Tolley®CPD

November 2013

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Chancellor's Autumn Statement

The Autumn Statement 2013 will be made by the Chancellor of the Exchequer, George Osborne, on Wednesday 4 December.

The draft Finance Bill will be published on Tuesday 10 December 2013.

Personal Tax

RDR1 replaces HMRC 6

In a very low profile announcement HMRC have issued the overdue replacement for HMRC6 – the official guidance on residence, domicile and allied matters – on 24 October 2013.

HMRC have published RDR1 — Residence, domicile and the remittance basis, a guide for residents and non-residents on the residence, domicile and remittance basis rules from 6 April 2013. It replaces booklet HMRC6, which should continue to be used for information on rules affecting residents' and non-residents' tax liability in the UK for tax years ending on or before 5 April 2013.

The RDR1 guidance reflects the introduction of the legislative changes to the remittance basis that came into effect for tax year 2012/13 and the introduction of the statutory residence test for tax years 2013/14 onwards.

The guidance is broken down into the following specific areas:

1. Impact of residence and domicile - outlining in simple terms residence and domicile and effect on tax liability. This also looks briefly at certain classes of taxpayers including MPs and NRLs
2. Residence – This is strangely brief less than half a page in length and largely comprises cross references to RDR3 and the tax residence indicator
3. Tax when coming to the UK- this naturally commences with residence moving onto an individual coming as an employee and self-employed. As well the consequences of the split year the chapter gives basic guidance on circumstances such as not working, entertainers and sportsmen and students coming to the UK
4. Tax when leaving the UK – This follows a similar pattern to the previous chapter but also highlights the special taxation rules for certain employees and offices working abroad
5. How does domicile affect your UK income tax and Capital Gains Tax liability – This sets out the basic principles on the various types of domicile and includes flow charts to determine your domicile. They are set out in 4 different circumstances but as previous versions focus on place of birth. These should be regarded as a guide rather than an answer as highlighted by the caveat in para 5.23 …" give you no more than a likely indication of your domicile" (this is at least better than the equivalent in HMRC6 which stated that they were not to be used in real circumstances)
6. Types of income – This chapter deals with different types of pay in a simple fashion: earned income; UK tax on earned income – when you are resident; UK tax on earned income – when you are non- resident; leave pay; Investment income; UK tax on Investment income – when you are resident; UK tax on Investment income – when you are non-resident. The brevity of the elements relating to CGT and the myriad hyperlinks demonstrates how the overall guidance does not create a standalone document of advice
7. Special rules for certain occupations – Useful but brief guidance on special occupations including entertainers and sportspersons and Non-resident landlords amongst others
8. UK personal allowances – Useful guidance on receipt, entitlement etc. in relation to PAs

9. The remittance basis of taxation – This is acknowledged as an overview and highlights key areas as would be expected in view of the complexity of the provisions introduced. The section highlights changes made in 2012 which apply before much of what else is contraini9ned in RDR1 as it it is directed at 2013-14
10. Double taxation – Again an overview of an area but it does stress at the beginning that it is an introduction by a background to DTAs and the principles of how they work. If you are resident in more than one country it is likely that you tax affairs are complex and consequently will depend upon individual circumstances
11. National insurance Contributions when leaving or arriving in the UK- Again na guide that valiantly attempts to covers a significant and complex area. It deals with the outline of Leaving and arriving from a EEA country or Switzerland on which the EU social security rules will apply; a country with which the UK has a bilateral Social Security Agreement; and another foreign country which is outside the EEA or Switzerland and does not have a Bilateral agreement with the UK
12. Record keeping – This chapter appears to be taken significantly from the guidance (unsurprisingly) in RDR1 – the detailed guidance regarding the Statutory Residence Test. It is, of course, useful but somewhat inconsistent with the rest of the guidance which is by its nature is general and not seeking to give definitive advice through positive statements. The record keeping gives detailed guidance.

The final section is headed “contact us” and deals with aeries of circumstances including inter alia Crown servants, foreign entertainers and sportsmen, leaving the UK and self-assessment tax return and predominantly a series of hypertext links.

The following information is not yet included in RDR1:

- Information note: remittance basis
- Guidance note: statutory residence test
- Guidance note: overseas workday relief

The guidance will be updated to cover these notes later in 2013.

“The new RDR1 is a poor substitute for the HMRC6 which was itself a poor substitute for IR20”, said Keith Gordon. “The new RDR1 goes so far out of its way to avoid making any promises that a taxpayer could rely on, that it puts caveats on propositions that are actually provided for by the statute. It also replicates the legislation so closely that it repeats words that are wholly unnecessary, adding further confusion and uncertainty.”

“To take just one example”, said Keith, the author of Residence: the definition in practice, “RDR1 advises readers: 'you are likely to be treated as not resident in the UK for income tax or capital gains tax purposes in the tax year if … you did not spend more than 15 days in the UK and were resident in the UK in one or more of the three previous tax years'. The words 'likely to be' are unhelpful and the statement would be more accurate if they were omitted. Furthermore, the phrase 'and were resident in the UK in one or more of the three previous tax years' adds nothing to the guidance and can also be omitted.”

He added: “The entire statement should be qualified by a note that 'day' actually means 'night' (or at least it usually does). Unfortunately, this rather basic definition is wholly absent from the text of the booklet, although eagle-eyed readers who already know the rules might be able to spot some clues to this rule.”

Keith concluded: “RDR1 will be an inadequate guide for anyone wishing to determine their residence status, whereas anyone who does rely on it will risk being misled.”

Contributed by Tony Jenkins

Limited duration workplaces are permanent workplaces

In 2008/09, the taxpayer claimed mileage expenses in respect of travel to and from his permanent and temporary places of work. He worked for GSI under three contracts. The first, a retainer contract, required him to work at various locations. The other two were short-term contracts which specified a single place of work.

HMRC said that under the retainer contract the taxpayer attended a temporary workplace, but under the short-term contracts he had a permanent workplace. On that basis, they allowed the claim only in relation to the retainer contract.

The taxpayer appealed.

Decision:

The First-tier Tribunal accepted that the work carried out by the taxpayer was essentially the same under each contract, but said it was the contractual provisions that determined the tax treatment. HMRC were correct to disallow expenses in respect of the short-term contracts. ITEPA 2003, s 339(5)(a)(ii) excluded a workplace from being a temporary one if the employee was required to work there for the duration of his contract.

The taxpayer's appeal was dismissed.

Comments – Many employees travel in the course of their employment and therefore there are detailed rules to distinguish between expenses which are deductible and those that are non-deductible. The rules draw a key distinction between travel to a temporary workplace and travel to a permanent workplace. This case is an excellent demonstration of the different rules as the taxpayer had travel to three workplaces one of which was accepted by HMRC as being a temporary workplace and the other two which were permanent workplaces. This is therefore an unusual case.

N Ratcliffe v HMRC TC2814

Not a pool car

The taxpayer was an employee, shareholder and director of S, a company that has ceased trading. His wife was also a director and employee. He had occasional use of a Porsche 911 vehicle, which he claimed was a pool car within the meaning of ITEPA 2003, s 167. HMRC said that the car was not a pool car and that the taxpayer was liable to car and car fuel benefits in respect of his use of it.

The taxpayer appealed.

Decision:

The First-tier Tribunal said the burden of proof lay with the taxpayer to establish that the car was a pool car. This did not include, as argued by HMRC, a company policy forbidding the use of the car for private purposes. Section 167(3)(d) specifically permitted a degree of private use, provided it was incidental to other use.

With regard to the evidence, there was nothing to show that the taxpayer and his wife both used the car in the same tax year. Similarly, no information was provided to show that other employees had use of the car. Thus s 167(3)(a) (a pool car has to be available and actually used by more than one employee in a particular tax year) was not satisfied.

Furthermore, the taxpayer had produced no details of the purposes for which he used the car, thus it was not possible for the tribunal to determine whether it was used for company or private purposes.

The taxpayer had not established that the vehicle was a pool car and his appeal was dismissed.

Comments – This case is another in the long line of cases where an individual often a director alleges that a particular vehicle is a pool car. To be a pool car it must meet the following conditions: used by more than one employee, not ordinarily used by one employee to the exclusion of others, not normally kept at or near employees' homes and used only for business journeys - private use is only permitted if it is merely incidental to a business journey (for example, commuting home with the car to allow an early start to a business journey the next morning). The verdict was therefore inevitable.

D Munden v HMRC TC2821

Evidence needed to prove expenditure

The taxpayer sold two properties in 2004/05. He appealed against HMRC's assessment on the basis that he had spent £40,000 on property improvements.

HMRC asked him to provide evidence of the expenditure, but he failed to do so. The assessment was confirmed, so the taxpayer appealed.

Decision:

The First-tier Tribunal agreed that it was “very likely” that the taxpayer had incurred costs on the properties, but it was impossible to ascertain how much had been spent. The taxpayer could not provide any details or proof of what had been outlaid. The tribunal had “no idea” why the taxpayer was “so vague about the expenditure” and said it was unfortunate that he could not offer any detail.

For this reason, the tribunal had no alternative but to dismiss the taxpayer's appeal.

Comments – Although we live in era of self-assessment, the figures reported on an SATR must be capable of substantiation. In the circumstances the tribunal had no alternative but to dismiss the taxpayer's appeal.

T Ridpath v HMRC TC2785

Income Shifting: HMRC’s view (Lecture P801 – 9.46 minutes)

We know that following the *Arctic Systems* case in the House of Lords, an attempt was made to consult on radical changes to the tax system which would, if enacted, change the whole face of tax planning within many family businesses.

The proposals were dropped in the November 2008 Pre-Budget Report, on the grounds that the economic crisis required business owners to concentrate on survival rather than having to face any major changes to the tax regime.

There was a threat of going back to the proposals at some stage, but currently we can feel reasonably relaxed - subject to appreciating what HMRC have to say on the current position in *Helpsheet 270* to the SA tax return for individuals where they give several examples, some of which are reproduced below as their stated position in a variety of circumstances by reference to existing legislation in ITTOIA 2005 where anti-avoidance rules are aimed at stopping income shifting in specific cases. Some of their views are certainly arguable.

Example 8 – shares with restricted rights

Ron is a director of, and owns all the shares in RH Trading Ltd. He creates a new class of B shares – these carry no voting rights and no rights to any assets in the event that the company is wound up. The company then issues these B shares to Ron's wife Anita.

Any dividends voted on the B shares are taxable on Ron. There is a settlement as Anita has been given the shares for nothing. Ron has kept an interest in it because the income is paid to his wife. As the B shares entitle Anita to income only, the exemption for outright gifts between spouses clearly does not apply.

Ron should include the dividends on the B shares in box 9 on the *Trusts etc.* pages of his tax return and a brief explanation in box 25. Anita does not include the dividends in her tax return but a brief note in the 'Any other information' box, box 19 on page TR 7 would be helpful.

Example 9 – dividend waivers

Gill owns 80 ordinary shares in GT Co Ltd and her husband Frank owns the remaining 20.

The company makes a profit of £25,000 in the year. Gill waives her right to any dividend and then the company declares a dividend of £1,000 per share. Frank receives £20,000.

Part of Frank's dividend payment is taxable on Gill. There is a settlement here as she has given away income which, in the absence of the waiver, would have gone to her – the company could not have paid £1,000 per share if Gill hadn't waived her right to a dividend as its profits were not large enough. So as a result Frank has received a larger dividend.

Without Gill's waiver, Frank's share of the total dividend would have been £4,000 (£20,000 multiplied by 20/100) and so the balance of £16,000 is taxable on Gill.

Gill should include the £16,000 in box 9 on the *Trusts etc.* pages of her tax return and a brief explanation in box 25. Frank should include £4,000 in the 'Interest and dividends from UK banks, building societies etc.' section on page TR 3 of his tax return with a brief note in the 'Any other information' box, box 19, on page TR 7.

Example 10

The circumstances are the same as in Example 9 on page 5 except that instead of 100 ordinary shares, Gill owns 80 A shares and Frank owns 20 B shares. The A and B shares are exactly the same in all respects.

The company made profits of £25,000, a dividend of £20,000 is voted on the B shares while no dividend is voted on the A shares.

Once again, part of the dividend is taxable on Gill. There is a settlement here as the dividend on the B shares could only have been paid in that amount because none was declared on the A shares. The shares rank equally and so if £20,000 had been declared for all the shares, only £4,000 would have arisen on the B shares. Frank's taxable income is £4,000 and Gill's is £16,000.

Example 11 – subscribed shares

Claire sets up a company to provide services to a number of clients. The company's share capital consists of two £1 shares. She subscribes for one and her husband Andy subscribes for the other. Claire is the sole director and Andy is the company secretary but otherwise takes no active part in the company.

There are no significant capital assets and the first year's trading results are as follows:

- Turnover £100,000
- Expenses £5,000
- Claire's salary £10,000
- Andy's salary £5,000
- Dividends £70,000

Claire undertakes all the work bringing in the turnover of £100,000 and her salary and dividends come to £45,000. Andy's salary and dividends amount to £40,000.

While there may be a settlement as Claire is allowing some of her earnings to be paid to Andy by way of a dividend, it is an outright gift between spouses. As Andy's share is an ordinary share, he is entitled not only to income but also to the capital of the company (even if there is hardly any capital). The outright gift exemption applies and this arrangement is therefore not treated as a settlement for Income Tax purposes. The issue of whether Claire has kept an interest does not therefore apply and she is not taxable on any part of Andy's dividend income

Contributed by Gerry Hart

Tax Free Shares for Employee Shareholders (Lecture P802 – 13.53 minutes)

This initiative applies to shares received through the adoption of this new status of ***employee shareholder***. It provides CGT exemption on gains made, within limits, but in exchange for giving up some employment rights.

Before considering the practical issues, the basic structure needs to be understood.

