futter*, the objective was to transfer assets out of a non-resident trust with stockpiled gains. Although this would incur a charge to CGT under s.87 TCGA 92, it was believed that the liability arising on the beneficiary would be covered by his personal CGT losses.

However, the premise on which the transfers were made was incorrect in that s.2(4) TCGA 1992 provides that allowable losses cannot be set off against gains attributed to beneficiaries in these circumstances. The trustees' solicitors had overlooked this provision when advising on the proposed operations.

The decision of the High Court was that the advancements were vitiated under the *Hastings Bass* rule and should be set aside.

The CoA allowed HMRC's appeal. As they had taken professional advice (even though the professional advice had turned out to be wrong), they had not been in breach of their fiduciary duties. The trustees' exercise of the power of advancement had been valid and there were no grounds for the court to intervene

The Supreme Court stated that the key issue was whether the trustees had failed in their duty to take relevant considerations into account. As they had taken professional advice, this was not the case. The appeal was therefore dismissed.

The facts in *Pitt* are as follows:

Mr Derek Pitt was very badly injured in a road accident in 1990, following which he received a structured settlement of a lump sum and monthly payments. Both were then settled into a discretionary trust, producing a sizeable IHT charge that could have been avoided if a disabled person's settlement had been created under s.89 IHTA 1984.

His widow acted for him under a power of attorney and argued that the trust would never have been established had she been aware of the tax rules that led to these charges.

The High Court had said that the settlement should be set aside under the Hastings-Bass rule, but the CoA had allowed HMRC's appeal, again on the grounds that there had been no breach of fiduciary duty in that professional advice had been taken.

The Supreme Court also dismissed the appeal in the Pitt case in that it failed on the Hastings-Bass rule.

There was a further issue to be considered in the *Pitt* case, namely whether there should be a rescission on the ground of mistake. A voluntary disposition could be set aside on the ground of equity where there had been a mistake which was, on an objective evaluation, sufficiently serious that it would be unconscionable or unfair to leave the mistake uncorrected. There would have been nothing artificial or abusive about Mrs Pitt's establishing the settlement so as to obtain protection under s.89. The hugely negative tax consequences deriving from this mistake warranted the transaction being set aside.

Going forward, it is clear that trustees and others acting in a discretionary capacity will not be able to rely on Hasting-Bass where they have taken professional advice.

If there are unwanted consequences (including unforeseen tax charges) from acting on that advice, they will need to bring an action against their advisors, unless (as in *Pitt*) they can argue that there has been a 'fundamental mistake'.

Contributed by Kevin Read

Administration

Overseas tax: whether enforceable in UK

The South Africa Revenue Service (SARS) obtained judgment for more than £200,000,000 (including penalties and interest) against a company (B) which was registered in the British Virgin Islands. SARS formed the opinion that B's assets had been transferred to another British Virgin Islands company (M), and that more than £7m of this money was held in a London bank account. SARS asked HMRC for help in recovering the amounts due, in accordance with art 25A of the double tax convention between the UK and South Africa. In February 2012, HMRC and SARS obtained freezing orders against B, M, and a Guernsey company (H), which was the registered holder of the shares in B and M. The companies appealed, and the Ch D allowed the appeal by H, but dismissed the appeals by B and M. B and M appealed to the CA, contending that FA 2006 s 173 should not be treated as having retrospective effect and that SARS' claim was unenforceable in the English courts.

Decision:

The CA unanimously rejected these contentions and dismissed the appeals. Lloyd Jones LJ held that the tax claims which HMRC and SARS were seeking to enforce fell within art 25A of the double tax convention, and that there was 'no unfairness in art 25A permitting the enforcement of pre-existing tax liabilities'. The tax enforcement arrangements were authorised by FA 2006 s 173.

Comments - The CA unanimously upheld HMRC's contention that the South African tax was recoverable in the UK. The case is also notable because the CA emphatically rejected contentions propounded in the book Mutual Assistance for the Recovery of Tax Claims by Dr Grau Ruiz (which the appellant companies had cited an authority), and because Jackson LJ criticised the skeleton arguments submitted by counsel for the companies, finding that they had failed to comply with practice directions 52A and 52C. He stated that 'any advocates who have cases pending in the Court of Appeal may care to review their skeleton arguments in the light of this judgment, bearing in mind the costs sanctions which are available to this court'.

Ben Nevis (Holdings) Ltd v HMRC (and related appeals) (CA)

Penalty reduced to 15% of tax

HMRC formed the opinion that a trader (C) who owned a garden centre, and also received rental income from several properties, had under-declared his income. They issued amendments to C's returns, and imposed penalties under TMA 1970 s 95, at the rate of 40% of the evaded tax.

Decision:

The FTT held that C had been negligent, finding that he 'was disorganised and simply failed to discharge the burden of showing us how he financed the apparent cash shortfall'. However, the tribunal reduced the penalties to 15% of the evaded tax (allowing abatements of 20% for disclosure, 30% for cooperation and 35% for seriousness).

Comments -The FTT upheld HMRC's contention that the appellant had been negligent, but significantly reduced the amount of the penalty, from 40% of the evaded tax to 15% of the evaded tax.

G Carter v HMRC (No 2) TC2661

Registration Penalty mitigated by 20%

An accountant registered for VAT in 1977 and deregistered in 1997, although he continued to practise. HMRC subsequently discovered that his turnover had exceeded the VAT threshold in the year ending 5 April 2004 and in each of the five subsequent years. They imposed a penalty under VATA 1994 s 67.

Decision:

The FTT upheld the penalty in principle, but mitigated it by 20% to take account of the fact that the appellant was aged over 80.

Comments - In most cases, an accountant who had failed to register for VAT for six years, in which his turnover had consistently exceeded the registration threshold, could expect little sympathy from HMRC or the tribunal. However, in this case Judge Gort mitigated the penalty by 20% to take account of the fact that the appellant was aged over 80.

Argent v HMRC TC2680

Company in liquidation: former directors requesting assignment of appeal

A company (G) sold its assets in 2004 and ceased trading. In 2008, it went into liquidation. In 2009, HMRC submitted a proof of debt for unpaid corporation tax for 2003 and 2004. In 2010, G's liquidator began proceedings against G's two former directors, alleging misfeasance. In 2012, HMRC issued discovery assessments on G, charging further corporation tax in respect of the disposal of G's assets. The liquidator appealed against these assessments, but subsequently indicated that he had 'doubts as to the merits of the substantive appeals'. The directors requested that the appeals should be assigned to them, and the liquidator applied to the Ch D for directions under Insolvency Act 1986, s 167(3).

Decision:

The Ch D held that the right to appeal could only be exercised by the liquidator and could not be assigned.

Comments - The Ch D held that the right of appeal against the corporation tax assessments could not be assigned to the company's former directors.

Williams v Glover & Pearson (re GP Aviation Group International Ltd) (Ch D)

Failure to make trust return: requirement for third party software

HMRC issued a trust and estate tax return to the trustee of a settlement in April 2011. HMRC received the completed return on 20 December 2011. They imposed a penalty of £100 under FA 2009 Sch 55. The trustee appealed, contending that the penalty was unfair because he had intended to file the return online, but did not have the appropriate software and considered that it was unreasonable to expect him to purchase third party software.

Decision:

The First-tier Tribunal rejected this contention and dismissed the appeal, applying the principles laid down in Peck & Wilson v HMRC [2011] UKFTT 859 (TC), TC01693.

Comments - The First-tier Tribunal upheld HMRC's view that it was not unreasonable to expect the trustee to obtain the requisite software to enable him to submit the outstanding return.

Trustee of the Georgia Vickery, Franki and Mia Settlement v HMRC TC2688

Suspension of surcharges: deferred payment agreement

A married couple appealed against surcharges relating to a substantial CGT liability, contending that they had been seeking to raise funds by selling shares and had requested a deferred payment agreement.

Decision:

The First-tier Tribunal accepted their evidence and allowed their appeals. Sir Stephen Oliver found that HMRC had received the couple's application but had failed to reach a decision, and that the couple had 'had reasonable grounds for expecting that a time to pay agreement would be reached'.

Comments - FA 2009 s 108 provides for the suspension of surcharges where there is a deferred payment agreement. The First-tier Tribunal held that, since HMRC had failed to respond to the appellants' application for such an agreement, they had a reasonable excuse for not paying the tax by the due date.

G & Mrs L Kofteros v HMRC TC2692

VAT: amount of penalty

An association made significant under-declarations of output tax in three successive returns. It notified HMRC of the errors after HMRC had arranged a visit to inspect its records. HMRC imposed penalties under FA 2007 Sch 24, calculated at the rate of 15% of the potential lost revenue.

Decision:
The First-tier Tribunal dismissed the association's appeal. Judge Poole observed that, since the errors were not notified until after HMRC had arranged an inspection visit, the disclosure was a 'prompted' disclosure within Sch 24 para 9(2)(a), so that 15% was the statutory minimum penalty.

Comments - The First-tier Tribunal upheld HMRC's imposition of penalties at the rate of 15% of the potential lost revenue.

United European Gastroenterology Federation v HMRC TC2698

Surcharges: reasonable excuse

HMRC began an enquiry into the 2009/10 return submitted by a trader (S) who owned a yacht chartering business. While the enquiry was in progress, HMRC issued a protective estimated assessment for 2007/08. S did not pay the tax charged by the assessment, and HMRC imposed a surcharge, against which S appealed.

Decision:
The First-tier Tribunal allowed his appeal. Judge Redston observed that, since the tax liability had not been finalised, S could have applied for postponement of the tax, and held that the circumstances constituted a reasonable excuse.

Comments - The First-tier Tribunal held that, since the tax liability had not been finalised, the appellant had a reasonable excuse for not paying the tax which HMRC had assessed.

A Salmon v HMRC TC2711

Penalty imposed at 50%

HMRC formed the opinion that a company director (D) had failed to declare benefits and had underdeclared other income. They issued assessments (and amendments to D's self-assessments), and imposed penalties at the rate of 50% of the tax allegedly evaded. D appealed.

Decision:
The First-tier Tribunal reviewed the evidence in detail and upheld the assessments in principle but reduced them in amount. The tribunal upheld the imposition of penalties at 50% in respect of the majority of the undeclared income and benefits (but directed that the penalty relating to the use of a motorboat should be reduced to 45% of the evaded tax, and that the penalty relating to the CGT due on the sale of a flat should be reduced to 35% of the evaded tax).