The Structure

1. Employees exchange some of their existing employment rights for the right to own shares in the business.

2. The Employment Rights Act 1996 is amended to create a third employment status (in addition to that of ***employee*** and ***worker***) of ***employee shareholder*** which is created by the Growth and Infrastructure Act (GAI) 2013.

3. The scheme offers employees between £2,000 and £50,000 of shares, with any gains being exempt from CGT. However, in return employees must give up their UK rights relating to unfair dismissal, redundancy, flexible working and time off for training, and will have to give 16 weeks' notice of a firm date of return from maternity leave. It is possible for businesses to build more generous employment conditions into their contracts, should they wish.

4. The House of Lords have imposed amendments to GAI 2013, and in particular the employer must provide legal advice and a 7 day cooling off period before an employee is able to relinquish the employment rights.

5. Also as required by the House of Lords, the company proposing an employee shareholder agreement has to give to the individual a written statement setting out details of the statutory employment rights which would not be available as a result of being an employee shareholder together with specified details on the rights which would attach to the shares being offered in return (for example, rights in relation to voting and dividends).

6. Another significant amendment is that the employee shareholder agreement will be of no effect unless having been given the statement referred to above, the individual takes advice from a "relevant independent adviser" on the terms and effect of the proposed employee shareholder agreement. The reasonable costs of that advice are to be borne by the company, whether or not the individual ultimately enters into the employee shareholder agreement, and there is no income tax charge on this benefit.

7. A "relevant independent adviser" is the same definition as for the purposes of a compromise agreement so in practice is likely to be a solicitor, barrister or qualifying trade union official. However in the case of employee shareholders, the adviser will not only have to advise on employment rights, but also on the rights attaching to the employee shareholder shares.

8. Income tax and NICs will be payable when the employee shareholder acquires shares, but not on the first £2,000 of share value.

9. Employees who receive full CGT relief on shares awarded as part of their contract would remain eligible for existing employee ownership schemes, such as the Enterprise Management Incentive Scheme.

10. The scheme is available to all employers, whatever their size or area of activity, but the aim is for SMEs in particular to benefit from the additional flexibility afforded by the new contracts.

11. While employee shareholder contracts will be optional for existing employees, businesses can choose to offer only this type of contract when taking on new staff.

12. Employers choosing to operate the new employment status can offer employees fully paid shares with all types of shares being eligible. They can carry rights to dividends, voting rights etc. They can also be subject to any restrictions, including the surrender of shares on an employee leaving.

13. If shares are surrendered the employer has to buy them back at a reasonable value, by reference to the UMV at the time they were awarded.

14. If a sale of the shares is via a company buy-back, a special tax provision ensures that is not treated as a distribution. CGT treatment is therefore guaranteed, with the gain exempt from tax.

15. The company will obtain corporation tax relief on the amount taxed on the employee, plus on the exempt £2,000.

Practical issues

We now have detailed guidance from HMRC with a number of issues identified. We also can now see the circumstances when this scheme can be particularly attractive, but of course the main aspect is whether the employee to whom it is offered agrees with the degree of incentivisation it provides.

Issues to consider are:

Shares must be offered with a value of between £2,000 and £50,000. If there are restrictions attaching to the shares it is the AMV rather than the UMV which must be at least £2,000. However, the £50,000 limit for the purposes of the CGT exemption on disposal applies to the UMV on acquisition. In other share schemes where the shares have some restrictions attached, the Shares & Assets Valuation (SAV) usually seek to agree the AMV and then suggest an uplift of 20% to arrive at the UMV.

An individual having a material interest does not qualify for the normal CGT exemption on gains made on the disposal of shares acquired under this arrangement of up to £50,000 in value, or indeed for exemption from income tax of the first £2,000 in value when issued. This means someone owning at least 25% of the voting rights (or assets if a close company), with the inclusion of holdings by connected persons. What this means is that a working shareholder already owning say 10%, can receive more shares as an employee shareholder and he is more likely to regard that as an incentive than someone who is not already a shareholder. He may well also be less inclined to be concerned about the employment rights he has to give up.

The less than 25% test above also means that the arrangement is unlikely to be of use in a business start-up. This is because a maximum permitted holding of 24.99% has to be worth at least £2,000, which in turn means the company must be valued at a minimum of £8,003.

The first £2,000 worth of shares is exempt from income tax, by way of a deemed payment of £2,000 having been made under the employment-related securities legislation.

For shares issued with a value in excess of £2,000, the income tax charge is under PAYE if the shares are readily convertible assets – and in that case NICs are due as well. Otherwise the tax is paid via SA.

The value of the shares to be issued can be agreed in advance with SAV, using form VAL232. They anticipate agreeing the value within 4 weeks in a straightforward case – from the date they receive form VAL232 or any further information they require is obtained. The agreed value is effective for 60 days.

There is no arrangement for HMRC approval to issuing shares under this arrangement. Reporting the issuing of shares is made, however, via form 42 after the end of the tax year of issue.

The type of restrictions to the shares which the employer may wish to include typically involve some or all of the following:

- The shares cannot be traded
- No entitlement to dividends
- Requirement to sell the shares back to the company on leaving the employment
- On leaving the employment the shares continue to be owned by the individual, unless a company buy-back arrangement applies or a sale is required under the company's articles or under the employment contract.

Contributed by Gerry Hart

Pension from International Bank: whether exempt under UK/USA double tax convention

A UK resident (M) worked in the USA for the International Bank for Reconstruction and Development from 1976 to 1998, when he retired and returned to the UK. He received pension payments from the bank. In July 2008, he claimed error or mistake relief on the basis that these payments should be treated as exempt from UK tax under article 17(1) of the UK/USA double tax convention 2001. In December 2008, HMRC rejected the claims. However, in April 2009, M submitted identical claims for 2003/04 and 2006/07, without referring to their previous rejection. A different HMRC officer accepted the claims and authorised a repayment. In March 2010, HMRC issued discovery assessments to recover the tax.

Decision:

The First-tier Tribunal dismissed M's appeal, holding that the bank's pension plan was not 'established in the USA' for the purposes of the double taxation agreement, and that the discovery assessments were authorised by TMA 1970 s 29. Judge Walters held that the claim which M had made in April 2009 'was abusive, and the proper course, if (M) had decided that he wished to pursue the matter in the fact of HMRC's refusal of 10 December 2008, was to seek to bring an appeal out of time against that refusal'.

Comments -The First-tier Tribunal upheld HMRC's contention that the pension payments which the appellant had received from the International Bank failed to qualify for exemption from UK tax under the UK/US Double Tax Convention, and that the discovery assessments were authorised by TMA 1970 s 29. Judge Walters was unfavourably impressed by the tactics adopted by the appellant in submitting a duplicate claim for relief, without making any reference to the fact that his claim had been already been rejected by an HMRC officer. Judge Walters' comments on this issue are self-explanatory.

M Macklin v HMRC TC2943

Assessments under Proceeds of Crime Act

The Serious Organised Crime Agency had begun an investigation into the tax affairs of an individual (F), who had been the controlling shareholder of a company (S), which bought and sold building materials, although he was not a director.

They seized more than £200,000 in cash, and discovered that F had made significant deposits into certain bank accounts, although he had declared on his tax returns that he had no taxable income for 2006/07 to 2008/09.

They issued discovery assessments under Proceeds of Crime Act 2002 s 317, and imposed penalties under TMA 1970 s 95. F appealed.

Decision:

The First-tier Tribunal dismissed F's appeals, finding on the evidence that he had been involved in fraudulent mortgage applications, had been convicted for handling stolen property and had been charged with the theft of bricks and roof tiles. Judge Demack observed that F had 'made no attempt whatsoever to run his companies' businesses or his business with regard to accepted, indeed essential, accounting and administrative principles'. The evidence pointed 'to his having treated his affairs and those of the companies as interchangeable, and as having been arranged with the intention of evading tax, and to ensure that the tax authorities would have the greatest difficulty in finding, let alone tracing, any audit trail'.

Comments -The First-tier Tribunal upheld the estimated assessments which SOCA had issued, and the penalties which they had imposed. Judge Demack's comments are self-explanatory.

GM Fenech v Serious Organised Crime Agency TC2944

Avoidance scheme: definition of 'securities'

A company (L) which operated a pharmacy entered into a scheme intended to take advantage of the 'restricted securities' provisions of ITEPA 2003 s 423 and pay its controlling director (F) £300k, without accounting for PAYE or NIC. HMRC issued determinations charging PAYE and NIC on the basis that the scheme was ineffective.

Decision:

The First-tier Tribunal dismissed L's appeal, specifically distinguishing the Upper Tribunal decision in UBS AG v HMRC (No. 2) [2013] STC 68.

Judge Raghavan observed that 'whether the shares were "restricted securities" is not directly in point as the issue this case turns on is whether the award of bonus is to be regarded as falling within the "money" exclusion to Part 7 in s 420(5)(b), such that Part 7 does not apply'. He held that, when the shares were awarded, 'realistically what (F) was getting was money. On that basis Part 7 is not accessed.' The transaction was 'one which it was the intention of Parliament to exclude from the regime in Part 7 by operation of the "money" exception', and the scheme amounted 'to a bonus of money rather than shares'.

Comments - The scheme was ineffective on the grounds that, applying a realistic view of the relevant transactions, the director had actually received money, rather than securities.

LM Ferro Ltd v HMRC TC2853

Capital Taxes

Case Law developments on PPR exemption (Lecture P804 – 19.59 minutes)

Not a main residence

Mr Llewellyn and his partner lived at 10 Netley Terrace, Southsea — a property purchased as tenants in common in 1976. By 1996, they had personal difficulties and he purchased 10 Henderson Road, Southsea in 1996, moving into the property with a sleeping bag and basic necessities. The house was in a poor state and it took a year to refurbish it. During that time he returned to Netley Terrace to collect mail and carry out work on that property.

By the summer of 1998, his relationship with his partner had improved and Mr Llewellyn moved back to Netley Terrace, subsequently renting out Henderson Road. Letting continued until 2005 when, following further work to it, the property was put it up for sale, being sold in May 2007.

HMRC requested information to support the claim that only or main residence relief and lettings relief applied to Henderson Road, because their information was that he had lived permanently at Netley Terrace. Following various correspondences with the accountant, HMRC issued an amended self-assessment refusing relief and, following reviews, the appeal against this came to the First-tier Tribunal.

Decision:

There was some dispute as to when Henderson Road was first occupied, but the tribunal accepted that Mr Llewellyn moved there in November 1996, although living in very spartan conditions. It was noted, however, that he was still registered to vote at Netley Terrace and no other institutions appear to have been advised of an address change. In response to questions from HMRC, he also admitted that he gave Netley Terrace as his address when applying for a credit card. Rent records indicated that the property was let from October 1997.

The tribunal accepted that the taxpayer had occupied the property, but some degree of permanence or continuity was required. The tribunal did not consider, on the balance of probabilities, that this had been satisfied and refused the relief.

The tribunal concluded with "a procedural matter". Despite both parties confirming that no witnesses were being called, HMRC had asked to put questions to Mr Llewellyn. He could have refused to answer, in which case it would have been left to the tribunal to determine whether HMRC's application to question Mr Llewellyn should or should not be granted. Had this not been granted, there would have been no opportunity for HMRC to question him.

The tribunal did not think it fair for HMRC to wait until the hearing to “spring upon” an individual a request to give evidence where that individual has been led to expect that this would not be required. The tribunal decided not to comment on whether his accountant should have decided not to call Mr Llewellyn as a witness in support of his own case.

Comments – The principal private residence relief is a very important and valuable relief. There have been many cases demonstrating the importance of being able to prove the permanence of the occupation of the property of which the Goodwin v Curtis case is one of the most often referred to. The permanence must be demonstrated and the quantity and the quality of the evidence can often be a determining factor. The almost complete lack of evidence therefore worked against the taxpayer.

Wade Llewellyn v HMRC TC2726

Whether house used as principal private residence

A financial adviser (M) purchased a two-bedroomed house (110H) in 2002. He let it to tenants until November 2006, when he moved into it after separating from his wife. However, he arranged for correspondence to be sent to the house of his new partner (J), with whom he purchased another house in July 2007 (and whom he subsequently married after divorcing his first wife). In August 2007, M sold 110H. HMRC issued an amendment to his self-assessment, charging CGT on the gain. M appealed, contending that he had occupied 110H as his principal private residence.

Decision:

The First-tier Tribunal rejected this contention and dismissed his appeal. Judge Walters found that M's occupation of the house 'did not have any degree of permanence or expectation of continuity' and that he had 'an expectation of being able to move from (110H) and set up home by buying a house jointly with (J)'. M had never envisaged 110H as a long-term home, so that his occupation of it did not constitute 'residence' for the purposes of TCGA 1992 ss 222, 223.

Comments

As observed by David Whiscombe (director at BKL Tax), this case 'concerned PPR relief on a property which had been occupied as a home for a period of seven months before sale. Somewhat surprisingly, relief was denied, essentially on the grounds that such a period was too short to give the degree of permanence required to constitute the property a residence. If that decision is correct (which is doubtful), many gains previously considered exempt may be at risk of challenge and it may be appropriate to consider “protective” disclosures under [HMRC's recent] property sales campaign.'

P Moore v HMRC TC2827

Principal private residence relief

A doctor (EO) agreed to purchase a house in December 2006. He completed the purchase in March 2007 but sold the house in May 2007, realising a gain of £550k. HMRC issued an assessment on charging CGT on the gain. EO appealed, contending that he had occupied the house as his principal private residence.

Decision:

The First-tier Tribunal rejected this contention and dismissed his appeal, observing that EO 'had chosen (or been advised) not to attend or give evidence'.

Comments - The appellant's occupation of the house did not have a sufficient degree of permanence for it to have constituted his principal private residence. The tribunal was unfavourably impressed by the fact that the appellant declined to attend the hearing of his appeal or to give evidence. This decision is in line with the recent tribunal decision in P Moore v HMRC (TC2827).