Comments - The First-tier Tribunal upheld HMRC's imposition of penalties at the rate of 50% of the evaded tax.

S Denny v HMRC TC2714

Human frailty acknowledged

The taxpayer submitted his 2009/10 self-assessment tax return online on 31 January 2011. In so doing, he made an error at box 12 “losses used against income” of the capital gains summary by showing a figure of £20,595, which he also entered in box 5 “losses brought forward and used in the year”. This generated a tax overpayment of £7,981.

HMRC reviewed the return and discovered the mistake. They told the taxpayer that the claim to set his losses against income was incorrect because the losses had already been set against capital gains. As result, the taxpayer underpaid tax of £8,238 which he immediately repaid.

The inspector decided the inaccuracy constituted carelessness on the part of the taxpayer and imposed a penalty of £1,235.70, ie 15% of the underpaid tax. The taxpayer appealed, saying the penalty was excessive. He had made a genuine mistake: he said the return was misleading and he should not be expected to read through pages of tax guidance to understand it. Furthermore he had been abroad for ten years and this was the first return he had submitted online.

Decision:

The First-tier Tribunal found the taxpayer to be honest and sincere. The judge agreed that he had taken reasonable care in completing his tax return and had not been careless. His mistake had been understandable.

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

Comments – This case demonstrates a number of aspects of tax – the complexity of principles and interaction of different provisions, the importance of the integrity displayed and evidence thereof. It is one of the aspects of a just system that the Tribunal takes into account the circumstances and facts of a taxpayer.

D Jones v HMRC TC2663

Notice of objection to witness statements: whether UT entitled to overturn FTT decision

A company (E) reclaimed input tax of more than £1m on the purchase of a large number of mobile telephones. HMRC rejected the claim on the basis that the transactions formed part of an MTIC fraud, and E appealed. HMRC applied for several witness statements to be admitted in evidence. E objected to some of the statements.

The First-tier Tribunal directed that statements by two of HMRC's witnesses should be excluded.

HMRC appealed to the Upper Tribunal, which upheld the First-tier decision in respect of one of the witnesses.

Judge Bishopp observed that 'this was evidence HMRC wished to put in after the expiry of the time limit imposed by tribunal directions, already extended several times, and when they knew that an application for permission would be necessary. A litigant wishing to put in late evidence has a duty to make the application promptly and, in a case such as this where the evidence is being compiled, to forewarn his opponent: it is not a case in which doing so would undermine the purpose of the evidence. HMRC did not forewarn, and took an unexplained amount of time to produce the evidence.' However Judge Bishopp allowed HMRC's appeal in respect of their other witness, whose statement related to the conviction of one of the people involved in the transactions on two counts of conspiracy to cheat the revenue. Applying the principles laid down by Lightman J in Mobile Export 365 Ltd v HMRC [2007] STC 1794, 'the presumption must be that all relevant evidence should be admitted unless there is a compelling reason to the contrary'. E appealed to the CA.

Decision:

The CA unanimously upheld Judge Bishopp's decision. Arden LJ observed that the statement was 'relevant to explicate the convictions', and that 'HMRC would be prejudiced by its exclusion'.

Comments - The CA unanimously upheld the Upper Tribunal decision that, in the circumstances of the case, the First-tier Tribunal had erred in law in declining to admit evidence relating to the criminal conviction of one of the people involved in the relevant transactions.

Atlantic Electronics Ltd v HMRC (No. 4) (CA)

Taxpayer's evidence preferred

The taxpayer, CED Ltd, appealed against a penalty of £22,735 charged for failing to submit the monthly PAYE payments on time for months one to nine and month 11 in 2010/2011.

HMRC claimed that these payments had been between two and five days late. Their evidence included pages with photocopies of the cheque for the PAYE tax for the relevant periods, with “processing date” at the top of each page. Most cheques had their processing date falling between two and five days after the due date and were signed by the financial director of CED.

HMRC presented the First-tier Tribunal with an internal record of a letter sent to the taxpayer, warning that further late payments may incur a penalty. CED had paid late only once at this point. At the hearing, CED's financial director said he was not aware of this letter.

The director demonstrated that he had a system in place where he would post the cheques on the day before the due date, unless it fell on a weekend or a bank holiday, in which case he would send them on the last working day.

The Royal Mail's published aim is to deliver 93% of first class mail on the next day. The tribunal recognised that the taxpayer had no reason to doubt that first class post would not be delivered to the tax office the next day.

The tribunal also recognised that the financial director did not seem to be careless and that the warning letter of 29 May 2010 did not appear to have been passed on to him, if it was received by the taxpayer at all.

Decision:

The tribunal decided not to accept HMRC's evidence, on the basis that the usual procedure of the department was to note the date of receipt of cheques and not the date of processing.

The taxpayer's appeal was allowed.

Comments – This is another case where filing is left to the vagaries' of the UK postal system. The director had a system albeit that he was "cutting it fine". He was fortunate as the Tribunal focused on the deficiency in the HMRC system. It is always better to aim to file ahead of the deadline rather than having to argue the toss in the Tribunal.

CED Ltd v HMRC TC2633

No power to quash penalty

The taxpayer decided that, because of cash flow problems, during 2010/11 it would pay the employees and delay making PAYE payments to HMRC. The director of the company confirmed that it had entered into time-to-pay arrangements for previous periods, although not for the year in question.

HMRC charged penalties for the late PAYE. The taxpayer appealed. The director said he had not had reasonable notice that penalties would be charged, only that they may be charged. The penalties were notified 17 months after they had arisen which, the director said, meant they were imposed retrospectively and not in a timely way. HMRC should notify taxpayers during the relevant period, not many months later. He did not say there was a reasonable excuse for the late payment.

Decision:

The First-tier Tribunal, while sympathising with the taxpayer's predicament, said that in light of the Upper Tribunal's decision in Hok, it had no jurisdiction to deal with the taxpayer's complaints because they related to administrative law. The First-tier Tribunal had no power to adjust or cancel a penalty because it was perceived to be unfair, as was the basis of the taxpayer's argument.

The taxpayer's appeal was dismissed.

Comments –The comments in the decision are self-explanatory.

Kudos v HMRC TC2660

Obligations fulfilled

The taxpayer, a two-partner firm with two employees, was late filing its employer's annual return for 2010/11. HMRC imposed a penalty against which the taxpayer appealed.

Speaking on behalf of one of the partners, C explained that one of the partners had been very ill, the business was suffering financially and had ceased trading in December 2010. When the business closed, the partners made its employee returns and paid all outstanding business and employee tax. They also informed HMRC about the closure. C said that it had not occurred to the partners that, even though they had already complied with their tax obligations, they would still have to file an end-of-year return. Once they did realise a return was required, they filed it immediately.

Decision:

The First-tier Tribunal accepted that the partnership had a reasonable excuse for the late filed return. The partners had acted “quite properly” with regard to their responsibilities when they closed the business and it was “not unreasonable for the partners to have then concluded that their obligations to HMRC were over”.

The taxpayer's appeal was allowed.

Comments – Lady Judith Mitting as Tribunal judge described succinctly in 4 paragraphs in total the case above and again demonstrated how the Tribunal will treat taxpayers who have behaved properly and have a reasonable excuse in the Tribunal’s opinion.

Hott Joint Carvery v HMRC TC2644

Gift Aid with no real gift - update

The Gift Aid rules allow charities to claim a repayment of tax on qualifying donations of money by individuals. Donors who pay higher and additional rates of tax can claim tax relief on the difference between their marginal rate of tax and the basic rate of tax.

Project 2010 is a scheme designed to exploit these rules and the previous spotlight on 'Gift Aid with no real gift' explained how avoidance schemes like Project 2010 were structured. HMRC said that they would challenge the use of this scheme and would litigate where appropriate.

HMRC is now preparing to take legal action, but will first contact the remaining users of this scheme to invite them to reconsider their position and let HMRC know if they wish to withdraw their claims.

Spotlight 9: Gift Aid with no real gift (29 March 2010)

An avoidance scheme exploiting the Gift Aid provisions has recently been disclosed to HM Revenue & Customs (HMRC).

The scheme seeks to exploit the rules which enable a charity to claim a repayment of tax at the basic rate on a qualifying donation by an individual. The individual may claim relief for the donation on the difference between the higher and basic rates of tax.

The scheme depends upon a circular series of payments. It starts with the charity purchasing, say, gilts of £100,000 which pass through a third party to an individual taxpayer for perhaps £10. The taxpayer is expected to make a sale for £100,000 and pass the money to the charity. There is an option that ensures the gilts will be returned to the charity if it does not receive a cash gift of £100,000 within one or two days.

HMRC do not accept that the charity is entitled to a repayment of tax or that Gift Aid relief is due to the individual. In HMRC's view a gift has not been made to the charity as it is no better off than before entering the arrangements. Therefore Gift Aid is not due.

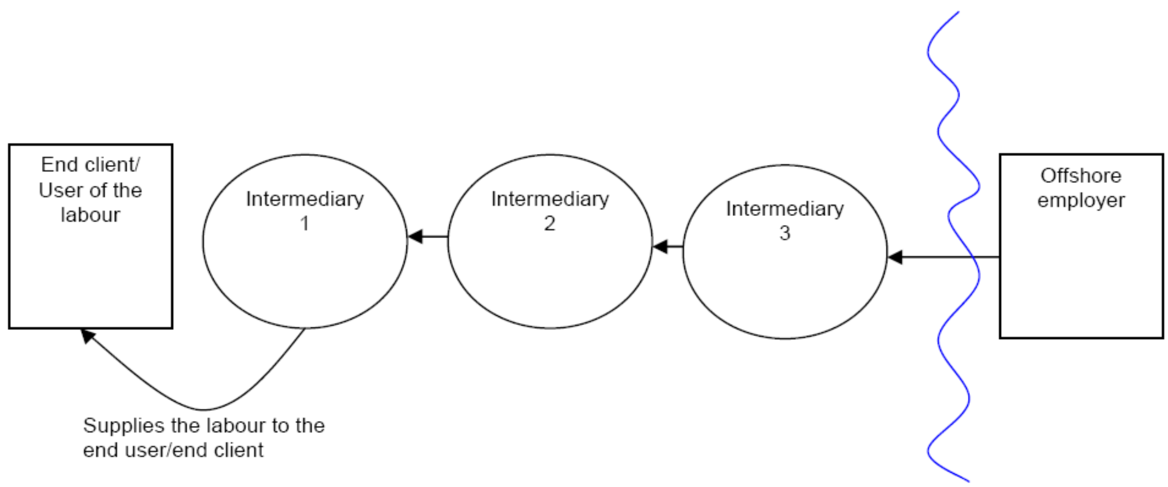
HMRC will challenge the reliefs claimed in any instances where this scheme has been used and will litigate where appropriate.

Consultation document on offshore employment intermediaries.

A consultation paper has been published on offshore employment intermediaries.

The basic issue is illustrated as follows:

Offshore Employment Structure



This consultation is in two parts. The first is a technical consultation on creating employment obligations on offshore employers and, in the case of a default moving these obligations to an onshore engager of the labour. The second is a policy consultation on the associated record keeping and filing requirements.

Making the offshore employer the secondary contributor

The plan is to make the offshore employer the secondary contributor, responsible for accounting for income tax, NICs and student loan deductions through the RTI system. This means that for tax and NICs, they will have all of the usual obligations of a UK based employer.
The requirements will apply equally to office-holders as they do for employees.

Default by the offshore employer

If the offshore employer defaults on any of its tax and NICs obligations for a 3-month period commencing from the first day of employment of the worker then the responsibility for meeting the obligations in respect of that worker will move to Intermediary 1.

Intermediary 1 is defined as the business that contracts directly with the end client to provide the worker's labour or for provision of service that includes the supply of labour. The intention is to catch composite services where part of that service includes the supply of labour to ensure that the new obligation cannot be sidestepped through the use of a composite service contract.

Intermediary 1 will record where the workers provided to the end client come from and how they are ultimately paid. If Intermediary 1 defaults because of insolvency or bankruptcy, the historic debt and prospective employer obligations will move to the end client.

However, the charge will not move to the end client where they are an individual who is not making use of the labour or services including the provision of labour as part of carrying on a trade or profession. So where services are provide to an individual for private, not business, purposes the charge will not move.

Contributed by Tony Jenkins

Withdrawing notices to file self-assessment returns (Lecture P781 – 11.31 minutes)

Background

For tax years prior to changes introduced in this year's Finance Bill, HMRC has no express statutory power to rescind a tax return filing notice. There is no right of appeal against a filing notice issued by HMRC. The recipient of a filing notice is therefore strictly obliged to submit a completed return, or face late filing penalties.

Filing an unnecessary return can be a frustrating and time consuming exercise for that person, or potentially costly in terms of professional fees for an agent. HMRC would probably also prefer not to deal with the additional administration caused by such returns, given its shortage of resources.

The legislation

The legislation concerning notices to file personal tax returns for individuals is in TMA 1970, s 8. There are corresponding provisions for trustees (s 8A) and for partnerships (s 12AA).

These provisions broadly allow HMRC to issue a notice to file a tax return within statutory time limits, where it considers that a return is necessary.

Pre-Finance Bill position

Whilst HMRC previously had no express statutory power to rescind a tax return filing notice, TMA 1970, s 1 ('Responsibility for certain taxes') states:

'The Commissioners for Her Majesty's Revenue and Customs shall be responsible for the collection and management of—

(a) income tax,

(b) corporation tax, and

(c) capital gains tax.'

In February 2012, HMRC started inviting individuals who had received a notice to file a self-assessment return, but did not think they should be within self-assessment, to contact them. If HMRC agreed that the return was unnecessary, the filing notice was withdrawn using the above discretionary powers, and any late filing penalty was cancelled under 'special reduction' provisions (FA 2009, Sch 55, para 16).

Finance Bill changes

Legislation was introduced in Finance Bill 2013 to provide HMRC with a power to withdraw a notice to file a self-assessment return for individuals, trustees and partnerships in certain circumstances. It applies to filing notices for 2012/13 and later tax years (or, for partnerships which include one or more companies, in respect of a relevant period beginning on or after 6 April 2012). The new legislation also provides for late filing penalties to be cancelled if HMRC uses its power to withdraw a filing notice.

Points to note

The recipient of a tax return filing notice must request HMRC to withdraw the notice. The request must be made during a statutory withdrawal period.

For individuals and trustees, this 'withdrawal period' is two years from the end of the tax year to which the filing notice relates (or possibly longer at HMRC's discretion in exceptional circumstances). For the partner of a partnership which includes one or more companies, the normal 'withdrawal period' is two years from the end of the period in respect of which the filing notice was required (or longer in exceptional circumstances).

If HMRC accepts the request, a withdrawal notice will be issued specifying the date on which the filing notice is withdrawn. However, this does not prevent HMRC from later issuing a further filing notice for the same tax year, if necessary.

Late filing penalties may have been incurred as a result of HMRC having issued a filing notice. If a request by an individual or trustee for the filing notice to be withdrawn is successful, HMRC's withdrawal notice may cancel the late filing penalty as well.

There are consequential changes to the statutory requirement to notify chargeability to income tax and capital gains tax (TMA 1970, s 7), and also the penalty provisions for failure to notify (FA 2008, Sch 41) and the late payment interest charge provisions (FA 2009, Sch 53), broadly to deal with the position where a tax return notice has been issued and withdrawn, but a tax return is subsequently necessary.

[Note: the above is based on legislation as published in this year's Finance Bill, and is subject to possible amendment prior to Royal Assent.]

Contributed by Mark McLaughlin

RTI current developments (Lecture B784 – 6.30 minutes)

Annual schemes

The annual scheme process with HMRC is somewhat tortuous at present. If you are able to register a scheme as annual – see the conditions below – you will find that you will need to file nil EPS or inactivity reports for the moment, until there is an update to the computer system.

Once the software is fixed the scheme can then move to file one FPS only in the month in which the employees are paid. If in the interim you have filed monthly FPS showing monthly salary you will not be permitted to register the scheme as annual.

Requirements to register as an annual scheme

An annual scheme must meet all of the following requirements:

- all the employees are paid annually
- all the employees are paid at the same time/same date
- the employer is only required to pay HMRC annually

Submitting Employer Payment Summaries

Once a business is registered as an annual scheme, an Employer Payment Summary (EPS) is not required for the 11 months of the tax year where no payments are made to the employees. HMRC's debt management system will already have a record of the month the employer is due to pay, based on payments in previous years. This information has been transferred to a new accounting system and is recorded as the annual payment/filing month.

If an existing annual employer changes the date/month of payment to the employee(s), they should complete a Full Payment Submission (FPS) for the month that the payment is made to the employee(s). On receipt of the FPS HMRC's systems will change the annual payment/filing month over to that month.

Looking forward to 2014

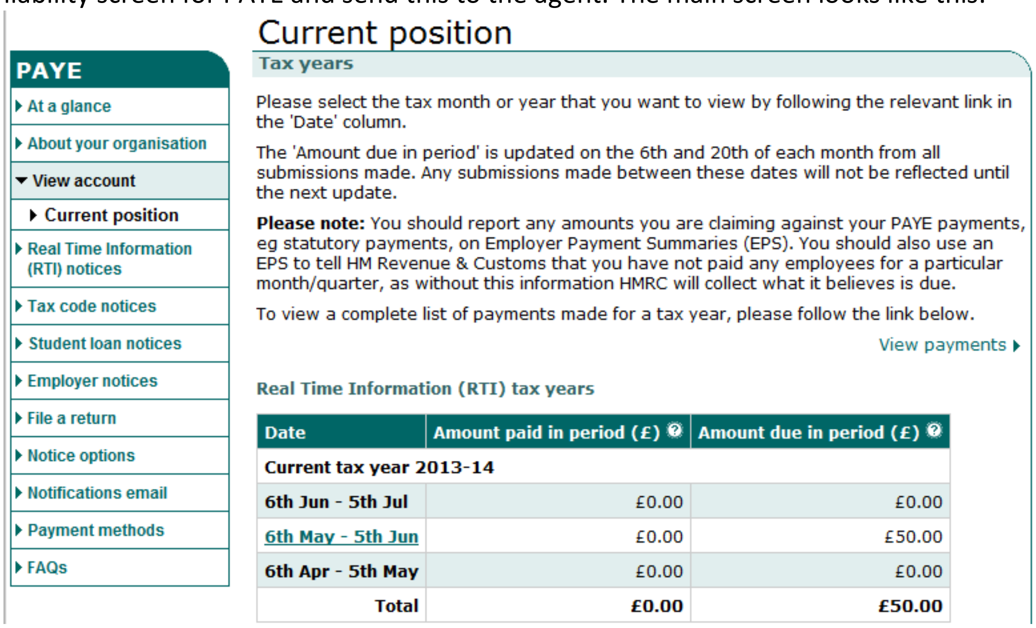
Those schemes which you have not been able to register as annual for the current year may wish to move to annual payment in future – particularly director only schemes. In that case, you could start preparing towards the end of the current tax year to allow time for any delays in registration.

Payments reconciliations

There are a number of reports coming through that employers are having difficulty reconciling the amounts that they believe are due for any tax month with the amounts shown by HMRC's debt management (DMB) system. This is normally due to the dates used on the RTI submissions and potential mis-matches, particularly for the weekly paid where occasionally a weekly payroll run is allocated to a different tax month by HMRC's DMB system to that used by the employer.

For agents, dealing with differences in the tax and NIC due is exacerbated by the dearth of information. Only the client can access the business tax dashboard which shows the amount due to HMRC. Without access to this information, the agent is pretty much working in the dark. Information of this nature will become available to agents as part of the agent strategy programme, but that will not be delivered in the current tax year.

One solution is for clients who can access HMRC's systems to log on and print out the payment and liability screen for PAYE and send this to the agent. The main screen looks like this:



PAYE
- At a glance
- About your organisation
- View account
  - Current position
- Real Time Information (RTI) notices
- Tax code notices
- Student loan notices
- Employer notices
- File a return
- Notice options
- Notifications email
- Payment methods
- FAQs

Current position

Tax years

Please select the tax month or year that you want to view by following the relevant link in the 'Date' column.