Dr A Eghbal-Omidi v HMRC (TC02841

IHT form R27: application to appeal against calculation of tax due

The executor of an accountant (T) opted to use the form R27 procedure rather than to submit a tax return giving details of T's income. After receiving the completed form R27, HMRC issued a calculation showing a small repayment due, which it duly made. T's executor sought to lodge an appeal, contending that the repayment was inadequate. HMRC applied for the appeal to be struck out on the grounds that the calculation was not an assessment and there was no right of appeal against it.

Decision:

The FTT accepted this contention and struck out the appeal, applying Judge Bishop's decision in Prince v HMRC [2012] SFTD 786. Judge Porter observed that the executor would have a statutory right of appeal if he filed a self-assessment return.

Comments - The FTT upheld HMRC's contention that there is no right of appeal against a tax calculation issued following the submission of a form R27. This is in line with the earlier decision in Prince v HMRC, where the FTT had upheld HMRC's contention that there is no right of appeal against a form P800. Judge Porter observed that, if the executor wished to have a right of appeal, he would need to submit a tax return rather than to use the informal non-statutory procedure.

JG Taylor (Executor of J Taylor deceased) v HMRC (TC02866)

Entrepreneurs' Relief –Traps (Lecture P803 – 13.01 minutes)

Background

Entrepreneurs' relief offers a capital gains tax rate of 10% on aggregate net chargeable gains of up to £10 million. A claim for entrepreneurs' relief is available on a material disposal of business assets.

This includes a disposal of shares of a company where, throughout the period of one year ending with the date of disposal, the following requirements are satisfied (TCGA 1992, s 169(6)):

> "(a) The company is the individual's personal company and is either a trading company or the holding company of a trading group; and
>
> (b) The individual is an officer or employee of the company or (if the company is a member of a trading group) of one or more companies which are members of the trading group."

'Personal company' in this context is defined as follows (in s 169S(3)):

> "(3) For the purposes of this Chapter "personal company", in relation to an individual, means a company—
>
> (*a*) at least 5% of the ordinary share capital of which is held by the individual, and
>
> (*b*) at least 5% of the voting rights in which are exercisable by the individual by virtue of that holding."

The above requirements have the potential to cause difficulties in practice, which can result in the inadvertent loss of entrepreneurs' relief.

'Ordinary share capital' requirement

1. Definition

The definition of 'ordinary share capital' is widely defined for these purposes (in ITA 2007, s 989):

> "Ordinary share capital", in relation to a company, means all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits".

Thus an individual's shareholding in the company could be diluted by shares held by other shareholders that confer little or no rights.

2. 'Issued share capital'

For the purposes of the 5% ordinary share capital test, the question arises as to what 'issued share capital' means, i.e. it is measured in terms of the nominal value of the shares, or the actual value of the shares?

For example, a shareholder may have subscribed for the company's shares at par (i.e. £1 per £1 ordinary share), but their actual value may be higher or lower (e.g. £10 per £1 ordinary share).

In *Canada Safeway Ltd v Inland Revenue Commissioners* [1973] 1 CH 374 (a stamp duty case), it was held that 'issued share capital' referred to the nominal value of the shares, as opposed to the actual value. This approach was subsequently supported by the Upper Tribunal in *HMRC v Taylor and Haimendorf* [2010] UKUT 417 (TCC), which concerned the 'connected person' provisions for EIS relief purposes.

3. Voting rights

(a) Shares held jointly

Shares can he held jointly by two or more persons. For the purposes of the 'personal company' test in s 169S(3), each individual is treated as the sole shareholder of an appropriate number of ordinary shares (and voting rights) as is proportionate to the value of the individual's share (s 169S(4)).

For example, if husband and wife beneficially own a joint 10% shareholding in equal proportions, they are treated as each holding 5% of the shares and 5% of the voting rights.

(b) Exercisable or exercised?

HMRC accepts (following the CGT retirement relief case *Hepworth v Smith* [1981] STC 354) that it is not necessary for the voting rights actually to be exercised to count for entrepreneurs' relief purposes. It is only necessary to look at whether the voting rights are exercisable.

However, any voting rights which come into force only in certain circumstances are not ‘exercisable’ while those circumstances do not exist.

HMRC cites the following example (CG64050):

> “Preference shares in a company may entitle the shareholder to a vote only if the dividend on these shares was six months in arrear at the date of the company's annual general meeting. Such votes would not be exercisable if the preference dividend never fell into six months' arrear.”

‘Officer or employee’ requirement

(a) Meaning

For entrepreneurs’ relief purposes, an ‘employment’ has the same meaning as in the employment income legislation (*ITEPA 2003, s 4*), most commonly under a contract of service. The term ‘office holder’ also has the same meaning as for employment income purposes (*ITEPA 2013, s 5(3)*), and includes “any position which has an existence independent of the person who holds it and may be filled by successive holders.”

HMRC guidance states (at CG64110):

“There are no specific requirements regarding either working hours or the level of remuneration. The condition is simply that the individual should be an officer or employee.”

An individual who is not an office holder may be required to demonstrate that he or she is engaged under a contract service. This will be a question of fact.

(b) Resignation or termination

Where an individual is selling his or her shares and withdrawing from the business, care is needed on the timing of their withdrawal (e.g. resignation as an office holder or termination of employment with the company).

For example, on the sale of trading company shares, if the office or employment ends prior to the disposal of the shares, the requirement to have been an officer or employee throughout the period of one year ending with the date of disposal will not be satisfied, and entrepreneurs’ relief entitlement would be lost.

However, on a disposal of shares following the cessation of trading, entrepreneurs’ relief may still be available if certain conditions are satisfied (see s 169I(7)).

EMI shares

The entrepreneurs' relief conditions (in s 169I) were relaxed by Finance Act 2013 in respect of enterprise management incentive (EMI) shares. Among the changes, the normal 5% minimum shareholding (and voting rights) requirement for entrepreneurs' relief purposes does not apply to EMI shares.

In addition, the qualifying one year holding period runs from the date on which the qualifying EMI option is granted. These changes apply in relation to disposals of relevant EMI shares on or after 6 April 2013.

Contributed by Mark McLaughlin

Administration

Discovery determination

A company (N) submitted a return claiming to have made a loss in 2005. HMRC formed the opinion that N had claimed deductions for substantial expenditure which was not wholly and exclusively for the purposes of its trade. In December 2011, it sent a letter to N's accountants purporting to disallow the deductions, and stating that it had made 'protective discovery assessments'. N appealed, contending as a preliminary issue that HMRC had not made a 'discovery determination' within FA 1998 Sch 18 para 41(2), so that the losses remained available to carry forward. In June 2012, HMRC sent a letter, headed 'notice of determination', to N.

Decision:

The FTT allowed N's appeal against this determination, holding that it had been made outside the statutory time limit. Judge Sinfield rejected HMRC's contention that it had made a 'discovery determination' in December 2011, holding that the letter which HMRC had issued at that time 'did not have the appearance of an official record of a decision to make a determination in relation to a taxpayer but appeared to be part of the ongoing correspondence between HMRC and (N's) accountant in relation to the tax dispute. The only decision that the letter clearly recorded was the decision to issue protective assessments.' (An appeal against an information notice under FA 2008 Sch 36 para 1 was dismissed.)

Comments - This appears to be the first case dealing with what constitutes a 'discovery determination' under FA 1998 Sch 18 para 41(2). Judge Sinfield rejected HMRC's contention that a letter which it had issued in December 2001 constituted a 'discovery determination'.

Nijjar Dairies Ltd v HMRC TC2828

Special relief granted

The taxpayer instructed his accountant to complete his tax returns for 2006/07 and 2007/08. The agent fell ill assuring his client everything was under control, but died before completing the documents. HMRC had issued determinations for both years in September 2009, saying that the returns needed to be filed by 31 January 2011 to have them amended.

The taxpayer appealed, saying that the determinations were excessive, he was entitled to equitable treatment, and he had relied on his accountant to submit the returns, (which had eventually been submitted in July 2012). He added he was a pensioner and that other clients of the late accountant had had penalties lifted in similar circumstances. He claimed special relief under TMA 1970, Sch 1AB para 3A (the statutory replacement of equitable liability), stating it would be unconscionable for HMRC to recover the excess tax due.

HMRC rejected the claim. The taxpayer appealed.

Decision:

The First-tier Tribunal ruled that the taxpayer had satisfied the conditions in para 3A. He had acted appropriately in relation to his tax affairs, and had been unaware of his accountant's illness.

The taxpayer's appeal was allowed.

Comments - This appears to be the first case in which the First-tier Tribunal has considered the provisions of TMA 1970 Sch 1AB para 3A concerning 'special relief' (the statutory replacement for the practice formerly known as 'equitable liability'). Judge Rankin held that the statutory conditions were satisfied and that HMRC should have granted the relief.

Keith Gordon of Atlas Tax Chambers said: “This case is an important reminder of the benefit of having an independent tribunal determine a matter that was formerly adjudicated on only internally within HMRC. Therefore, although there are some limitations on the special relief rules, when compared with the former equitable liability practice, the case does show some of the advantages of the new rules.

“However, it is impossible to comment on the case without asking the logical prior question, which is 'how did the case get anywhere near the tribunal in the first place?'. The taxpayer won because the tribunal found HMRC's preferred approach to be unconscionable. This is not simply a case of HMRC taking a tougher line in a particular scenario than they might have done previously, but one where they have been found to have been acting in a way that could not be defended in any way whatsoever. The facts were crying out for relief and it is amazing (for which I mean seriously concerning) that the case would have passed through a number of different HMRC officers, none of whom seemed to be able to act conscionably.

“If Mr Maxwell had to pay his accountant to act for him in this, I seriously hope that consideration will have been given to making a costs application.

“This type of case should never have got to the tribunal and I hope that HMRC will change their procedures to ensure that it never happens again.”

W Maxwell v HMRC TC2849

Notice of objection to witness statements

A company (M) claimed a substantial repayment of VAT. HMRC rejected the claim on the basis that it appeared that the relevant transactions formed part of a MTIC fraud. M appealed. HMRC made an application to admit evidence relating to certain transactions with a Curacao bank. M opposed the application, but the First-tier Tribunal granted it and the Upper Tribunal upheld this decision ([2011] STC 1000). M subsequently made a further application to exclude 15 HMRC witness statements, including evidence relating to its dealings with the Curaçao bank, a statement by an HMRC officer (S) concerning MTIC fraud, and a statement by a KPMG accountant (F) concerning the 'grey market'.

Decision:

The First-tier Tribunal dismissed M's application. Judge Walters noted that the Upper Tribunal had previously held that the evidence relating to the Curacao bank was admissible. He noted that previous tribunal judges had reached contrasting decisions with regard to witness statements by S, and held that the challenged statement contained matters of relevance which were 'appropriate to be considered by the tribunal', although the statement also contained expressions of opinion which should be disregarded and which HMRC should not rely on. F's evidence concerning the grey market was expert evidence, and was admissible.

Comments - This is the latest instalment in what has become something of a long-running saga. However, the decision is of particular interest because different First-tier Tribunal judges have reached conflicting decisions with regard to HMRC witness statements submitted by a specific HMRC officer, who is well-known to barristers who specialise in MTIC fraud cases, and who HMRC regards as a particular authority on MTIC fraud. In the case of Globalbis Distribution Ltd v HMRC (TC00808), Judge Wallace took the somewhat unusual step of refusing to admit a witness statement by the officer in question. However, witness statements by the officer in question have been admitted in subsequent cases, and in this case Judge Walters rejected the company's application to exclude the officer's statement (as well as several other statements which HMRC wished to adduce in evidence).

Megantic Services Ltd v HMRC (No.5) TC2881

PAYE determination: construction workers

HMRC issued a determination under the Income Tax (PAYE) Regulations, SI 2003/2682, that a civil engineering contractor (W) was acting as an employer. W appealed, contending that the workers were self-employed. The General Commissioners accepted this contention but the Ch D remitted the case for rehearing.

The FTT reheard the case and Judge Nowlan upheld HMRC's determination (TC00032). However, Judge Wallace subsequently ordered a rehearing in Colchester rather than London, observing that it was 'unfortunate' that the case had been heard while W's adviser (a retired accountant) was on holiday, and that it was not clear 'why the matter was listed in London when the Tribunal had written in July 2008 agreeing to a local hearing' (TC00177).

The FTT re-heard the case in Colchester and again dismissed W's appeal (TC01660). Judge Walters held that 'the workers were controlled in the sense relevant to employment' and 'did not exercise their respective trades independently'.

Decision:

However, the Upper Tribunal remitted the case for rehearing for a different judge. Judge Hellier held that the wording of parts of Judge Walters' decision suggested that he might have been unduly influenced by the earlier decision of Judge Nowlan.

Comments - This has become something of a long-running saga. The General Commissioners had held that the workers were self-employed, but three different judges have disagreed, with both Judge Nowlan and Judge Walters upholding the reg 80 determinations which HMRC had issued. However, the Upper Tribunal has now remitted the case for rehearing by a further judge. (Judge Hellier's decision has not yet been released by the Tribunal Centre, but is available on the Pump Court website.)

PJ Wright v HMRC (No. 5) (Upper Tribunal)

Application for stay of appeal proceedings

HMRC issued a ruling that a company (P) should have accounted for NIC on substantial payments to an employee benefit trust. P appealed, and applied for the proceedings to be stayed pending the Upper Tribunal decision in HMRC v Murray Group Holdings Ltd. HMRC opposed the application

Decision:

The FTT granted it. Judge Herrington held that 'the further appeal proceedings in Murray Group Holdings will be of material assistance to the FTT in the present appeals. The reason for this is because that appeal will give rise to a binding decision on the FTT as to which of the two approaches articulated in the Murray Group's majority and minority decisions is the correct legal approach. The principle derived from consideration of those issues will be fundamental to the way in which the FTT will need to approach the facts of these appeals.'

Comments - As observed by David Pickstone and Kelly Stricklin-Coutinho (PwC Legal) this case 'revisits in some detail the principles the tribunal will take into account when deciding whether to grant a stay … Citing previous tribunal case law, the tribunal repeated the following two stage test: (1) would the decision of another court be of "material assistance (not necessarily determinative) in resolving issues before the tribunal or court in question"?; and (2) would it be "expedient" to stay the appeal?' In this case, the FTT decided that both tests were met. The appellant's application was allowed, and all further proceedings in these appeals were stayed until 56 days after the release of the Upper Tribunal's decision on the appeal in Murray Group Holdings.

Peel Investments (UK) Ltd v HMRC (and related appeals) TC2800

Incorporation of medical professionals **(Lecture B801 – 8.43 minutes)**

HMRC's interest in the incorporation of medical professionals started with Shares & Assets Valuation (SAV) announcing several months ago that they were applying a "cross-directorate project" to examine and if appropriate challenge business goodwill valuations used in incorporations involving Medical Professionals.

They made the following points, many of which should be capable of resistance:

1. HMRC's view is that a company cannot carry on a profession.

2. A company that employs professionals to exercise their profession as its employees has not succeeded to the practice previously carried on by the professional in their own right.

3. A key concern is whether any goodwill involved is actually personal to the individuals involved by virtue of their professional skills and reputation and therefore not capable of being transferred.

4. Another concern they have is whether a business that is capable of being sold as a going concern in the open market is involved, and if so, whether and to what extent any goodwill of value resides in that business.

What's New

This project has developed into specific attacks where HMRC are asking for a substantial amount of information. Much of it is answered easily enough, and relate to HMRC seeing whether they have grounds for reducing the goodwill value, but there are some surprising requests as well. The requests include the following, *with my comments in italics:*

- What were the main reasons for the incorporation of the business? *(what are HMRC looking for here? – perhaps one needs to concentrate on the commercial advantages of operating as a limited company, but not emphasising any thoughts that as a sole practitioner the business will have less value than as a limited company)*
- Full details of any changes to the business in the four years to the date of valuation *(why four years and are HMRC looking for evidence to support a restriction to any goodwill value?)*
- Full details of any comparable sales of similar businesses between unconnected parties upon which the goodwill valuation may rely – these should be acquisitions by corporate unconnected bodies or partnership businesses *(there are plenty of these around where a practice has been purchased without, as an example, the dentist or medic being retained by the new owners, thus demonstrating that there is a substantial goodwill value)*
- Details of the registration of the business with the Care Quality Commission (CQC) and copies of any reports/inspections made by the CQC
- If NHS work is part of the fee income we will require a copy of the NHS/PCT contract and its assignment *(a reasonable request, showing that it is essential to have the contract transferred to the limited company with all relevant permissions)*

The Good News

HMRC can surely not ignore the Employment Tribunal case reported in *Taxation* which supported the view that free goodwill does indeed exist. It was reported on an anonymous basis with the main points being as follows:

1. Mr and Mrs A ran a highly specialised surgical business in partnership, with their main business being located at a local private hospital.

2. The business name was well known owing to the specialist work undertaken at the hospital.

3. Mr A carried out the medical and surgical work and Mrs A supported the business in a non-medical capacity.

4. The business was incorporated, using a goodwill valuation supplied by an independent specialist valuer.

5. A year later Mr and Mrs A through their limited company considered expansion by taking on a further surgeon, but during the negotiation process Mr A died in an accident.

6. Following the death the new surgeon continued to assist with operations already booked, and he entered into discussions with Mrs A to purchase the business.

7. Agreement could not be reached and the limited company was liquidated. A dispute arose as to who was liable to pay the redundancy costs of the two employees – essentially had the new surgeon taken control of the business?

8. The dispute went to the Employment Tribunal who first of all considered whether an economic entity was in existence before what was alleged to be a transfer following the death of Mr A.

9. As a key point in the goodwill arena, the tribunal said that if the limited company was an "economic entity" within the meaning of the Transfer of Undertakings (Protection of Employment) Regulations, then there would have been a transfer. Looking at the website and marketing brand, they were more than simply an *"economic activity based on the personal reputation and skill of Mr A"*

10. Of course HMRC are not likely to accept without a fight any attempt to use this Employment Tribunal decision out of context. However, they can hardly ignore the specific comments made so that the goodwill is NOT personal and is transferable. That was the case even after the death of the individual that HMRC considered owned the non-transferable asset. The goodwill value was not extinguished on the death of Mr A, and indeed the new surgeon had offered to purchase for a six-figure cash sum after the death.

Contributed by Gerry Hart

Whether doctor guilty of fraudulent conduct

HMRC discovered that a doctor (E) had failed to declare income arising from offshore bank accounts. Following an enquiry, it formed the opinion that E had significantly underdeclared his income for several years. It issued discovery assessments and imposed penalties at the rate of 50% of the potential lost revenue.

Decision:

The First-tier Tribunal reviewed the evidence in detail and found that E 'was attempting to conceal information from HMRC: this was not merely negligent conduct, but fraudulent conduct'.

The tribunal also found that 'HMRC was justified in regarding the disclosed deposits of undeclared business income as merely examples of what was likely to be a more widespread practice'. The tribunal upheld all the assessments and penalties. (The tribunal also upheld assessments, and penalties at the rate of 42.5%, on a company of which E was the controlling director, and which had failed to account for tax under what is now CTA 2010 s 455.)

Comments - While it is relatively common for the tribunal to find that an appellant has been guilty of negligent conduct, it is relatively rare for the tribunal to find that an appellant has been guilty of fraudulent conduct. However, after a detailed review of the evidence, Judge Clark held that the doctor's conduct amounted to fraudulent conduct, and upheld the penalties which HMRC had imposed. The decision here is in line with the Ch D decision in Rowland v Boyle [2003] STC 855.

Dr S Easow v HMRC (and related appeals) TC2882

Penalties for failure to make payments: allocation of payments made

HMRC imposed a penalty under FA 2009 Sch 56 on the basis that an individual (F) had failed to pay his 2010/11 tax liability by the due date. F appealed, contending that he had sent a cheque for the liability but that HMRC had allocated this against arrears for previous years, rather than against his 2010/11 liability.

Decision:

The First-tier Tribunal allowed F's appeal. Judge Khan held that F had 'a reasonable excuse for assuming that HMRC would allocate the payments to the current liability rather than to the oldest debt due.

'The practice of the Commissioners does not appear to be covered in the legislation but rather in the Debt Management and Banking Manual (paras 210105 and 210120). It does not appear that these were brought to the notice of the taxpayer. In these circumstances, therefore, a taxpayer should be able to ask the Commissioners to reallocate the payments.'

Comments - This case demonstrates that, where a taxpayer has fallen into arrears, it is important to ask HMRC to allocate payments in such a way as to minimise liability to subsequent penalties and interest. HMRC sought to allocate the payments made to the oldest liabilities, which would mean that further penalties would arise in respect of the current liabilities. However, the First-tier Tribunal observed that there was no statutory backing for HMRC's action, and held that the payments should have been allocated to the current liability first, so that HMRC was not justified in seeking to impose further penalties.

J Francis v HMRC TC2860

Mitigation of penalty imposed by HMRC

HMRC formed the opinion that a civil engineer had underdeclared his income by more than £70,000. It issued an amendment to his self-assessment, and imposed a penalty under TMA 1970 s 95, at the rate of 60% of the evaded tax.

Decision:

The First-tier Tribunal upheld the penalty in principle but directed that it should be reduced to 45% of the evaded tax. Judge Tildesley observed that 'the tribunal is entitled to take an overall view of the appropriate penalty, and not obliged to follow HMRC's approach of giving abatements for various categories of conduct'.

Comments - The FTT decided that HMRC had been unduly harsh in imposing a penalty at the rate of 60% of the tax lost, and reduced it to 45%. The interesting feature of this case is that, unlike several other tribunal judges, Judge Tildesley specifically declined to follow the general HMRC procedure of arriving at the percentage rate by giving specific discounts for the extent of disclosure, the seriousness of the offence and the degree of cooperation. Judge Tildesley's comments are self-explanatory, although it is uncertain whether other tribunal judges will adopt a similar approach.

Dr J Kohal v HMRC TC2870

Mitigation of penalty

HMRC formed the opinion that a trader (E) had underdeclared his turnover and imposed a penalty, which it mitigated by 40%. E appealed.

Decision:

The FTT slightly reduced the amounts of the underlying assessments, but upheld the imposition of the penalty. Judge Nowlan held that 'the percentage reductions that HMRC has conceded were certainly fair, if not generous'.

Comments - The FTT held that there were no grounds for any further mitigation of the penalty. Judge Nowlan's comments are self-explanatory.

BS Eyin v HMRC (No. 2) TC2834

Company applying for costs against HMRC

A company's appeal against the rejection of a claim to input tax had been allowed on the second day of the hearing. The company applied for costs

Decision:

The First-tier Tribunal rejected the application, holding that HMRC had not acted unreasonably.

Comments - The First-tier Tribunal rejected the company's application for costs, holding that costs could only be awarded against HMRC if it had acted unreasonably and finding that it had not done so in this case.

Market & Opinion Research International Ltd v HMRC (No. 3) TC2876

Notice confirmed in part

HMRC issued notices under TMA 1970, s 19A to the taxpayers in respect of their lettings business. The notices related to bank statements and money market transactions. The taxpayers appealed. The appeal was late, but despite HMRC's objection, the First-tier Tribunal granted it because of some "procedural irregularities" in the relevant correspondence.

Decision:

The First-tier Tribunal noted that the business was run through a bank account that was also for personal purposes. Despite this, the details of the transactions required by HMRC were "reasonably required" because they related to the lettings business.

With regard to the money market documents, the judge said it would be "unduly onerous" to require the taxpayers to provide these, so removed them from the notices.

The taxpayers' appeal was allowed in part.

Comments – HMRC Compliance Handbook Manual sets out clearly their powers regarding information and inspection. Information or an inspection can only be reasonably required where it could affect a person's tax position. In this case because the business was run through an account which was also used for personal purposes it fell within the information that HMRC were entitled to see.

I Phillips; P Phillips; Ivan and Patricia Phillips (a firm) v HMRC TC2756

No excuse for late appeal

The taxpayer, a barrister, completed her pupillage in 1996. She then had a short period at the bar before returning to academia. She went back to the bar in 2003, but her chambers closed in 2005 and she moved home to care for her sick mother. Later in 2005, she joined new chambers and appointed an accountant.

She drew up her accounts on the basis that the seven-year rule under which barristers are taxed on the amounts received or invoiced began in 2003/04, not in 1996 when she was called to the bar.

HMRC opened enquiries into her 2004/05, 2005/06 and 2006/07 tax returns and found that her income was understated. They also discovered that her tax return for 2003/04 was incorrect. The taxpayer said the understated income arose mainly because of her belief that the seven-year period began in 2003/04.

HMRC issued assessments and imposed penalties, against which she appealed. After an internal review went against the taxpayer, she claimed to have appealed to the tribunal. This appeal was not received and several months later, she completed another appeal form.

Decision:

The issue before the First-tier Tribunal was whether to accept a late appeal. The tribunal said it was for the taxpayer to show why the late appeal should be granted. In this instance, the judge said that, regardless of the taxpayer not having any proof that she did submit an appeal in time, she did not have grounds to appeal against the penalties. She submitted incorrect returns through negligence on her part and much of the information that had been needed to make accurate returns was later provided to HMRC during the enquiry. Although she had taken professional advice, it was not known what information she had given her adviser and, in any event, it was her responsibility to submit correct returns.

Permission to appeal out of time was refused.

Comments – The decision is self explanatory.

L A Davidson v HMRC TC 2771

Two wrongs …

The taxpayer was a barrister who was entirely funded by the Legal Services Commission. In 2007, he appointed an accountant to deal with his tax returns. The adviser told the taxpayer how much tax he had to pay each 31 January, except for the year 2010/11. The taxpayer did not query this because he had been notified by HMRC that he had no tax to pay in respect of that year, although he was expecting to make a payment on account for the following year. Eventually, on 27 January, the adviser told the taxpayer that he should pay £11,351 on 31 January. Because he did not have cash available to pay this sum, he had to realise an investment and paid the tax on 30 March.

HMRC imposed a 5% late payment penalty on the taxpayer, against which he appealed, claiming reasonable excuse on the following grounds:

- for the eight weeks the tax was outstanding, the Legal Services Commission owed him more money than the amount due and HMRC and the commission are both part of the UK government;
- HMRC's notice misled him into believing he had no tax to pay;
- his accountant had been negligent;
- the public purse has not suffered because he paid other tax liabilities early and he had paid interest on the late paid tax;
- the tax return was filed on time; and
- he did not receive a statement from HMRC setting out his tax liability until 22 February 2012.

Decision:

The First-tier Tribunal said that none of these constituted reasonable excuse. Although reliance on a third party could constitute reasonable excuse, in this instance the cause of late payment was not the adviser's failure to act, but the taxpayer's lack of action once he realised the agent had not done what he expected of him.

With regard to the Legal Services Commission owing the taxpayer money and being a government body, the tribunal said this was not a reasonable excuse because it did not cause the default. The taxpayer had funds available but not immediately accessible, regardless of the money owed to him.

The taxpayer's appeal was dismissed.

Comments – The concept of reasonable excuse is incredibly important and therefore cases which appear to rely must be considered carefully. The taxpayer had a significant number of reasons illustrated above as to why he considered he had a reasonable excuse and whilst they might appear to be justified unfortunately none of them constitute an acceptable reasonable excuse. In recent times the Tribunals have pushed the border of what can be considered a reasonable excuse but this is not one of those circumstances.

M Duffy v HMRC TC2795

HMRC application for decision to be set aside

HMRC had sent a tax return to an executor in April 2012. HMRC received the completed return form on 14 January 2013, and imposed a penalty. The executor submitted an online return on 24 January 2013, and appealed against the penalty.