The 'Amount due in period' is updated on the 6th and 20th of each month from all submissions made. Any submissions made between these dates will not be reflected until the next update.

Please note: You should report any amounts you are claiming against your PAYE payments, eg statutory payments, on Employer Payment Summaries (EPS). You should also use an EPS to tell HM Revenue & Customs that you have not paid any employees for a particular month/quarter, as without this information HMRC will collect what it believes is due.

To view a complete list of payments made for a tax year, please follow the link below.

View payments

Real Time Information (RTI) tax years

Date	Amount paid in period (£)	Amount due in period (£)
Current tax year 2013-14		
6th Jun - 5th Jul	£0.00	£0.00
6th May - 5th Jun	£0.00	£50.00
6th Apr - 5th May	£0.00	£0.00
Total	**£0.00**	**£50.00**

Further information about payments made can be found by clicking the link on the right "View payments". However, be aware that the screen is not updated in real time, so for this employer, the payment made to an employee on 30 June and filed under RTI on 28 June is not yet shown as the screen shot was taken at 1 July.

Easement for small businesses

The easement allowing employers with no more than 49 employees to report their payments on the next payroll run but at least monthly has now been extended to cover the whole of the 2013/14 tax year. During that time, HMRC will work with employer representatives to establish the precise impact of RTI on employers, and in particular, the smallest employers.

HMRC is adamant that the easement in this form will come to an end on 5 April 2014, but it is hoped that some leeway can be negotiated for the very smallest employers.

Employers not yet filing under RTI

HMRC is now seeking to address those employers who have not yet started reporting under RTI. This may produce an increased level of contact from businesses which do not presently have an agent for payroll, so firms would do well to consider their response.

Contributed by Rebecca Benneyworth

Business Taxation

Effect on future trade

The taxpayer, a roofing contractor, appealed against a decision by HMRC to cancel his gross payment status under the construction industry scheme. The reason for removing his status was because the taxpayer had not paid his self-assessment tax for 2010/11 on time and thus failed the compliance test.

The taxpayer said he had been working away from home and "simply overlooked making the payment sooner". He accepted that this was not a reasonable excuse but said that, because he was subject to an individual voluntary arrangement (IVA), the withdrawal of gross payment status would probably lead to his bankruptcy and to the necessity of laying off the subcontractors he employed.

HMRC replied that the taxpayer could continue working in the construction industry without the gross payment status and said the "possible effect on future trade is not relevant".

Decision:

The First-tier Tribunal was concerned that HMRC had not referred the tribunal to all the authorities that might be relevant to the case. The judge said that, although the failure to do that was "not, to borrow a phrase from the penalty regime of FA 2007, Sch 24 'deliberate' … it may well have been careless". He said that in future, care should be taken to "ensure that all relevant authorities (including those that do not assist the case advanced by HMRC) are brought to the attention of the tribunal".

Moving on to the case in hand, the tribunal noted that HMRC had discretion to withdraw gross payment status even where the compliance test had been breached. Thus the tribunal had the power to review their decision to cancel because HMRC's discretion arose from the relevant legislation. It was not a judicial review function.

In this instance, the Revenue had not considered the effect that withdrawing gross payment status would have on the taxpayer's future trade, even though this was a relevant factor. The tribunal concluded that this was the wrong decision in law. The taxpayer's appeal was allowed.

Comments – The loss of gross payment status to organisations in the Construction Industry can have dire consequences. Therefore the law sets outs circumstances where discretion or special treatment should occur. HMRC had not considered the effect that withdrawing gross payment status would have on the taxpayer's future trade, even though this was a relevant factor. The tribunal concluded that this was the wrong decision in law.

John Kerr Roofing Contractors (TC2564)

Series of blows

A self-employed plastering contractor held gross payment status under the construction industry scheme. An HMRC review found that he had made several late payments of PAYE tax as well as paying his own self-assessment tax late. Explaining the reasons for the delayed tax payments, the taxpayer said his young daughter had died suddenly in 2011. In addition, one of the companies for which he worked had gone insolvent owing him money, and another customer had not paid for an extension on which the taxpayer had worked. This led to the bank reducing his overdraft facility by half.

The taxpayer and his wife called HMRC's business support service several times to discuss the tax payments due, but received no help. He later entered an individual voluntary arrangement (IVA).

HMRC said that insufficiency of funds was not an excuse and withdrew gross payment status. They said it was not possible for them to consider the consequences for the taxpayer of so doing.

The taxpayer appealed.

Decision:

The First-tier Tribunal concluded that the taxpayer had reasonable excuse for the late payments of tax. He had acted as a reasonably competent businessman in the circumstances. He could not have foreseen the chain of events causing him to default on his tax payments and his tax record before the problems arose had been good.

The taxpayer's appeal was allowed.

Comments – Another case where the loss of gross payment status had to be reviewed by the Tribunal and again a case where the Tribunal overturned the decision of HMRC.

T Daniel (TC2565)

Dealing with clients previously on the cash basis

Introduction

The main impact of the cash basis on professional firms will therefore be when a firm is engaged by an existing business which has previously used the cash basis of accounting. At some point the firm may decide (or it may be necessary) top switch to the conventional accounting basis.

Transitional provisions

The transitional provisions for the cash to accrual basis already exist – there are standard provisions to deal with any change of accounting basis in ITTOIA 2005. (Chapter 17 : ss 226 – 240).

However, these provisions are used infrequently, and were last of major import when service providers (including accountancy firms) were required to account for unbilled services at the year end by UITF 40.

The basic principles of the transitional rules are that:

(a) Receipts are taxed once and once only;
(b) Payments are deducted once and once only.

The provisions of Chapter 17 ITTOIA 2005 in relation to adjustment income in relation to accruals accounts, apply equally to the cash basis. Those provisions are designed to ensure that paragraphs (a) and (b) above are met. They are also designed to prevent abuse by moving from one basis to another to avoid income being taxed, or enable double relief for expenses.

Adjustment income – general principles

As indicated above, the rules on changing accounting policies in general have been applied to changing to and from the cash accounting basis to accruals accounting. This has been done by the introduction of new S 227A ITTOIA 2005. This section applies chapter 7 of ITTOIA to the cash basis if:

(a) An election has been made for the cash basis for the current tax year but not for the following one i.e. a business leaving the cash scheme; or
(b) No such election was made for a tax year but one has effect for the following tax year i.e. a business joining the scheme.

The general approach to such changes as in S 228 requires an amount by way of adjustment to be calculated in accordance with S 231 and

(a) If this adjustment is ***positive***, it is referred to as "***adjustment income***" and is charged to tax as if it arose on the ***last*** day of the year (in the case of the cash basis, on the last day of the basis period).
(b) If the adjustment is ***negative***, it is an "***adjustment expense***" and is treated as an expense of the trade arising on the ***last*** day of the first period in which the new basis is adopted.

However, when the adjustment income arises on leaving the cash basis, it is spread over the subsequent 6 years under s 238. It is possible to elect to accelerate this adjustment income charge under s 239 as a result of which the remaining adjustment income is spread evenly over the remaining period.

Calculation of the adjustment income / expense

S 231 requires the amount of the adjustment to be calculated using a step approach as follows:

Step 1 Add together any amounts representing the extent to which, comparing the two bases, profits were understated (or losses overstated) on the old basis

- Receipts which on the new basis would have been brought into account in calculating the profits of a period of account before the change, so far as they were not so brought into account;
- Expenses which on the new basis fall to be brought into account in calculating the profits of a period of account after the change, so far as they were brought into account in calculating the profits of a period before the change;
- Deductions in respect of opening trading stock or opening work-in-progress in the first period of account on the new basis so far as they:
  - Are not matched by credits in respect of closing trading stock or closing work in progress in the last period of account before the change, or
  - Are calculated on a different basis that if used to calculate those credits would have given a higher figure.
- Amounts recognised for accounting purposes in respect of depreciation in the last period of account before the change, so far as they were not the subject of an adjustment for income tax purposes, where such an adjustment would be required on the new basis.

Step 2 Then deduct any amounts representing the extent to which, comparing the two bases, profits were overstated (or losses understated) on the old basis:

- Receipts which were brought into account in a period of account before the change, so far as they would not have been so brought into account if the profits had been calculated on the new basis;
- Expenses which were not brought into account in calculating the profits of a period of account before the change, so far as they:
  - Would have been brought into account for a period of account before the change if the profits had been calculated on the new basis, and
  - Would have been brought into account for a period after the change, if the profits had continued to be calculated on the old basis.
- Credits in respect of closing trading stock or closing work-in-progress in the last period of account before the change so far as they:
  - Are not matched by deductions in respect of opening trading stock or opening work in progress in the first period of account on the new basis, or
  - Are calculated on a different basis that if used to calculate those deductions would have given a lower figure

An amount so deducted may not be deducted again in calculating the profits of a period of account.

The net effect of step 1 and 2 is the adjustment income or expense.

Example

Peter has been using the cash basis for a couple of years but his receipts in 2015/16 have now hit £200,000 and he is no longer eligible to use the cash basis. At 5th April 2015 there were £30,000 of sales and debtors which had not been included within his tax returns for 2014/15.

The starting point for the 2015/16 tax computation will be GAAP accounts. In the GAAP accounts to 5th April 2016, he will not include the £30,000 of sales made in the year to 5th April 2015, because under GAAP his turnover will be from 6th April 2015 to 5th April 2016.

This £30,000 is therefore, "receipts which on the new basis would have been brought into account in calculating the profit of a period of account before the change insofar as they were not brought into account". They are required to be included in step 1 in the calculation of the adjustment.

If that is the only adjustment, adjustment income is £30,000 and is spread over 6 years i.e. £5,000 per annum is added to the taxable trading profit.

Peter can elect for an additional amount of adjustment income to be treated as income for 2015/16, or for any subsequent year of the six year period. He must make that election on or before the first anniversary of the normal self-assessment filing date for that year.

Imagine that Peter wishes to include an additional £4,000 adjustment income (in addition to the standard amount of £5,000) income in 2018/19.