Decision:

Judge Brannan allowed the appeal, holding that since HMRC had not submitted the paper return in evidence, and there was no proof that it had been signed, it should not be treated as a valid return for the purposes of TMA 1970 s 8A. Accordingly, the online return should be treated as the valid return, so that no penalty was due (decision TC02804). HMRC subsequently lodged an application for the decision to be set aside. Judge Brannan rejected the application, applying the principles laid down by Judge Poole in Fraser v HMRC [2012] UKFTT 189 (TC), TC01884.

Comments - In Fraser v HMRC, Judge Poole observed that 'the function of the tribunal is to provide efficient resolution of disputes between taxpayers and HMRC. Whilst some latitude may be allowed for taxpayers who are inexperienced in presenting their case, it would completely undermine the tribunal's function if it were routinely to allow losing parties (whether taxpayers or HMRC) to relitigate appeals on the basis that they did not feel they had put sufficient evidence before the tribunal when it first heard the appeal. Parties should be well aware that an appeal offers a one-off opportunity to put their case as best they can, not an opportunity to hope for successful outcome on the basis of minimal effort and then make a better second attempt if the first fails, possibly followed by an even better third attempt, and so on. To put it in layman's terms, an appellant must realise that the appeals system gives him one bite at the cherry unless a very good reason can be shown why he should have a second.' Judge Poole's observations were directed at taxpayer appellants, but Judge Brannan has confirmed that the same principles apply to cases where HMRC would prefer to take a second 'bite at the cherry'.

T Rosenbaum's Executor v HMRC (No. 2) TC2884

Application for disclosure of documents

Two companies reclaimed input tax. HMRC rejected the claims on the grounds that it appeared that the transactions were connected to MTIC fraud. The companies appealed, and lodged an application for *HMRC to disclose various documents, including 'a copy of all of the respondents' policy documents in relation to "contra-trading" and the allocation of alleged tax losses'.*

Decision:

The First-tier Tribunal dismissed the companies' applications. Judge Sinfield held that 'the appellants' submission that HMRC cannot deny the appellants' right to deduct input tax on goods without allocating the amount of the VAT loss to the appellants' input tax claims and notwithstanding the possibility of double or multiple recovery of the VAT loss is unsustainable'.

Comments - The First-tier Tribunal rejected the companies' contention that HMRC should be required to disclose a large quantity of policy documents relating to MTIC fraud. Judge Sinfield's comments are self-explanatory.

Abbott International Trading Ltd v HMRC (and related appeal) TC2893

Condition not met for enquiry

The taxpayer submitted his 2008/09 tax return claiming that he was not resident and not ordinarily resident. He said he emigrated to Gibraltar in March 2008. He had sold his car and tried to dispose of his home but had to let it because of poor market conditions. He owned another property in the UK in which his daughter lived.

HMRC required other information which the taxpayer supplied, except for his bank, building society and credit card statements. HMRC issued a notice under FA 2008, Sch 36 for those documents. The taxpayer appealed.

HMRC were relying on condition B in para 21(6) that they had reason to suspect that the taxpayer had income for the year on which tax would be due.

Decision:

The First-tier Tribunal found that the condition was not satisfied. HMRC admitted that none of the information they held gave them reason to suspect that income should have been assessed to tax for the chargeable period that may not have been. HMRC's assertion that they might find additional information from the documents (required by the notice) that would show additional income should be assessed was not acceptable. The tribunal said “seeking information or documents in order to try to meet condition B is simply the wrong way round”.

Had the notice been given in the course of enquiry under para 21(4), HMRC could have relied on the “more generous terms of condition A”, but they had lost the opportunity to do that.

The taxpayer's appeal was allowed.

Comments - The Tribunal concluded that condition B was not met. In order for condition B to be met, there had to be reason to suspect that an amount that ought to have been assessed may not have been assessed. None of the information held by HMRC, either singly or taken together, gave reason to suspect that an amount that ought to have been assessed to relevant tax for the chargeable period may not have been assessed. HMRC had admitted that it sought additional information on the basis that it could, when added to the information already held by HMRC, give the ‘reason to suspect’ required by para.21(6)(a). That was not the correct approach. Seeking information or documents in order to try to meet condition B was simply the wrong way round. The notice was set aside.

K Betts v HMRC TC2824

Loss carried back: whether penalty due

An accountant notified HMRC on 24 January 2012 that his client (R) had incurred 'current year losses', which he wished to set against his profits for 2010/11. In May 2012, R submitted his 2011/12 return. In the meantime, HMRC had imposed a penalty for failure to pay the 2010/11 tax by the due date of 31 January 2012.

Decision:

The First-tier Tribunal dismissed R's appeal against the penalty. Judge Cornwell-Kelly held that TMA 1970 s 42(1A) required a claim to be quantified. Therefore, the letter of 24 January 2012 could not be treated as a claim.

Comments -The First-tier Tribunal upheld HMRC's contention that the appellant was liable to a penalty for failing to pay the tax due for 2010/11 by 31 January 2012, even though the tax liability was subsequently extinguished by loss relief carried back from 2011/12.

ME Robins v HMRC TC2902

M D Cotter

The Supreme Court began hearing HMRC's appeal against the CA decision in MD Cotter v HMRC [2012] STC 745 on Thursday 3 October. This is an important case, as the CA specifically rejected HMRC's long-held view that a tax return for one year cannot include a claim for loss relief relating to a subsequent year.

The facts are that an individual (C) submitted a 2007/08 tax return showing a significant liability. In January 2009, he submitted an amendment to the return, stating that he had made a loss in an employment for 2008/09 and that he should be allowed to set this loss against his income for 2007/08 under ITA 2007 s 128(2). HMRC began an enquiry into the loss claim, on the basis that it arose from an avoidance scheme, and also took the view that C was not entitled to make a claim in a 2007/08 return for loss relief relating to 2008/09, but should have made a separate claim under TMA 1970 Sch 1A. In June 2009, HMRC began county court proceedings to collect the tax shown in C's original return. The Ch D gave judgment for HMRC, holding that C's claim for loss relief was not a defence to HMRC's claim for payment of the tax originally shown as due for 2007/08. C appealed to the CA, which unanimously allowed his appeal.

Arden LJ held that the effect of TMA 1970 s 9A(4) was that HMRC could enquire into 'anything contained in the return, or required to be contained in the return'. Therefore, 'if HMRC decides to challenge matters contained in the return in response to the boxes provided, it must use either the section 9A procedure or seek to make a correction to the return under section 9ZB (if applicable). This is so even if HMRC is correct that, under the relevant statutory provisions governing loss relief claims, that claim could not be the subject of relief against liability to tax for the year to which the return relates.

In that case, it is up to HMRC, if it wishes to achieve the contrary result, to make sure that the form of the return does not permit such a claim to be made.' Furthermore, the fact that the loss claim was contained in an amendment to the return, rather than in the original return, was not material. HMRC should have used the procedure under TMA 1970 s 9A, and C should have had a right of appeal to the First-tier Tribunal to adjudicate on his claim to loss relief.

Felixstowe Docks

The ECJ has begun hearing the case of Felixstowe Dock & Railway Co Ltd v HMRC (and related appeals) (ECJ Case C-80/12). Several members of a group of companies (with an ultimate Hong Kong parent) claimed group relief in respect of losses made by a UK company (HUK) through an intermediate holding company (HS) which was resident in Luxembourg. HMRC rejected the claim on the basis that the effect of ICTA 1988 s 402(3B) and s 406(2) was that the companies were not entitled to relief. The companies appealed, contending that the relevant UK provisions contravened EC law. The First-tier Tribunal directed (see decision TC01674) that the case should be referred to the ECJ for a ruling on whether Articles 49 and 54 of the TFEU should be treated as precluding 'the requirement that the “link company” be either resident in the United Kingdom or carrying on a trade in the United Kingdom through a permanent establishment situated there'.

Business Taxation

Purchase of Own Shares – Update (Lecture B803 – 14.35 minutes)

Where a company buys back its own shares from an individual shareholder, there is generally a distribution in respect of any payment in excess of the capital originally subscribed for the shares. For tax purposes, the transaction normally falls to be treated as an income distribution (*CTA 2010, s 1000(1)*).

However, there is an exception in the case of unquoted trading companies (*CTA 2010, s 1033*). If certain conditions are satisfied, the vendor is generally treated as receiving a capital (as opposed to an income) payment on a purchase of own shares.

The tax legislation on company distributions (*CTA 2010, Pt 23, Ch 3*) includes provisions specifically dealing with the purchase of own shares by an unquoted trading company (*CTA 2010, ss 1033–1048*). The purchase of own shares rules exclude from distribution treatment payments made by a company on the redemption, repayment or purchase of its own shares, if certain conditions are satisfied. Guidance on the tax treatment of a company purchase of own shares is contained in HMRC's Company Taxation manual (at CTM17505 onwards), mainly in respect of income distribution treatment, and in the Capital Gains manual (at CG58600 onwards) relating to capital gains treatment.

It is important to note that a purchase of own shares must comply with company law requirements (in *Companies Act 2006*) to be valid. HMRC can only consider a request for clearance on a transaction which appears to be a valid purchase of own shares (Tax Bulletin, Issue 21 (February 1996)). Failure to comply with the legal requirements could make the transaction void and legally unenforceable, and render the company and its officers liable to sanctions (*CA 2006, s 658(2), (3)*).

HMRC guidance points out that he shares are not treated as cancelled, and legal ownership remains with the vendor (CTM17505). In the case of owner-managed companies, there are potential tax implications including a potential liability for the company under the 'loans to participators' provisions (*CTA 2010, s 455*), and a taxable benefit for the vendor under the beneficial loan rules (*ITEPA 2003, s 175*). However, this treatment may not always apply (see *Kinlan & Anor v Crimmin & Anor* [2006] below).

Company law requirements

The *Companies Act 2006* specifies a procedure for share buy-backs. The following is a brief outline of the main company law requirements. Some amendments were introduced by *The Companies Act 2006 (Amendment of Part 18) Regulations 2013*, *SI 2013/999*, to ease the statutory requirements for purchases of own shares in relation to the new employee shareholder shares (*FA 2013, s 55, Sch 23*), which became available from 1 September 2013.

- Power to purchase own shares - A company is not required to have the power in its Articles of Association to purchase its own shares. However, the members may restrict or prohibit a purchase of own shares through the company's Articles if they wish (*CA 2006, s 690*).

- Payment for purchase of shares - The shares purchased must be fully paid, and the company must pay for the shares on completion (*CA 2006, s 691*). However, there is an exception from the requirement for payment upon completion in the case of private companies purchasing shares for the purposes of, or pursuant to, employee share schemes by instalments, with effect from 30 April 2013 (*SI 2013/999, reg 3*).

- Funding for the purchase – Subject to the exception below, a company is required to purchase its own shares out of distributable profits, or out of the proceeds of a fresh share issue to finance the purchase (*CA 2006, s 692(2)*). However, a private company may purchase its own shares out of capital, and using cash without having to identify it as distributable reserves, from 30 April 2013 (following *SI 2013/999*), subject to certain limits and conditions (*CA 2006, ss 692(1); 709–723*). The above cash limit must not exceed the lower of £15,000 or 5% of the value of the company's share capital.

- Authority for purchase - A contract for an 'off-market' company purchase of own shares must be approved in advance. However, separate conditions apply if the purchase is for the purposes of or pursuant to an employee share scheme, with effect from 30 April 2013 (*CA 2006, ss 693, 693A*). A company may enter into a contract to purchase its own shares if (*inter alia*) the shareholders approve the contract terms by an ordinary resolution (*CA 2006, s 694(2)*). Prior to the changes introduced by *SI 2013/999*, a special resolution was required.

- Disclosure - A copy of any written contract or a memorandum of its terms must be made available to the members. For resolutions at meetings, it must be available for inspection at the company's registered office for at least 15 days prior to the meeting, and also at the meeting itself (*CA 2006, s 696(2)*).

- Cancellation of shares - Following the company share repurchase, the relevant shares are treated as cancelled. The company's share capital is reduced by the nominal value of the cancelled shares (*CA 2006, s 706*). However, this rule does not apply to treasury shares.

- Inspection of contract - The company must keep a copy of the contract, or a memorandum of its terms, available for inspection for a period of at least ten years from conclusion of the contract (*CA 2006, s 702*). Alternatively, a copy of the contract (or any variation) may be kept for inspection at an alternative location in the UK to be notified to the registrar (*Companies (Company Records) Regulations, SI 2008/3006*). The company must notify the registrar of the place where the contract is available for inspection.

- Reporting requirements - A return must be made to Companies House within 28 days, stating the number of shares purchased, their nominal value and the date of purchase (*CA 2006, s 707*). Other than treasury shares which are not cancelled, the company must also give notification of the

cancellation of the shares within 28 days, together with a statement of the company's share capital (*CA 2006, s 708*).

Company law conditions not satisfied

In the (non-tax) case *Kinlan & Anor v Crimmin & Anor* [2006] EWHC 799 (Ch), the company (in liquidation) was seeking the repayment of proceeds paid to a departing shareholder on a purchase of own shares. The court held that the transaction was void as it breached company law (ie by reason that part of the consideration for the shares was deferred). However, it was also held that the shareholder was entitled to keep the money received from the company, based on certain "important and unusual features of the case". These were broadly:

- If the parties had been made aware that the deferred consideration provision breached company law, they would have changed the terms of the agreement so that the purchase price had to be paid on completion.

- The company was a 'quasi-partnership' in which the shareholder's rights were protected by a combination of his rights as a shareholder and his position as a company director and employee. When his shares were 'bought' he ceased to take an active part of the company's affairs. His position had therefore changed on the assumption that the agreement was valid.

The tax implications of the decision were not considered.