The adjustment income will therefore be taxed as follows :

Adjustment income	*30,000*
Taxed in 2015/16	*(5,000)*
Taxed in 2016/17	*(5,000)*
Taxed in 2017/18	*(5,000)*
Taxed in 2018/19	*(9,000)*
Balance	*6,000*
Taxed in 2019/20	*(3,000)*
Taxed in 2020/21	*(3,000)*

Transitional adjustments for capital allowances

Transitional arrangements are also required in relation to capital allowances. The basis of the arrangements need to ensure that:

(a) Before entering the cash basis an existing business will have been eligible to claim capital allowances.
(b) Capital allowance may not be claimed whilst electing for the cash basis.
(c) After leaving the cash basis capital allowance can be claimed.

New chapter 17A ITTOIA 2005 provides for adjustments for capital allowances.

Leaving the cash accounting scheme

New S66A provides that on leaving the cash basis any unrelieved qualifying expenditure can be allocated to a new capital allowances pool in the subsequent chargeable period.

The intention is that where an asset has been acquired but has not been fully paid for, such as under a hire purchase agreement, the amount still unpaid can be allocated to an appropriate pool when leaving the cash basis.

Where someone on a cash basis elected to claim actual costs for business motoring plus capital allowances, the capital allowances will continue undisturbed.

Contributed by Rebecca Benneyworth

Consultation Document on Corporate Debt and Derivative Contracts

A consultation document has been published about modernising the rules governing the taxation of loan relationships and derivative contracts.

The tax regime for loan relationships was originally introduced in 1996, and the derivative contracts rules followed in 2002 with many subsequent changes. Changes will be introduced over two years, in 2014 and 2015, with the most significant structural changes in 2015.

There is to be no wholesale departure from the present approach to the taxation of loans and derivatives, for example, there is no change to the basic principle of providing tax relief for interest payable. However the proposals do include some significant changes to the structure and detailed rules of the current regime.

Purpose and scope

It is intended to articulate more clearly the purpose and scope of the regime, and in particular, to clarify the role to be played by a company's financial statements in identifying and quantifying taxable amounts. Although accountancy will very often give an appropriate outcome for tax purposes, the tax regime will sometimes need to take a different approach, to ensure that the full amount of the profits, gains and losses from loan relationships and derivative contracts are brought into tax. The intention is that the tax regime should be clearer as to when taxation is to depart from the accounting treatment.
It is proposed that the loan relationship and derivative contract regimes should be based on amounts recognised in profit or loss in a company's accounts, in line with the normal approach to calculating taxable profits. By contrast, the current tax rules recognise amounts appearing anywhere in the accounts.

A single code

There may be merit in combining the separate regimes for loan relationships and derivative contracts into a single code to reduce the length of the legislation and eliminate unintended discrepancies. The document makes no firm proposal, but invites views on the extent to which the benefits of amalgamation would justify the inevitable transitional disruption.

Connected party debt
Views are sought on the appropriate tax treatment of connected party debt and transfers of debt around a group, and options are presented on these. The general approach is to question the extent to which special rules, departing from the accounting treatment, are necessary.

Foreign exchange and hedging

A substantial overhaul of the approach to the taxation of foreign exchange and hedging relationships is proposed. Generally, only forex movements in respect of loans and derivatives held for trading or property business purposes would be taxed or relieved. Other forex movements would only be brought into account in prescribed circumstances, principally in the context of hedging relationships. As a result, it is envisaged that the Disregard Regulations could be substantially repealed.

Partnerships
Proposals are made with a view to ensuring that the tax outcome from loan relationships and derivative contracts held through a partnership is in line with the result had each corporate partner held the appropriate proportion of the instruments directly. They also address the consequences which follow from this where there is a change in the partners' interests.

Debt restructuring
Proposals are made regarding the tax treatment of restructuring of debt, in particular where a debt is released in exchange for shares issued by the debtor. At present, where debt is released in these circumstances, the debtor is exempted from tax on the accounting credit arising. It is proposed to link this exemption explicitly to debt releases made in a 'corporate rescue' where the debtor is at risk of insolvency.

Compound and hybrid instruments
The current tax treatment of compound or 'hybrid' instruments, such as debt which is convertible to equity, and of instruments which include an embedded derivative, is to mirror the accounting approach by treating each component as if it were a separate instrument. As a result of anticipated changes to the accounting for such instruments, many of the special tax rules for particular instruments may become redundant. It is now proposed to repeal a number of these rules so as to simply tax (on an income basis) holders of such instruments on the profits, gains and losses arising.

Index-linked gilts
The Government is inviting comments on how the relief in respect of increases in the value of index-linked gilts attributable to inflation could be better targeted.

Bond funds
It is proposed that the current rules governing the taxation of corporate investors in certain collective investment schemes which hold primarily debt and derivative-type assets (bond funds) should be repealed. The purpose of these complex rules is to counter tax avoidance, and the proposal is to replace them with a more closely-targeted rule, perhaps including a test of purpose, so that only tax-motivated transactions would be affected. Particular rules would however be needed for offshore funds.

Anti-avoidance
Comments are invited on anti-avoidance provisions which will be effective without impacting unnecessarily on genuine commercial activity where there is no tax-avoidance motivation. Two elements are proposed:

- To replace the existing patchwork of highly specific anti-avoidance rules dealing with aspects of the loan relationships and derivative contracts regime with a single provision covering the whole code to prevent manipulation and exploitation of the rules. This would include a test of purpose and, where it applied, would require a just and reasonable remedy to the arrangements caught.
- To update the current 'unallowable purpose' rules to address certain specific areas of doubt or disagreement over their application (including where there is a fungible source of funding and where the tax advantage sought is subject to a contingency), and also to align the operation of the derivative contract and loan relationship rules.

Contributed by Tony Jenkins

Payments to employee benefit trusts

Two associated companies, which promoted film financing schemes, claimed deductions for substantial payments to employee benefit trusts in favour of their controlling directors. HMRC rejected the claims, considering that in reality the payments were distributions of profits, rather than expenses incurred for the purpose of earning profits. The companies appealed.

Decision:

The FTT reviewed the evidence in detail and dismissed the appeals. Judge Nowlan found that the companies had engaged in a 'highly contrived scheme' in the hope of 'achieving the precisely opposite corporation tax treatment for the EBT contributions than the result intended by parliament'. He observed that 'the deliberate and all-pervading objective of achieving a corporation tax deduction makes it impossible to treat the corporation tax result sought for the contributions as the “ordinary, intended or realistically expected outcome” of making salary, bonus or equivalent payments'. He also found that one of the company directors (an accountant who had subsequently been declared bankrupt) had 'admitted that he had lied to the tribunal' when giving evidence as to the date of certain documents, and appeared also to have fabricated evidence and forged certain documents. (The FTT allowed the companies' appeals against PAYE determinations.)

Comments - The FTT upheld HMRC's contention that the payments were not allowable deductions in computing the company's profits. Judge Nowlan's comments are self-explanatory.

Scotts Atlantic Management Ltd v HMRC (and related appeals) TC2704

Intangible fixed assets: goodwill acquired from related party

A trader (M) formed a company (B) in 2006. B purchased the business which M had previously carried on, issuing shares in return. M subsequently sold the shares in B to an unrelated company. In 2008, B claimed a deduction for the amortisation of the goodwill which it had acquired from M. HMRC rejected the claim on the grounds that M and B had been 'related parties' at the time of the acquisition, so that the deduction was prohibited by what is now CTA 2009 s 882(1)(b).

Decision:

The First-tier Tribunal dismissed B's appeal against this decision, finding that M had been a participator in B at the time when B acquired the goodwill from him.

Comments - The First-tier Tribunal upheld HMRC's contention that the company was not entitled to a deduction for the amortisation of goodwill, since it had acquired that goodwill from a 'related party', within what is now CTA 2009 s 882.

Blenheims Estate and Asset Management Ltd v HMRC TC2696

Commercial for one year only

The taxpayer began a charter business in 2006. As well as trading as a sole proprietor in respect of private clients, he set up a company, B Original Ltd, to handle the corporate charters, on the basis that a corporate image was more suitable for corporate clients. He stopped trading as a company in 2009 and began operating only as a sole proprietorship.

For the years 2007/08 to 2009/10, he claimed to off set losses from his sole proprietorship business against his other income. HMRC disputed the figures and revised them down, saying that the sole proprietorship element had not been run commercially.

The taxpayer appealed.

Decision:

The First-tier Tribunal noted that under the commercial test in ITA 2007, s 66, a trade was commercial if it was carried on “throughout the basis period for the tax year on a commercial business and with a view to the realisation of profits of the trade”. In this instance, the tribunal accepted that the taxpayer approached the private client element of his business in a business like way, but that the allocation of business expenses between the sole proprietorship and company “did not reflect a fair attribution in accordance with their respective uses” of the ship. The former was “starved of business and used for the off-setting of expenditure”. The judge concluded that for 2007/08 and 2008/09, the sole proprietorship was not being run in a commercial fashion.

For 2009/10, the sole proprietorship failed to be profitable but this was mainly due to the recession causing a fall in the number of charters. The judge said the fact that the taxpayer did not make a profit in that year was due to factors outside his control, and therefore his business was commercial within the meaning of s 66 for that year. He was entitled to off-set his trade loss for 2009/10 against his general income, but not the losses incurred in the previous two years.

The taxpayer's appeal was allowed in part.

Comments – This is an interesting case as it examines the treatment of how the business is carried on – with a view to profit or not. Although approached in a business like fashion this was not carried through to the allocation of the expenses. Accordingly the Tribunal determined that the set-off of the losses was restricted to one year.

Charles Atkinson v HMRC TC2606

Double tax relief: underlying tax

A company (P) claimed credit for double tax relief of £21,103,383 in its return for the year ending 31 December 2004. HMRC issued a notice of amendment restricting the credit to the underlying tax which had actually been paid (£7m). P appealed, contending that the effect of ICTA 1988 s 801(4B) was that it should also be entitled to credit for the balance of £14m.

Decision:

The First-tier Tribunal rejected this contention and dismissed P's appeal. Sir Stephen Oliver held that P's claim was 'unsound in law having regard to the strict wording of the computational rules'. Its claim was based on 'tax that has never been payable' and was 'completely at odds with' the provisions of ICTA 1988 Part XVIII Chapter 1, which granted relief in respect of tax payable.

He also observed that P had entered into a scheme which 'was designed and implemented for no reason other than tax avoidance. It depended on the alchemy of turning share capital into distributable reserves almost overnight.' The purpose of ICTA 1988 Part XVIII was 'to give credits for tax paid on the profits out of which the relevant dividend is paid'. For such a claim to be effective, 'there has to be a payment that can properly and realistically be characterised as a dividend, and the claim must relate to foreign or UK tax borne on the relevant profits represented by the dividend'. On the facts here, there were 'neither profits on which tax was borne nor any payment that could realistically be classed as a dividend'.

Comments - The specific details of this case are primarily of historical interest. The scheme that the company had sought to implement was blocked when ICTA 1988 s 801(4B), which had been introduced by FA 2001, was repealed by FA 2005 with effect for dividends paid on or after 2 December 2004. However, the case remains noteworthy as an example of the attitude taken by the tribunal to artificial avoidance schemes which are designed to produce a tax repayment. Sir Stephen Oliver's comments are self-explanatory.

Peninsular & Oriental Steam Navigation Company v HMRC TC0725

Double Taxation Treaty Passport Scheme

The Double Taxation Treaty Passport (DTTP) Scheme for overseas corporate lenders has been revised.

The Scheme applies only to loans taken out on or after 1 September 2010.

There are two significant changes:

- The removal of the requirement for the UK borrower company to send a completed form DTTP2 notification to HMRC within 30 working days of the start of the borrower’s loan relationship with the lender. Instead, the borrower should send the form to HMRC at least 30 working days before the first interest payment is due on the loan.
- HMRC will now in certain circumstances consider issuing a treaty passport to a US disregarded LLC or US S-Corporation.

Full details of these changes, along with other minor updates are in the revised DTTP Overview, Terms and Conditions, and Technical Questions and Answers.

An overseas corporate lender in a country with which the UK has a double taxation treaty that includes an interest or income from a debt-claims Article, may apply for a 'Treaty Passport' from HMRC. If a Treaty Passport is granted by HMRC, the passport holder is entered onto a publicly available online Register of Double Taxation Passport holders with a unique DTTP number. Prospective UK resident corporate borrowers should check the register to verify the lender's Treaty Passport holder status.

If the UK borrower enters into a loan agreement with a lender who is registered as a Treaty Passport holder, the lender will notify them of their passport holder status and reference number.

The UK borrower should then notify HMRC of the making of a 'passported' loan using form DTTP2. HMRC will use the DTTP2 notification details to issue a 'direction' to the UK borrower to pay the interest with income tax deducted at the rate set out in the relevant Double Taxation Treaty.

Dealing with mixed partnerships (Lecture B781/782/783 – 10.12/9.05/17.30 minutes)

Introduction

Introducing a corporate partner into a partnership has been popular for many years and has significant tax advantages for profitable partnerships.

Invariably the partners will also be the owners of the company and as such the profit earned by the business will essentially stay in the same ownership – albeit with a significant element of the profit routed through a company.

The principle tax advantage is securing a lower tax rate on a significant part of the partnership profits.

There are other advantages which include holding cars in the partnership rather than the company so as to avoid any benefits in kind on the partners' cars.

Example 1

ABC partnership has three partners – Mr A, Mr B and C Limited. C Limited is owned by Mr A and Mr B.

Mr A drives a Range Rover Sport (£60,000 new) and Mr B drives a BMW X5 (£55,000 new). Both cars are held in the partnership and are used for business and private purposes.

The profit for the year to 31 March 2013 was £400,000. This has been allocated as £50,000 to Mr A, £50,000 to Mr B and £300,000 to C Limited.

C Limited will pay corporation tax at 20% on its profit share. Had the £400,000 profit been allocated to Mr A and Mr B they would have been exposed to the 40% and 45% income tax rates.

In using a corporate partner the partners have avoided a car benefit and halved their immediate tax rates on the £300,000 routed through the company. They still have to extract their profits from the corporate but this could be done when the profits of the partnership are at a lower level or indeed as a capital distribution at a later stage.

Volatile profit levels

Partnerships with volatile profit levels may be attracted to such arrangements. A farming partnership for example could make £50,000 in one year and £500,000 in the next year. Sheltering the good years from the higher rates of income tax would be sensible – especially when a bad year could be just around the corner.

In the bad years the partners can draw dividends from the company.

Working capital requirements

Many business structure themselves in this way so as to improve their working capital position. The excess profits are allocated to the company which would then pay corporation tax at 20%.

The company will often draw in the region of 20% of their profit allocation – so as to cover their corporation tax liability. The remaining 80% would be left in the partnership so as to fund their working capital requirements. The company invariably has a large capital account in the partnership when using this structure for working capital requirements.

One issue for such partnerships is that they will not be entitled to an Annual Investment Allowance so there is a downside to this structure if the business has significant capital requirements.

Deferred bonus arrangements

Many professional partnerships have adopted this structure. In some sectors significant bonuses are available but the business is keen to reward long term growth rather than pay out a bonus based on one years performance. By using a corporate partner you can reduce the immediate tax liability until such a time as the bonuses are withdrawn from the company.

Overdrawn partners current accounts

In many cases the corporate partner would only take enough of their profit allocation to cover its corporation tax liability on their allocation. The 80% is left in the partnership and the other partners draw on this sum – effectively making their own current accounts go overdrawn. In many cases the corporate partners current account in the partnership could be significant and likewise the partners current accounts significantly overdrawn! Their intention might be to liquidate the company at some stage and then use their capital distribution from the company to repay their overdrawn current account

Example 2

XYZ partnership has three partners – Mr X, Mr Y and Z Limited. Z Limited is owned by Mr X and Mr Y.

The partners' current account for the year to 31 December 2012 was as follows:

	Total	Mr X	Mr Y	Z Limited
At 1 January 2012	20,000	(500,000)	(450,000)	970,000
Profit for the year	400,000	50,000	50,000	300,000
Drawings	(360,000)	(150,000)	(150,000)	(60,000)
At 31 December 2012	60,000	(600,000)	(550,000)	1,210,000

In can be seen that Mr X and Mr Y are enjoying the use of the partnership profits without paying the top rates of income tax. Eventually Z Limited will be liquidated and Mr X and Mr Y will use their capital distribution to repay their overdrawn partnership current accounts.

Any capital distributions from the company should be taxed at 10% on Mr X and Mr Y.

Where a "replacement" company is planned, clearance should be sought so as to ensure HMRC will not apply the phoenix company rules to the distributions ie treat them as income rather than capital.

New Anti-avoidance rules on loans made by close companies

Finance Bill 2013 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 (covered later in these notes).

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.

Scenario 1 will catch loans to Employee Benefits Trusts (EBTs) where beneficiaries (actual or potential) are also participators in the company. EBTs were always caught when they owned shares in the company but these new rules mean that they need not hold shares to be caught.

Scenario 2 will catch loans from a corporate partner back to the LLP of which they are a member. Prior to this change, the lending of money by a corporate partner to the LLP was not regarded as a loan to a participator – it was to the LLP rather than to the individual partners.

In both instances it is important to appreciate that the new rules only apply to loans or advances on or after 20 March 2013. Any loans or advances prior to that date are not caught and as a result can remain outstanding with no s.455 CTA 2010 implications.

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 (outlined in Example 2 above) means that the participator will have an overdrawn current 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.

It would therefore appear that any overdrawn loan account as at 19 March 2013 will not be subject to these new rules.

It may be worth considering creating a pre and post change current account in the nominal ledger of the business. In example 2 above all the partners drawings to 19 March 2013 could be added to the pre-change current account. The resultant current account balance as at 19 March 2013 will not create a s.455 liability in the corporate partner.

Example 2 (contd)

The partners' current account as at 19 March 2013 could be as follows:

	Total	Mr X	Mr Y	Z Limited
At 1 January 2013	60,000	(600,000)	(550,000)	1,210,000
Profit for the year	Nil	Nil	Nil	Nil
Drawings	(60,000)	(30,000)	(30,000)	Nil
At 19 March 2013	Nil	(630,000)	(580,000)	1,210,000

There should not be any profit allocation to account for in the period to 19 March 2013 as this will not arise until after the year end when the profit is determined and allocated to the partners' current accounts.

Mr X has an overdrawn current account as at 19 March 2013 of £630,000 whilst Mr Y has an overdrawn account of £580,000 at the same date.

In my opinion these should be ring fenced as current account 1 in the books and records of the company. Any future drawings and profit allocations should be allocated to current account 2. Providing current account 2 is not overdrawn at the key s.455 dates then the company will not have any s.455 tax to pay.

For those partnerships with a 31 March 2013 year end it is quite likely that no account is taken of any profit for that year when calculating the current account balance at 19 March 2013. The profit is not known or indeed allocated until the year has finished. Logically you might expect the profit to accrue evenly during the year but that is not my understanding of how HMRC would expect the rules to apply. The taxpayer then gets the advantages of posting drawings to the current account up to the 19 March 2013 but not being required to post profit until after 31 March 2013. This will maximize the overdrawn current accounts as at 19 March 2013.

Partnership consultation document

A consultation document has been published on two aspects of the partnership rules which has a closing date for comments of 9 August 2013.

The proposals which were announced at Budget 2013 are directed at:

- removing the presumption of self-employment for some LLP members to tackle the disguising of employment relationships through LLPs; and
- countering the manipulation of profit and loss allocations (by some LLPs and other partnerships) to achieve a tax advantage.

Salaried members of LLPs

Current tax rules mean that individuals who are members of an LLP are taxed as if they are partners in a partnership established under the Partnership Act 1890, even if they are engaged on terms closer to those of employees. The government believes that LLPs are being used and marketed as a means of disguising employment and thus avoid employment income tax and NICs.

The following changes have been proposed:

- remove the presumption that all individual LLP members are treated as partners and hence self-employed for tax purposes; and
- set out the factors which will be taken into account in deciding whether an individual member of an LLP should be treated as an employee for the purposes of employment taxes.

This will be achieved by providing that an individual member who meets either of two conditions will be classed as a salaried member and will be liable to income tax and primary Class 1 NICs as an employee. The LLP will become the secondary contributor and be liable to pay secondary NICs.

The first condition is that a salaried member of an LLP is an individual member of the LLP who, on the assumption that the LLP is carried on as a partnership by two or more members of the LLP, would be regarded as employed by that partnership.