More recently, in *Baker v Revenue & Customs* [2013] UKFTT 394 (TC), the First-tier Tribunal held that a company purchase of own shares (in cash and in kind) during 2005-06 was void by reason of the failure to comply with Companies Act requirements (i.e. a provision for deferred consideration and an insufficiency of distributable profits).

The appellant was therefore under an obligation to return funds to the company. This meant that those proceeds did not, as HMRC contended, amount to an income distribution for tax purposes. The appeal was therefore allowed.

Contributed by Mark McLaughlin

GAAR Guidance **(Lecture P805 – 7.55 minutes)**

There is no doubt that whatever your client base the general anti-abuse rule (GAAR) needs to be carefully considered in your day to day work in the tax field.

GAAR overturns tax arrangements which are abusive as defined, which in turn involves a "double reasonableness" test. It does not automatically apply whenever some tax is avoided. In essence GAAR is an issue where there are arrangements entered into or carried out which cannot reasonably be regarded as a reasonable course of action in relation to the relevant provisions having regard to all the circumstances.

That may sound subjective, which is a concern given that the GAAR is policed via the self assessment system with no opportunity to test the water with HMRC beforehand via a clearance service. Fortunately, HMRC have published a 200 page guidance document. Part D covers 41 examples.

In all of them they approach the issues in the same order, and this is best considered by looking at one of their examples (example 19). In that example the conclusion that GAAR does not apply is probably not surprising (albeit it is reassuring) but the approach to be adopted in all cases is clearly illustrated. It is that approach which should be followed by the tax adviser whenever GAAR is considered.

Gifts Between Spouses

This example is intended to illustrate standard tax planning on gifts between spouses.

D19.1 ***Background***

D19.1.1 This example considers the capital gains tax position on an arrangement involving a gift of shares between spouses, followed by death of the transferee.

D19.2 ***The facts***

D19.2.1 In January 2012 Mr and Mrs Jones are told that Mrs Jones is terminally ill. In February Mr Jones gives his shares in an investment company, which are standing at a significant gain, to his wife. Under the terms of her Will as drafted at the date of the gift he will inherit those shares when she dies. Mrs Jones has full capacity at the time of the gift.

D19.2.2 Mrs Jones dies in June and the shares pass to Mr Jones under the terms of her Will. Mrs Jones has not executed a new Will since the gift.

D19.3 ***The relevant tax provisions***

Sections 58, 62(1)(b) and 62(4)(a) TCGA 1992.

D19.4 ***The taxpayer's tax analysis***

D19.4.1 The gift of the shares is a transfer between a husband and wife who are living together. This transaction is treated by s58 TCGA 1992 as taking place for such consideration as will give rise to neither a gain nor a loss.

D19.4.2 All the assets of the deceased which pass to his or her personal representatives are deemed to have been acquired by them at market value at the date of death under s62(1)(b)TCGA 1992. When beneficial ownership of any asset of the estate passes from the personal representatives to a legatee, S62(4)(a) TCGA 1992 provides that no chargeable gain shall accrue to the personal representatives.

D19.4.3 In summary, there is no chargeable gain on the gift of shares by Mr Jones to Mrs Jones and Mr Jones re-acquires the shares at market value at the date of his wife's death. In effect, the gain that has accrued during the earlier ownership of shares by Mr Jones has disappeared.

D19.5 ***What is the GAAR analysis under s206(2) of FA 2013?***

D19.5.1 The main purpose of the arrangement is to obtain a tax advantage. The gift of shares was made by Mr Jones in the hope of washing out the gains on the understanding that his wife would leave them back to him.

D19.5.2 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*
Yes. The principle of s58 TCGA 1992 is to allow assets to be transferred between spouses and between civil partners on the basis of no gain/no loss.

Assets passing on death to personal representatives are treated as taking place at market value and no gain is charged when the assets are passed to the legatees.

D19.5.3 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The means of achieving the tax results depend upon the gift, the death of Mrs Jones and her choosing to leave the shares to Mr Jones in her Will. There are no abnormal or contrived steps here; the transactions are normal arrangements between spouses or civil partners.

D19.5.4 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

No.

D19.5.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

Yes. HMRC sets out in its instruction manuals how these transactions are to be treated for CGT purposes.

D19.6 ***Conclusion***

D19.6.1 These arrangements can reasonably be regarded as a reasonable course of action in relation to the tax provisions having regard to all the circumstances. The GAAR would not apply.

D19.7 ***An alternative arrangement - What if the facts were the same as those above but the gift of shares was made on the day of Mrs Jones' death?***

D19.7.1 HMRC's view is that so long as Mrs Jones was in full capacity at the time of the gift the analysis would be the same and that the GAAR would not apply. This assumes of course that the gift was validly completed prior to death.

Contributed by Gerry Hart

R&D credit: draft guidance

HMRC has published for comment until 31 January 2014 draft guidance on the new 'above the line' research and development expenditure credit, available to companies within the charge to corporation tax for expenditure incurred on or after 1 April 2013 (by virtue of FA 2013 Sch 15).

Dealing in mobile phones: whether trade ceased

An individual (K) bought and sold large numbers of mobile telephones between 2000 and 2006, mostly as an agent for a Singapore company but also as an independent principal. In 2010, he submitted a 2006/07 tax return claiming terminal loss relief of £24m, on the basis that his trade had ceased in 2006. HMRC rejected the claim and K appealed.

Decision:

The First-tier Tribunal dismissed his appeal, observing that he had remained registered for VAT and had resumed active trading in 2009, and finding that he 'did not in fact cease trading in 2006/07'. (The tribunal also held that K was carrying on a single trade, regardless of whether he was acting as an agent or as an independent principal.)

Comments - The First-tier Tribunal upheld HMRC's contention that the appellant had not ceased to trade and was therefore not entitled to the terminal loss relief which he had claimed.

D Kishore v HMRC TC2855

Laundry is commercial

A syndicate funded a project to build a laundry in the Lanarkshire enterprise zone at Wishaw. The laundry was to be used by local NHS hospitals. The taxpayer, one of the investors in the syndicate, claimed an initial allowance under CAA 2001, s 305 contending that the building was a “commercial building” within s 271(1)(b)(iv). HMRC refused the claim on the grounds that, although the laundry was a building, it did not have a commercial use — the organisations using the facility could not make a profit.

The taxpayer appealed, saying there was a trading relationship between the NHS trusts using the laundry.

Decision:

The First-tier Tribunal said one issue was in point: was the laundry building a commercial one in the sense that it was used for a trade? It considered that it was. Although there was no profit motive, the arrangements between the hospitals were at arm's length. The Lanarkshire Primary Care NHS Trust leased the laundry and then made arrangements with two other health boards for them to use it

because it was larger than Lanarkshire required. The tribunal said the laundry activity in the building constituted a trade and therefore the building was commercial.

The taxpayer's appeal was allowed.

Comments - The First-tier Tribunal accepted the appellant's contention that the laundry qualified as a 'commercial building' within CAA 2001 s 271. Judge Mure held that 'the defraying of overheads and other expenses approximates to a profit motive in this context' and that 'the absence of an additional excess element of profit makes little difference'. The laundry activity conducted within the building was within the definition of a trade, and the building qualified as a commercial building.

D Thomson v HMRC TC2858

Whether losses can be surrendered to holding company

A company (G) which operated a football club submitted returns claiming losses, which it claimed to surrender to its holding company. HMRC issued discovery determinations, refusing the claims on the grounds that G's business had not been carried on 'so as to afford a reasonable expectation of gain', within what is now CTA 2010 s 44.

Decision:

The First-tier Tribunal reviewed the evidence in detail and dismissed G's appeal. Judge Walters observed that the directors' report had 'indicated that the accounts had been prepared on a going concern basis only by reference to the directors' and shareholders' indication of their intention to continue to support the club'.

Comments -CTA 2010 s 44 provides that relief under CTA 2010 s 37 is not available for a trading loss, unless 'the trade is carried on on a commercial basis, and with a view to the making of a profit in the trade or so as to afford a reasonable expectation of making such a profit'. The First-tier Tribunal upheld HMRC's contention that the company's trade had not been carried on in such a way as to afford a reasonable expectation of making a profit, so that its holding company was unable to claim relief for the losses which the football club had incurred.

Glapwell Football Club Ltd v HMRC TC2904

HMRC develops a new approach to Business Records Checks

HMRC Business Records Checks (BRCs) programme uses on-site visits to encourage customers to keep better records, and keep up to date. The checks help and encourage small and medium-sized enterprises to improve the standard of records they keep. This then helps them to send correct returns to HMRC.

Customers whose records were not adequate on first inspection, and who received follow up visits, all improved their record-keeping standard. HMRC have not had to charge any penalties.

In the latest phase of BRC, many of the customers contacted by HMRC have been keeping records correctly. So HMRC wants to explore how to better target this activity.

From 4 November 2013, HMRC's BRC activity in the Edinburgh, Glasgow, Leeds, Bradford and Stockport areas will explore new ways of using the checks. As part of this, HMRC will evaluate new risk processes and ensure new approaches are cost-effective and fit with its wider compliance activity.

HMRC will also work with tax agents' representatives to review the benchmarks of what good record-keeping should be. Many tax agents already do much to improve their clients' record keeping and HMRC wants to work with them to improve standards.

For customers outside the development areas HMRC will continue with existing BRCs until they are completed. This means:

- if you have received a letter dated on or before 23 October 2013, HMRC will still contact you by telephone to ask you to complete an initial telephone questionnaire
- if HMRC has not yet booked a visit with you, they will offer you the opportunity to get advice on keeping business records from their Business Education and Support Team as an alternative to a visit
- if HMRC has already booked a visit, they will offer you the option of advice on keeping business records from a member of the Business Education and Support Team
- if you are waiting for a follow-up visit, this will still go ahead

International Agreements to Improve Tax Compliance

The government has stated that it will look to sign further Agreements with other jurisdictions as part of their commitment to combat tax evasion. The Crown Dependencies (Isle of Man, Guernsey and Jersey) and the British Overseas Territories (the Cayman Islands, the British Virgin Islands, Bermuda, Anguilla, Turks and Caicos Islands, Montserrat and Gibraltar) have all agreed to enter into automatic tax information exchange agreements with the UK.

The UK and the Isle of Man signed an IGA - the 'UK-Isle of Man Agreement to Improve International Tax Compliance' - on 10 October 2013. This is the first agreement of this type to be signed and published where neither party is the USA.

Guernsey and Jersey signed IGAs with the UK on the 22 October 2013 - the 'UK-Guernsey Agreement to Improve International Tax Compliance' and the 'UK-Jersey Agreement to Improve International Tax Compliance' - meaning that all the Crown Dependencies have now entered into automatic tax information exchange agreements with the UK.

Selected areas of draft guidance have been published alongside the Agreements to give clarity on the key differences in scope. Further draft guidance relating to issues specific to the Agreements will be published in full, along with draft regulations, later this year.

Automatic cancellation of a PAYE scheme

From 28 October 2013 HM Revenue & Customs (HMRC) will be issuing letters (RTI206) to employers to advise that, because our records indicate that they have **not** operated PAYE or paid any subcontractors, we have automatically closed the PAYE scheme due to inactivity.

The letters are generated following an automated review of our records. The benefit of this approach is that:

- HMRC identify that no returns are due at a much earlier point
- it removes the obligation to make real time submissions and subsequent requests for both returns and payment
- it removes an unnecessary burden on employers and the additional cost to HMRC of maintaining and administrating their record on our systems

For more information on the criteria HMRC apply for closing a scheme please see guidance on 'Automatic cancellation of a PAYE Scheme'.

Pension liberation

HMRC is committed to combating pension liberation activity. HMRC has been working closely with other government departments/agencies and the pension industry to take action to prevent pension liberation and preserve pension savings.

Increasing numbers of pension savers are being targeted by unscrupulous companies encouraging them to access their pension savings early. This is commonly known as 'pension liberation' and has significant tax consequences.

HMRC has made a number of changes to strengthen existing processes to deter pension liberation and safeguard pension savings. These changes will take effect from 21 October 2013 - read on to find out more.

Registering a pension scheme

HMRC has made the pension scheme registration process more robust by moving away from a 'process now, check later' approach. Scheme registration will no longer be confirmed on successful submission of the online form. This will enable HMRC to conduct detailed risk assessment activity before making a decision on whether or not to register a scheme.

Transferring pension funds between registered pension schemes

To help scheme administrators decide whether to make a transfer, HMRC has revised the process for responding to requests for confirmation of the registration status of the receiving scheme. Under this new process HMRC will respond to requests for confirmation of the registration status without seeking

consent from the receiving scheme. However HMRC will only provide confirmation where the receiving scheme is registered and the information held by HMRC does not indicate a significant risk that the scheme was set up, or is being used, to facilitate pension liberation. Otherwise, a response will be issued setting out the conditions in which HMRC will confirm registration status and explain that one or both of the conditions are not satisfied.

Other Information

HMRC will continue to raise the profile of the dangers of pension liberation to deter individuals from liberating their pension. HMRC has and will continue to publish clear information on their website. HMRC has recently added a factsheet to their website to highlight the tax

Sponsorship expenditure – more case law (Lecture B802 – 7.16 minutes)

Introduction

Sponsorship payments by a business are tax deductible if (and only if) they meet the "wholly & exclusively" test in Section 34 ITTOIA 2005 and Section 54 CTA 2009. This is made clear in para BIM42555 of the Business Income Manual, and as the amount of the payment can often be significant the arrangements have to be carefully put in place to obtain a deduction. That usually involves being able to show that all of the expenditure meets that test, with any private purpose being merely incidental, or a specific item of expenditure meets the teat.

Sponsorship expenditure is usually shown in the accounts as advertising and promotion. The general position is that it is tax deductible provided (a) the sponsorship payments do not also benefit the personal interest or hobby of one or more of the main directors and/or shareholders, or indeed of their family; (b) there is no business entertaining aspect to isolate and then disallow; and (c) there is no capital expenditure involved.