The second condition is that a salaried member of an LLP includes an individual member of the LLP who does not meet the first condition, but who:

- has no economic risk (loss of capital or repayment of drawings) in the event that the LLP makes a loss or is wound up;
- is not entitled to a share of the profits; and
- is not entitled to a share of any surplus assets on a winding-up.

Allocation of partnership and LLP profits and losses

The second area for proposals concern schemes where partnerships allocate profits or losses in order to reduce tax. These schemes often involve partnerships (not just LLPs) where there is a mixture of individual and company members. They relate to all types of partnerships including LLPs, foreign partnerships and entities established in other jurisdictions that are treated for UK tax purposes as partnerships.

The Government's objective is that tax advantages should not arise where there are inappropriate partnership in three distinct types of arrangement:

- Partnerships with mixed members (typically companies and individuals) where profits are allocated to a member that pays a lower rate of tax.
- Partnerships with mixed members where losses are allocated to a member that pays a high rate of tax.
- Partnership arrangements where members reduce their profit entitlement in return for payment made by other members who will be taxed more favourably on those profits.

The proposals do not cover issues 'where family members use partnership structures to allocate profits between them tax efficiently in circumstances such as those considered in the *Arctic Systems* case.'

Example 3

QPR partnership has three partners – Mr Q, Mrs P and R Limited. R Limited is owned by Mr Q and Mrs R and their spouses.

The partners' current account for the year to 31 March 2015 is expected to be as follows:

	Total	Mr Q	Mrs P	R Limited
At 1 April 2014	50,000	(300,000)	(350,000)	700,000
Profit for the year	330,000	40,000	40,000	250,000
Drawings	(310,000)	(35,000)	(35,000)	(240,000)
At 31 March 2015	70,000	(295,000)	(345,000)	710,000

In the past R Limited had similar levels of profit allocations but drew very little. This enabled Mr Q and Mrs P to draw in excess of their profit share and accumulate large overdraw current accounts.

Since 20 March 2013 this practice is no longer possible without creating a s.455 liability in the company. As a result, all partners have been withdrawing their profit share. R Limited will then pay dividends to its shareholders.

Practitioners will however need to ascertain whether any of the £250,000 profit share to R Limited needs to be reallocated to Mr Q and Mrs P. The key will be whether the £250,000 allocation represents a fair return on capital. The company has an opening capital account of £700,000 and under normal commercial principles would expect a return on that money.

A profit allocation of £250,000 represents a return of 35% and will undoubtedly be regarded as excessive. Practitioners will need to determine what they believe a fair return is and then reallocate the balance to Mr Q and Mrs P in a fair and reasonable manner.

What represents a reasonable return? This is unsecured money so a return in excess of 10% should be justifiable but how high do you go?

Post April 2014 these mixed partnerships may not be achieving their original goals and consideration should be given to liquidating the corporate partners, clearing the overdrawn partners' accounts and then incorporating the business. This would achieve more or less the same advantages as mixed partnerships but there will be some downsides e.g. car benefits.

Article by Dean Wootten

VAT

Sale of caravans: apportionment of consideration

A company which sold furnished caravans submitted a repayment claim on the basis that it had attributed an excessive proportion of the consideration to the standard-rated contents of the caravans.

Decision:

Judge Hellier reviewed the evidence in detail and expressed the view that the object of the method of apportionment 'should generally be such as to result in an outcome as close as possible to apportionment of the consideration so that the amount apportioned to the removable contents is its cost plus that proportion of the margin which that cost represents of the total cost'. However, he did not conclusively stipulate which method should be used, but conceded that 'no method will be completely satisfactory in these circumstances.'

Comments - The decision includes a lengthy discussion of various methods of ascertaining how much of the relevant consideration should be zero-rated and how much should be standard-rated. HMRC have appealed to the Upper Tribunal against this decision.

Colaingrove Ltd v HMRC (No 4) TC2701

Lease of land: whether a separate supply of water

Trustees of certain land in the City of London leased several properties, used as barristers' chambers, to tenants. The trustees had opted to tax the properties. The tenants were supplied with water. In accounting for VAT, the trustees treated part of the rent paid by the tenants as attributable to a zero-rated supply of water. HMRC issued a ruling that the trustees were making a single supply of a leased property, and that none of the consideration qualified for zero-rating.

Decision:

The Upper Tribunal upheld HMRC's ruling (reversing the First-tier decision). Judge Sinfield held that 'in order not to disturb the functioning of the VAT system, account must be taken of the requirement that every transaction must normally be regarded as distinct and independent and a transaction which comprises a single supply from an economic point of view should not be artificially split'. On the evidence, 'the leasing of the premises and the supply of the water to those premises under the lease form a single economic supply which it would be artificial to split because, from the point of view of the typical tenant, both the premises and the water are equally indispensable and inseparable'. Therefore 'the provision of the premises and the cold water is an indivisible supply which it would be artificial to split'.

Comments - As was widely expected, the Upper Tribunal has reversed Judge Khan's decision and upheld HMRC's view that the trustees were making a single supply of a leased property, so that none of the consideration qualified for zero-rating. The decision contains a useful review of the CJEU case law on single and multiple supplies.

HMRC v The Honourable Society of Middle Temple (Upper Tribunal)

Supplies of disposable barbecues

A company (W) sold disposable barbecues. It accounted for VAT at the standard rate. It subsequently submitted a repayment claim on the basis that it should have treated part of the consideration as attributable to supplies of charcoal and as taxable at the reduced rate. HMRC rejected the claim and W appealed.

The First-tier Tribunal dismissed the appeal, applying the principles laid down in Card Protection Plan Ltd [1999] STC 270. Judge Cannan held that 'it is not open to a taxpayer to carve out an element of what would otherwise be treated as a single supply in order to apply a reduced rate to that element of the supply'.

Decision:

The Upper Tribunal upheld this decision. Vos J held that 'it is precisely because the domestic statute did not expressly identify “charcoal as part of disposable barbecues” as being worthy of a reduced rate that they do not attract one. The disposable barbecue is acknowledged to be a single supply. The result is neither surprising nor undesirable since disposable barbecues are leisure items, and are not likely to be used as a regular means of using solid fuel for domestic cooking'.

Comments - The Upper Tribunal upheld the First-tier decision that the sale of disposable barbecues was a single supply which was entirely standard-rated. Vos J disapproved some of the reasoning of Judge Walters in the recent case of Colaingrove Ltd v HMRC (No. 3) [2013] UKFTT 116 (TC) TC02534. HMRC has appealed to the Upper Tribunal against that decision, and Vos J's observations appear to suggest that there is a strong possibility that their appeal will succeed.

WM Morrison Supermarkets Ltd v HMRC (Upper Tribunal)

Drugs and prostheses used to treat hospital patients

A charity (N), which operated several private hospitals, reclaimed input tax on drugs and prostheses which had been used from 1974 to 1986 in the course of treating patients at its hospitals. HMRC rejected the claim on the basis that the drugs and prostheses had been used in the course of a single composite supply of healthcare which was exempt from VAT. N appealed, contending that the drugs and prostheses should be treated as separate supplies which qualified for zero-rating.

Decision:

The First-tier Tribunal rejected this contention and dismissed the appeal, finding that, from the patient's perspective, 'there is no meaningful separation of the supply of drugs and prostheses from elements of the care and treatment they receive'. Accordingly N was making a single supply of healthcare which was exempt from VAT. Judge Brooks specifically declined to follow obiter dicta of Millett LJ in Wellington Private Hospital Ltd [1997] STC 445 (which the charity had cited as an authority), on the grounds that they were inconsistent with the subsequent CJEU decision in Card Protection Plan Ltd [1999] STC 270.

Comments - There was a great deal of money at stake in this case. The First-tier Tribunal upheld HMRC's contention that the drugs and prostheses had been used in the course of a single composite supply of healthcare, which was exempt from VAT, so that the charity was unable to reclaim the relevant input tax. Judge Brooks specifically declined to follow obiter dicta of Millett LJ in the Wellington Private Hospital case, on the grounds that they were inconsistent with the subsequent CJEU decision in the well-known case of Card Protection Plan.

Nuffield Health v HMRC TC2697

Three-year cap applies

The taxpayer, a farmer, had been VAT registered since 1983. She did not file her VAT returns for the periods 03/02 and 06/02. HMRC subsequently issued central assessments for those periods totalling £64,527. The taxpayer paid £59,356 towards the amount in August 2006 and eventually submitted returns for the two periods in January 2009. After calculating the VAT due, the taxpayer had overpaid VAT by £55,550. HMRC refused to repay the sum on the basis that, under VATA 1994, s 80(4), the assessments could not be changed because they were out of time.

The taxpayer appealed.

Decision:

The First-tier Tribunal noted that the four-year cap came into effect on 1 April 2009 and that before that, a three-year cap had applied. In this instance, the central assessments had been issued in February 2005, which meant that any claim for credit had to be made by 31 March 2008. The claim was made in January 2009, more than three years after the assessments were made, and was caught by s 80(4).

The taxpayer's appeal was dismissed and the taxpayer could not recover the overpaid VAT.

Comments - Neil Warren, independent VAT consultant, said: “This case is quite unusual because it is strange that it took a taxpayer nearly seven years to submit outstanding VAT returns for two periods. The key strategy for any business is to submit all returns and payments by the due dates, which then avoids having to untangle the legislation in situations such as this.”

E D Hitchens (TC2547)

Different rates for mixed supply

The taxpayer operated as an antiques centre renting out floor space to dealers, referred to as stallholders. Each one paid the taxpayer a weekly fee depending on the size and location of its space. In addition, the taxpayer offered stallholders a sales facility which allowed sales to take place if the stallholder could not be present at the centre.

The rental income received from stallholders was treated as exempt from VAT, but HMRC decided that the whole service constituted a sales service as well as a land service, all of which should be subject to VAT.

The taxpayer appealed saying there was a single exempt supply of a right to occupy land. The sales service was incidental to this service.

Decision:

The First-tier Tribunal said the position should be looked at from the point of view of the stallholders. They were getting two principal services: a designated area from which to trade and a sales service. Neither of these was ancillary or incidental to the other. Looking at the supplies another way, the tribunal said that the sales service could be omitted from the overall supply. It was in effect a service in itself and not just a way of enhancing the supply of space.