INTERFISH LIMITED v HMRC UKUT 0336

HMRC successfully challenged the claim for corporation tax relief in this case, at Upper Tribunal level.

Interfish is a successful seafood supplier based in Plymouth. It gave over £1m to its local rugby club, Plymouth Albion. The company gave cash to the club at different times and the funds were used to help the club financially and later to buy better players.

It was held by the FTT that Interfish should not be allowed to deduct its sponsorship payments for tax purposes as its intention to help the club buy players did not meet the "wholly & exclusively" test.

Mr Colam, the Interfish managing director, had already acquired shares in the rugby club and was able to assert influence at board level which also helped the club.

In giving evidence at the FTT hearing, Mr C said that making the payments to Plymouth Albion was beneficial to Interfish in various ways. As well as providing visible promotion he also described the Club as 'one of the most, if not the most, influential business meeting places in Plymouth'.

As an example Mr C got to know, amongst other people "on the best table" at events and functions there, a NatWest bank manager who served on the club's board. NatWest subsequently lent funds to Interfish whereas other banks had already refused toi do so. Mr C said that he felt that his company's involvement with the club had "opened doors' within NatWest and the Plymouth business community.

The essential issue was that Interfish accrued significant but immeasurable benefits as a sponsor - but were these commensurate with expenditure of £1.2 million?

The FTT thought that it was "unrealistic to assume that the NatWest credit committee were influenced to fund an unduly risky venture because Interfish was the benefactor of Plymouth Albion Rugby Club."

They found that advertising could have been obtained at the rugby club's published rates for about £10,000 The argument based on the dictum of Lord Reid in Ransom v Higgs 50 TC 1 that "if a trader is actuated by none but commercial motives, the Crown cannot merely say he has paid too much" was referred to but it seems in the end that aspect was ignored.

There seemed to be some aspects of the payments which benefitted Interfish and some which related to Mr C's private interest in the Club. However, the FTT and UTT focused on who really benefited from specific payments made by Interfish which were applied directly by the club to purchase players. They considered that these specific payments did not meet the "wholly & exclusively" test. Consequently the infamous duality of purpose aspect reared its ugly head, resulting in no tax relief.

Whilst clearly a worrying case, presumably if Interfish had just made smaller payments and had no influence on the way that the rugby club used them there may well have been no duality of purpose. Splitting the payments appropriately may also have helped their case, so as to avoid duality on some of the payments made.

SOUTHWEST COMMUNICATIONS GROUP v HMRC TC02370

HMRC challenged sponsorship payments of about £300,000 made by the company to Exeter Chiefs Rugby Club. As a result of new evidence from witness statements, submitted to the tribunal in May 2011, HMRC decided not to contest the taxpayer's appeal and the hearing before the FTT related to an application for costs on the grounds that HMRC had acted unreasonably in not making an earlier notification that it was not going to contest the case.

It was held that HMRC should have settled the case within 28 days of receiving the witness statements and should therefore pay costs from 20 July 2011.

Contributed by Gerry Hart

VAT

University: partial exemption

A university, which was partly exempt and had agreed a special method for attributing its input tax, reclaimed input tax on professional fees relating to the management of an endowment fund, which invested donations received by the university, and which was used to finance both taxable and exempt activities. HMRC rejected the claim, on the basis that the university's investment activities were not an economic activity (and if it had been an economic activity, the fees would have related to exempt supplies).

Decision:

The First-tier Tribunal allowed the university's appeal, holding that the input tax should be treated as residual and as partly recoverable under the university's special method. Judge Connell held that 'the VAT system achieves the greatest degree of simplicity and neutrality when the tax is levied in as general a manner as possible and when its scope covers all stages of supply'. He specifically rejected HMRC's contention that 'overheads relating to a non-economic activity undertaken for the purchase of an economic activity should not be regarded as recoverable'.

Comments - As observed by Vaughn Chown and Kevin Hall (Gabelle): 'As a result of this decision, educational establishments or indeed any businesses, charities or VAT registered organisations which manage their investments for the benefit of their wider activities should consider making claims of previously unrecovered input tax on related costs' .

Chancellor, Masters & Scholars of the University of Cambridge v HMRC (No. 2) TC2836

Input tax relating to sales of shares in subsidiaries

A company (T) reclaimed input tax on professional fees relating to the sale of shares in subsidiary companies. HMRC issued an assessment to recover the tax, on the basis that the input tax related to exempt supplies. T appealed.

Decision:

The First-tier Tribunal dismissed the appeal, holding that T's sale of the shares in the subsidiaries was an economic activity and was an exempt supply.

Comments - The tribunal upheld HMRC's contention that the sale of shares in subsidiary companies was an exempt supply, so that the company was not entitled to reclaim the related input tax.

TLLC Ltd v HMRC TC2857

Input tax on conversion of hairdressing salon into cafe

A woman (K) obtained a lease of a hairdressing salon and arranged for it to be converted into a cafe. In her first VAT return, she reclaimed input tax on the conversion. HMRC rejected the claim on the basis that it related to a supply of services which had taken place more than six months before K registered for VAT, and was therefore not deductible.

Decision:

The First-tier Tribunal (FTT) dismissed K's appeal, specifically distinguishing the earlier decision in Miller v C & E Commrs (VTD 18630), and holding that the invoice related to a single supply of services.

Comments - The FTT upheld HMRC's contention that the work of converting a hairdressing salon into a cafe was a supply of services rather than a supply of goods. Therefore, since the supply had been taken place more than six months before the appellant had registered for VAT, the input tax could not be reclaimed.

Ms A Khoshaba (t/a Cinnamon Cafe) v HMRC TC2864

Not Private tuition – Not exempt

The CA dismissed the partnership's application for leave to appeal against the earlier Upper Tribunal decision ([2012] UKUT 378 (TCC)). The partnership provided golf tuition, and HMRC accepted that, where such tuition was given by one of the partners, it qualified for exemption under VATA 1994 Sch 9 Group 6 Item 2. However, they issued a ruling that VAT was chargeable where the tuition was given by an employee. The partnership appealed, contending that this distinction violated the principle of fiscal neutrality.

The First-tier Tribunal rejected this contention and dismissed the appeal, and the Upper Tribunal upheld this decision. Henderson J held that, in order to qualify for exemption, 'the relevant tuition should be provided by a teacher who is acting both on his own account and at his own risk'.

Decision:

In the CA, Patten LJ held that 'a further appeal to this Court would have no prospect of success'.

Comments - The CA has upheld the Upper Tribunal decision that tuition given by an employee is not 'private tuition', and does not qualify for exemption from VAT under VATA 1994 Sch 9 Group 6 Item 2. The tuition must be provided by a sole trader or partners of a partnership to secure exemption under Item 2. Tuition income generated by employees of sole traders or partnerships represent taxable income for the business. Corporates would have to be an eligible body within item 1 to qualify for exemption.

Marcus Webb Golf Professional v HMRC (Court of Appeal)

Renovation of house: appropriate rate of VAT

A couple purchased a house and engaged a builder (B) to renovate it. B accounted for VAT at the reduced rate of 5% on his supplies. HMRC issued an assessment charging VAT at the standard rate. B appealed, contending that his supplies were within VATA 1994 Sch 7A Group 7.

Decision:

The First-tier Tribunal rejected this contention and dismissed his appeal, finding that the conditions of Group 7 Note 3 were not satisfied, as B had not shown that the house had been unoccupied for two years before the renovation.

Comments - VATA 1994 Sch 7A Group 7 Item 1 provides that certain supplies of services 'in the course of the renovation or alteration of qualifying residential premises' qualifies for the reduced rate of VAT. Group 7 Note 3 provides that one of the necessary conditions is that the premises have not 'been lived in during the period of two years ending with the commencement of the relevant work'. The First-tier Tribunal upheld HMRC's contention that the builder had not submitted evidence to show that this condition was satisfied, so that his supplies failed to qualify for the reduced rate.

GS Bhachu v HMRC (TC02887

Materials supplied with central heating systems: appropriate rate of VAT

A partnership installed central heating systems. In accounting for VAT, it treated part of the consideration which it received as qualifying for the reduced rate of 5%. HMRC issued an assessment on the basis that the partnership was making a single composite supply of a central heating system, which was chargeable at the standard rate of VAT.

Decision:

The First-tier Tribunal dismissed the partnership's appeal. Judge Paines held that 'the supply of the installation of energy-saving materials together with services of installation of a boiler or of a central heating system is a single supply subject to a single rate of VAT at the standard rate'.

Comments - The First-tier Tribunal upheld HMRC's contention that the partnership was required to account for VAT at the standard rate on the full amount of the consideration which it received. Judge Paines' comments are self-explanatory.

AN Checker Heating & Service Engineers v HMRC (TC02895

Compliance history cancelled

The taxpayer was one day late submitting its VAT return and payment for September 2011. HMRC imposed a default surcharge at 15% on the ground that the company had a history of late payment.

The taxpayer appealed, but decided not to attend the tribunal hearing, saying it had "nothing to add to the submissions" it had already made.

Decision:

The First-tier Tribunal noted that the return for May 2009 was addressed to S J Haworth, Drumkinnon Joinery and Building, but those for March, May, July and August 2010 were addressed to Drumkinnon Joinery and Building Ltd. Given that Drumkinnon was not incorporated until October 2010, the judge wanted to know why returns had been addressed to the company before that date.

HMRC ascribed the mistake to computer error, but said that regulation 6(3)(a) of the VAT Regulations 1995 applied. Namely, when a business was transferred, the new owner took over the liabilities of the previous owner. The tribunal judge did not agree, saying that the transferor and transferee were separate legal entities. In the tribunal's view, when Mr Haworth's VAT registration ended, his surcharge liability compliance history ceased. A new history began when the Drumkinnon Joinery and Building was incorporated.

The company was in effect given a fresh start with regard to the surcharge regime.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: "This case highlights that great care is needed when a new business retains the VAT registration number of a previous business where there is a transfer of a going concern. There could be hidden surprises lurking around the corner. A new VAT registration number for the limited company would have avoided this problem."

Drumkinnon Joinery and Building Ltd (TC2810)

Partial victory

The taxpayer's accountant applied to register the taxpayer, a café, for VAT from its first day of trading on 3 March 2008. In June 2009, the director of the café called HMRC to say that the company should not have been registered because its annual sales were below the registration threshold and he was unaware of the application to register made by his accountant. He wrote to HMRC in September 2009, asking that the business be deregistered from 3 March 2008. HMRC said they had no legal power to backdate the registration and instead deregistered the café from September 2009, this being the date when HMRC received the director's letter.

The taxpayer appealed.

Decision:

The First-tier Tribunal found that the application to register for VAT was made correctly. However, because the director called HMRC in June 2009 to deregister, this should be taken as the date when the taxpayer requested cancellation of its registration for the purposes of VATA 1994, Sch 1 para (13)(1).

The taxpayer's appeal was allowed in part.

Comments - Neil Warren, independent VAT consultant said: “The tribunal's approach indicates that any communication to HMRC to request deregistration can be effective, not just the formal VAT7 or letter procedure.”

Oliver's Village Café Ltd v HMRC TC2783

Proof of residential intent

The taxpayer was a company set up to renovate Ebley House with a view to selling it. It opted to tax the property from 21 November 2001. In July 2007, the taxpayer sold the property to a charity. The sale was treated as exempt from VAT. The taxpayer's agent explained that the company had taken steps to ensure the transaction was an exempt supply. This was because the purchaser planned to use the property as a residential school for children with learning difficulties, ie it would have a relevant residential purpose. The taxpayer argued that, under VATA 1994, Sch 10 para 5(1)(b), the option to tax had no effect and the sale was exempt.

HMRC said that the taxpayer had not shown conclusively that the building would be used as a residential school, as opposed to a non-residential one. It should therefore be treated as a standard-rated supply.

The taxpayer appealed.

Decision:

The First-tier Tribunal said it would have been preferable if, at the time of the sale, the taxpayer had obtained a certificate or other physical evidence from the purchaser as to his intended purpose, although the tribunal acknowledged that this was not a legislative requirement.

Referring to a letter from the purchaser, written six years after the property was purchased, confirming that the reason for buying the building was to open a residential school, the tribunal said there was “no reason why its contents should not be accurate” or why it should be viewed with suspicion. On the balance of probabilities, the tribunal was satisfied that the taxpayer did reasonably believe the property would be used for a residential purpose.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: "The case illustrates the need for a seller to make sufficient enquiries in relation to property sales where the option to tax election is to be overridden. Although the seller is not expected to put on a detective hat and make a detailed enquiry about the buyer's intentions, he needs to obtain enough information to confirm the intentions of the buyer, otherwise future problems could emerge as was the case here." He added that the "VAT liability is determined by the 'intentions' of the buyer at the time of the sale, not the actual use of the building in the future".

Ebley House Ltd v HMRC TC2816

Requirement for online VAT returns

A firm of solicitors objected to being required to submit online returns, and repeatedly submitted returns on paper. HMRC imposed penalties on the basis that the paper returns were not valid returns. The firm appealed.

The First-tier Tribunal dismissed the appeal. Judge Sheppard observed that the firm had used email to contact the tribunal, but appeared to have been 'determined to avoid submitting VAT returns by means of an electronic return system'. The use of an electronic return system was required by the VAT Regulations, SI 1995/2518, reg 25A(3).

Comments - The First-tier Tribunal upheld HMRC's contention that the submission of electronic VAT returns was mandatory, and that a paper VAT return was not a valid return.

Scottish case of A & R Robertson & Black v HMRC TC2848

Requirement to file VAT returns online – Tribunal favours taxpayer

In LH Bishop Electric Co Ltd v HMRC (and related appeals) (TC02910), Judge Mosedale allowed appeals by a small company and two sole traders against decisions by HMRC requiring them to submit online VAT returns, in accordance with FA 2002 s 135 and the VAT Regulations, SI 1995/2518, reg 25A. She concluded that 'because of its disproportionate application to persons who are computer-illiterate because of their age, or who have a disability which makes using a computer accurately very difficult or painful, or those who live too remotely for a reliable internet connection', reg 25A contravened both the European Convention on Human Rights as well as the principles of European Union law.