The tribunal concluded that the stallholders were receiving an exempt supply of space and a standard-rated supply of a sales facility.

The taxpayer's appeal was allowed in part.

Comments - Neil Warren, independent VAT consultant, noted that: "the tribunal felt it would be incorrect to dismiss one of the supplies as 'incidental' to the other, which would have been a logical process in most situations of this nature. This is another example of how output tax issues can become very tricky when two or more supplies are involved in a business deal."

Antiques Within Ltd (TC2507)

Too many no sales

The taxpayer acquired a general store as a going concern. The shop had two tills from which the till readings formed the basis of the quarterly VAT returns. HMRC found that in the period from 5 January 2008 to 28 June 2008 there had been 44,768 "no sale" transactions out of a total 131,783 transactions. They considered this excessive and concluded the taxpayer was underdeclaring takings to avoid VAT. They raised an assessment against which the taxpayer appealed.

The taxpayer said that there were good reasons for the number of no sales. For example, he had to pay lottery winnings, correct errors, store documents and pay staff wages. Furthermore, HMRC had delayed responding to the appeal for three or four years and the figure assessed was excessive.

Decision:

The First-tier Tribunal was not convinced by the taxpayer's evidence. His assertion that the till was opened on a no sales basis to serve the needs of the local community was uncorroborated. He suggested that if he did not give customers change when requested, he might be vulnerable to violence. The tribunal found there was no proof that the neighbourhood was unsafe. For example, it would have liked to have seen a community police report, photographic evidence of attacks on the shop or reports to the local police regarding threats. The taxpayer's cashbook was unreliable, containing figures that did not relate to the business's VAT returns. HMRC had acted reasonably and the assessment had been made to best judgment.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said the case highlighted a technique that HMRC use to check the credibility of a taxpayer's output tax declarations, ie making a detailed analysis of till rolls to identify any unusual trends. He added that "in effect, the taxpayer was claiming about 700 no sales every trading day, which was clearly excessive for a business of that nature. HMRC's powers under VATA 1994, s 73 [failure to make returns, etc] are very extensive when there is reason to doubt the credibility of a VAT return".

Thambithurai Sanjeevraj trading as Cambridge Food and Wine (TC2546)

Getting the VAT return right (Lecture B785 – 14.15 minutes)

There are a number of tips and quirks in completing VAT returns that it is important to recognise. A correctly completed VAT return can reduce the risk of a query being raised by HMRC on the accuracy of a particular figure in one of the nine boxes that need to be completed with each return.

Buying services from abroad

The 'reverse charge' calculation applies when a business buys services from abroad. As a starting point, you should be clear that the reverse charge applies to services bought from both EU and non-EU suppliers…..not just from those based in the EU. So if you use the services of an Indian based bookkeeper to do some accounts preparation work, then a reverse charge calculation must be made in exactly the same way as if you were using a firm based in Poland.

The basic principle of the reverse charge is that the customer deals with the VAT rather than the supplier. So here's an opening question: which boxes of the VAT return will be completed by a UK business that buys in a service (no overseas VAT charged) from abroad?

Example 1

John is an accountant in Birmingham and registered for VAT. He uses the services of a bookkeeping firm based in India and received services of £10,000 in the VAT period ended 31 March 2013. What entries will he make on his VAT return for these services?

Under the 'reverse charge' procedures, John must treat the services received as both his income and expenditure. He will make the following entries on his March 2013 VAT return:

Box 1 (output tax) - £10,000 x 20% = £2,000 i.e. value of services multiplied by rate of VAT that applies to that service in the UK, usually 20%

Box 4 (input tax) – same figure as Box 1 i.e. £2,000. This assumes that the expense in question relates to 'taxable' activities and there are no partial exemption/non-business issues. This is the case for John as an accountant.

Box 5 (VAT payable) – nil effect if Box 1 = Box 4

Box 6 (outputs)/Box 7 (inputs) – the net figure of £10,000 is included in both of these Boxes i.e. John is treating the services received as both his income and expenditure.

Here is a challenge for you. Can you think of a practical situation when the figures in Box 1/Box 4 would not be the same?

Example 2

A members golf club is partly exempt as far as VAT is concerned e.g. income from membership playing fees and competition entry fees are exempt from VAT but bar sales and equipment sales are taxable (standard rated).

So if a UK golf club paid an Italian based consultant to give some advice on the chemicals and grass seeds that are used on the course and paid him a fee of say £10,000, this payment would be subject to the reverse charge by the club on its VAT return but with a partial input tax block in Box 4 (depending on the partial exemption method adopted by the club) because the course has exempt use by members.

Note - the Italian consultant would not charge Italian VAT (correctly) because the place of supply is UK i.e. where the customer is based (and a golf club is 'in business' so the transaction would be classed as a B2B sale).

Selling services abroad

So if John our accountant from Example 1 did some accountancy work for a German business customer (or Australian business customer as the rules are the same for EU and non-EU customers), which boxes of the VAT return will he fill in?

(Note – John will not charge UK VAT in either case under the place of supply rules – the service is outside the scope of UK VAT).

The answer is 'only Box 6' (outputs). This answer can sometimes cause confusion – there is a view that if a service is outside the scope of VAT (i.e. the place of supply is outside the UK), then no entry is made on the VAT return. This statement is only correct in one situation…….if the business uses the flat rate scheme.

Warning – ignore Box 8 and Box 9 for services

Here is an important tip to save unnecessary hassle…….don't forget that the bottom two boxes of the VAT return (Box 8/9) only apply if you either buy 'goods' from a VAT registered business in another EU country, or sell 'goods' to a VAT registered business in another EU country. The boxes do not relate to services. So if a business only buys or sells services from abroad, then the figures in Box 8 and Box 9 will be zero.

Buying goods from abroad

The rules on buying goods from abroad are very different according to whether you are buying from an EU or non-EU country. In the latter case, VAT is paid at the point when the goods enter the UK (assuming they are standard rated goods i.e. not zero-rated items such as children's clothes and books), creating a source of input tax for the importer when he acquires the C79 VAT certificate issued by HMRC. But no VAT is charged by the supplier (or HMRC) in relation to an EU purchase from outside the UK, with the buyer accounting for 'acquisition tax' in Box 2 of his relevant VAT return.

Example 3

John has bought a new computer for his accountancy practice from a supplier in France for £1,000. The sale has been correctly zero-rated by the French supplier because he is selling goods to a VAT registered business outside of France.

John will make the following entries on his next VAT return:

Box 2 (acquisition tax) - £1,000 x 20% = £200 i.e. value of goods multiplied by UK rate of VAT applicable to those goods. Note – no tax would be due if the goods in question were zero-rated in the UK e.g. books.

Box 4 (input tax) – same figure as Box 2, assuming no input tax restrictions apply for exempt, non-business or private use.

Box 7 (inputs) – net value of goods i.e. £1,000

Box 9 (acquisition of goods from other EU states) – same figure as Box 7 i.e. £1,000.

Example 4

John has bought a new computer for his accountancy practice from a supplier in Hong Kong for £1,000. The computer is subject to a Customs duty charge of £100, so VAT payable at the point of entry into the UK is £220 i.e. £1,100 x 20%.

John will make the following entries on his next VAT return:

Box 4 (input tax) – to reclaim VAT paid at import, supported by a C79 certificate as evidence.

Box 7 (inputs) – net value of goods £1,100 i.e. including the Customs duty paid at the point of import.

What are the key issues from Examples 3 and 4?

The VAT payable on goods bought from an EU supplier finds its way into Box 2 of the return compared to Box 1 for services.
There is no Box 6 (outputs) entry for goods bought from an EU supplier. This is because the buyer in the UK does not need to treat the payment for goods as his own income as he does for services.
We have used Box 9 in the case of goods bought from an EU supplier - as explained above, we never use Box 8 or 9 for services.

Selling goods abroad

To complete the loop, let's assume that John is now selling two computers abroad, one to a VAT registered customer in France (EU) and one to a business in America (non-EU). Both sales are zero-rated. In the case of the EU sale, the proceeds will be recorded in both Box 6 (outputs) and Box 8 (sales of goods to VAT registered businesses in EU countries outside UK) but only in Box 6 for the sale to America. This is another important point – don't think that just because an entry has been made in Box 8 for a sale that the same sale is not included in Box 6 as well – it is! In effect, Box 6 reflects worldwide sales made by a business.

Box 7 (inputs)

The entry in Box 7 does not affect the amount of VAT paid by a business but it is important to be aware of the inclusions and exclusions in order to submit an accurate return. It is also useful to check the ratio between the inputs entry in Box 7 and the input tax figure in Box 4.

Expenses that are excluded from Box 7

- VAT itself (including input tax and VAT payments)
- Wages and salaries, PAYE and NIC
- Drawings
- Loans, dividends and gifts of money
- MoT certificates
- Local authority rates
- Motor vehicle licence duty

HMRC checking of VAT returns

An HMRC check that is being carried out with far greater frequency than in the past is to check that the 'outputs' figure on VAT returns is compatible with the turnover figure declared by a taxpayer on either his self-assessment tax return, partnership return or CT600 corporation tax return. This is an opportunity made much easier by the merged tax department.

Think about the situation of a business that sells services abroad (outside the scope of VAT in most cases) and forgets to include the income in Box 6 of its VAT returns. This omission could create a query from HMRC because the outputs figures on the VAT returns will be lower than the turnover declared for direct tax purposes.

So a useful tip is to carry out a reconciliation between outputs and turnover when you complete year-end accounts – but don't forget the following points:

The reverse charge entries explained above will not be included as turnover on the year end accounts
Adjustments will need to be made for opening and closing work in progress i.e. reflecting timing issues
If the business uses the cash accounting scheme for VAT, then debtors adjustments will be necessary as well

Another important check is for a business to ensure that the VAT payable (or repayable) figure in Box 5 of each return reconciles to the VAT creditor or debtor balance in the nominal ledger as at the same date. Although you would expect this to be automatic, it is not necessarily the case e.g. think about the situation where someone forgets to 'reconcile' the VAT return system on Sage after it has been completed. And how many computer systems exclude VAT journals from the VAT report? I even know one system that includes the previous quarter's VAT payment in the input tax figure for the following period.

Contributed by Neil Warren