Comments -This is a lengthy and controversial decision. It has been welcomed by the Low Incomes Tax Reform Group and by the ICAEW, which has described it as 'ground-breaking'. Judge Mosedale held that SI 1995/2518, reg 25A contravened European law. The full text of her decision extends to 154 pages. It would seem quite likely that HMRC will appeal to the Upper Tribunal (as it did in the similarly controversial case of Hok Ltd v HMRC, where it lost at the First-tier Tribunal but was successful in the Upper Tribunal).

LH Bishop Electric Co Ltd v HMRC (and related appeals) TC2910

Requirement to file VAT returns online – Tribunal sides with HMRC

A company (L) lodged a purported appeal against a letter received from HMRC, which stated that it was required to file its VAT return online. The tribunal struck out the appeal.

Decision:

Judge Mosedale held that the tribunal did not have jurisdiction under VATA 1994 s 83(1)(zc) to hear the dispute, as HMRC had made no decision against which an appeal could lie. The requirement on the company to file VAT returns online, to which the company objected, was contained in secondary legislation (VAT Regulations, SI 1995/2518, reg 25A(3), with effect from 1 April 2012) and applied directly, without the need for any decision on the part of HMRC. HMRC's letter was no more than notification to the company of its liability under the legislation. As the tribunal only had jurisdiction to entertain appeals against decisions made by HMRC, it had no jurisdiction to consider the company's complaint.

Comments -The decision here can be contrasted with the decision, also by Judge Mosedale, in the LH Bishop case, discussed above. The distinctions between the two cases may seem narrow but Judge Mosedale held that they were crucial, and that she had no jurisdiction to hear the company's appeal.

Le Bistingo Ltd v HMRC TC2912

Fraudulent deals

The taxpayer was involved in transactions where it acted as the broker in the purchase and sale of mobile phones. It bought goods from VAT registered traders in the UK and sold them to VAT registered traders in other EU member states. The taxpayer claimed repayment of input tax in respect of those deals. HMRC refused the claim on the grounds that the taxpayer was connected with missing trader intra-community fraud.

Decision:

The First-tier Tribunal dismissed the taxpayer's appeal, ruling that it should have known that its transactions were connected with VAT fraud. The taxpayer appealed, saying the tribunal had concluded incorrectly that it had conceded HMRC's point that fraud had taken place and that there was insufficient evidence to show that it should have realised fraud was present.

The Upper Tribunal agreed that the First-tier Tribunal was wrong to have ruled that the taxpayer accepted HMRC had proved the existence of fraud. However, the Upper Tribunal decided there was sufficient evidence for the First-tier Tribunal to have concluded that the taxpayer should have known that the transactions were fraudulent. In this respect, it had made no error of law.

The taxpayer's appeal was dismissed.

Comments - The Kittel principle can be broken down into three 'limbs': Was there fraudulent evasion of VAT? (VATF53100); Was the transaction ' connected with' that fraudulent evasion of VAT? (VATF53300) and Did the taxable person, when he entered into the transaction, know or should he have known that it was ' connected with fraudulent evasion of VAT'? (VATF53400). This is another case looking at the third limb and the decision is self explanatory.

Eyedial Ltd v CRC, Upper Tribunal

Planning tips with the flat rate scheme (FRS) (Lecture B804 – 13.48 minutes)

The basic principles of the FRS are as follows:

- It is available to a small business with VAT exclusive annual taxable turnover expected in the next 12 months to be less than £150,000. The aim of the scheme (as far as HMRC are concerned) is to save administration time for a business rather than to reduce its VAT payments. It should be 'tax neutral' – but there are winners and losers.
- Instead of paying VAT based on output tax less input tax, a business will apply a given flat rate percentage to its gross (VAT inclusive) business income (including exempt supplies but excluding those that are outside the scope of VAT) – the percentage is based on the category of business to which it belongs. The business still charges VAT to its customers in the normal way. It does not reclaim input tax – apart from capital goods in some cases.

Example 1

James has annual taxable sales (excluding VAT) of £149,000 (all standard rated) and very little input tax to claim (£500 per year). If he adopted the FRS, he would qualify for the 12% rate (other business services), reduced to 11% in his first year of VAT registration.

With the FRS, James' annual VAT bill will be calculated as follows:

Gross turnover (£149,000 x 1.2) x 12% flat rate = £21,456

Under normal VAT accounting, his VAT bill would be:

Output tax (£149,000 x 20%) = £29,800

Input tax = £500

Payable = £29,300.

The net VAT saving to James is £7,844 (£29,300 less £21,456).

Note - the two reasons why the FRS produces such a good deal in the above example is because the nature of the business means that James has very little input tax to claim and also his activity does not have its own FRS category and benefits from the generous rate of 12%.

Tips

- A business using the FRS does not reclaim input tax, unless it relates to capital expenditure goods costing more than £2,000 including VAT. A claim can also be made on pre-registration expenses according to the normal rules, i.e. if the business uses the FRS for its first period.
- An HMRC concession gives a newly VAT registered business an extra 1% discount on its flat rate percentage for the first 12 months of registration. As the scheme limit is potentially £180,000 (£150,000 plus VAT), the 1% discount could be worth up to £1,800.
- Any income that is outside the scope of VAT under the place of supply rules is excluded from the scheme calculations e.g. fees earned by a UK accountant from a Swedish or American business client.

Pitfalls

- The input tax concession relates to capital expenditure ‘goods’ and not services. The case of Sally March (TC 00062) related to input tax claimed on the costs of building a new riding school, which was deemed to be a supply of building services and therefore input tax could not be claimed with the FRS.
- All business income is included in the scheme calculations – including exempt and zero-rated income – but not income that is outside the scope of VAT e.g. under the place of supply rules. If goods are sold to a VAT registered business in an EU country outside the UK (zero-rated), then these sales are included in the scheme calculations.

Four common challenges with the scheme

1. Marie is a tax consultant and wants to join the FRS but is unsure which business category she should choose. She is worried that HMRC could try and put her in a higher percentage category on a future visit and assess extra tax. Are her fears justified?
2. Having made her choice, Marie then discovers that she could have saved a lot of tax if she had joined the scheme five years ago. Can she join on a retrospective basis and claim the extra tax in Box 4 of her next VAT return?
3. Two years later, Marie concludes that she did choose the wrong category when she first joined the scheme – she should have classed herself as ‘other business services’ rather than an ‘accountant’. Can she adjust the overpaid tax (difference between two percentages) on her next VAT return?
4. Marie has bought a flat in her own name as a private investment. The rental income will be £1,000 per month. How does she deal with this income as far as the flat rate scheme is concerned? Her tax consultancy business is as a sole trader.

The solutions.........
Challenge 1……..Choosing a business category

The choice of trade sector and the relevant flat-rate percentage to adopt is down to the individual business to choose from the table produced by HMRC. In making a choice, the everyday meaning of the words should be used.

To assist businesses in their choice of trade sector, HMRC has produced a ready reckoner (available at www.hmrc.gov.uk) that lists trades and trade sectors. This includes drop-down lists of trades that HMRC believes belong in each sector.

Once HMRC has approved a business to join the scheme, it will not change the category of business on a retrospective basis as long as the choice made by the business was reasonable and records have been kept as to why it was chosen. For example, there may be certain businesses that could overlap into two different categories, and the final choice will require a careful analysis of the business activity to decide the most appropriate category.

Many advisers and clients are concerned about the prospect of an HMRC officer making a routine visit and telling the taxpayer he has chosen the wrong flat rate percentage (too low), and that a retrospective assessment for the last four years (error adjustment period) will be issued.

However, reassurance is given by HMRC's VAT Notice 733 (para 4.2), which states:

> 'if we approve you to join the scheme, we will not change your choice of sector retrospectively as long as your choice was reasonable. It will be sensible to keep a record of why you chose your sector in case you need to show us that your choice was reasonable.'

To HMRC's credit, there have not been reports (as far as I know) about visiting officers hunting for easy game by unfairly reclassifying flat rate categories and going against the spirit of para 4.2. There may have been a few cases where officers have 'tested the waters' with an alternative proposal – but nothing too serious.

Chilly Wizard Ice Cream Co Ltd v HMRC (VTD 19,977)

This was a case where HMRC challenged the taxpayer's chosen category at a VAT Tribunal….and lost! Chilly Wizard operated an outdoor kiosk selling ice-cream and milkshakes, including two tables and six chairs for the use of customers. They had opted to use the favourable 2% flat rate that applied at the time to 'retailers of food, confectionery, tobacco, newspapers or children's clothing'. However, HMRC ruled that the chosen rate should have been 12% for 'catering services, including restaurants and takeaways'.

The tribunal's reasoning confirmed that there was no element of service (catering) in the supplies being made by the business – the supplies being of goods to meet the need of individuals for refreshment. The tribunal also hinted that 'takeaways' would generally involve hot food. On this basis, the tribunal supported the taxpayer's conclusion that his main activity was 'retailing food', i.e. the 2% flat rate was the correct option.

Challenge 2…….Backdate joining date to save tax

The legislation gives HMRC the power to backdate an application to join the scheme in 'exceptional' circumstances. However, to my knowledge, there have been no exceptional circumstances since the scheme was introduced. The HMRC approach is that the aim of the scheme is to save time and administration dealing with VAT – if a return has already been completed based on normal VAT principles, then it is impossible to save time.

Extract from HMRC Internal Guidance – FRS3300

Treatment of Applications: Considering requests for retrospective use of the FRS

When considering a request for retrospection, you should first ensure that the business met the eligibility conditions in force at its requested start date and period of intended use.

For example:

- As the scheme did not come into effect until 25 April 2002, you cannot allow an earlier start date to this.
- If the business's turnover was above a previous entry threshold, or exit threshold, for joining/leaving the scheme in force during the retrospective period, then the business would be ineligible for the FRS.

Once the business's basic eligibility for the FRS has been established, you should then take into account the following:

- Each case should be considered on its own merits. Consider all relevant facts relating to the request, including the business's overall compliance record. In line with the rationale of the scheme, (see next but one bullet) the fact that a business will pay, or would have paid, less tax, is not sufficient reason to authorise retrospective use of the FRS.
- Belated notification of a liability to register for VAT - including 'trader liable no longer liable' cases - is not a reason to disallow retrospection automatically. This is because use of the scheme may help both the business and HMRC to calculate the arrears more quickly and easily. However, if you have further reason to doubt the business's compliance (for example, there is other evidence that allowing the scheme would present a revenue risk) then retrospection should be disallowed.
- The policy is to refuse retrospection where the business has already calculated its VAT liability for the period(s) using a different accounting method (but see next bullet, below). The reason for this is that the FRS exists to simplify VAT accounting and record keeping for small businesses, so that they are able to spend less time on VAT. If allowing retrospection will enable the business to benefit in this way, then you should consider granting the request.
- The proper exercise of the power to allow retrospection means that we should be prepared to recognise there may be exceptional circumstances where the policy described in the previous bullet should be set aside. In principle, such cases are likely to involve compassionate circumstances, or the survival of the business, but we have not identified to date any case where such circumstances justify a departure from the normal policy. If you think that there are

such circumstances, the case should be reported to **Accounting, Registration and Exports Team, Queens Dock, Liverpool**

SD Solutions Ltd (TC 00529)

The taxpayer joined the FRS in June 2009 but attempted to backdate the application to June 2005, the date when the company first became VAT registered. The company had financial problems, and argued that the tax windfall earned from retrospectively joining the FRS would enable more money to be paid to creditors. The taxpayer lost the case – saving tax was not an 'exceptional circumstance'.

Anycom Ltd (TC1496)

The taxpayer joined the scheme in April 2009 but then submitted a request for the joining date to be backdated to April 2005 so that his company would enjoy a large windfall of tax (£17,735). The legislation states that a business can backdate its entry to the scheme, if approved by HMRC, but HMRC only backdate an application in exceptional circumstances – and a VAT windfall or saving is not considered relevant because the scheme is intended to simplify administration for a small business, not save tax. Hardship and financial problems for the company were not relevant issues. The taxpayer's appeal was dismissed.

JMB Wilmington (TC1975)

The taxpayer put forward the view that her husband's serious illness was the reason that she was unable to focus on the tax and administrative savings she would have made with the scheme. However, HMRC and the Tribunal took the view that the late application was caused by the failure of her previous accountant to submit the application form when she first registered or advise her of the benefits. The appeal was dismissed.

Yeabsley Financial Solutions Ltd (TC2044) – withdrawing from the scheme on a retrospective basis

A different situation here.....the taxpayer made an error in his scheme calculations, thinking that tax was payable based on' net' rather than 'gross' sales. His error was identified at an HMRC visit in 2011, producing an assessment of £4,958 going back to when he first joined the scheme in 2007.

The taxpayer then requested that he be allowed to withdraw on a retrospective basis but this can only be done with the agreement of HMRC in 'exceptional' circumstances. It was not an exceptional circumstance that the scheme had proved financially disadvantageous for the business, especially as HMRC's view is that the scheme is about time rather than tax savings. The appeal was dismissed.

Note – this seems to be quite a common error, clients thinking that the scheme calculations are based on 'net' rather than 'gross' figures, which is obviously not the case.

Challenge 3……Retrospectively changing choice of flat rate category

As explained above, HMRC have sensibly confirmed they will not challenge a taxpayer's choice of category on a retrospective basis as long as the initial choice was sensible. This confirmation is important because not every business will exactly fit into one of the 55 different categories, so an element of judgement is needed by taxpayers in many cases.

However, what happens if a new scheme user plays safe and adopts a category with a high flat rate percentage and then subsequently discovers that this choice was incorrect? The following cases give the answer.

Archibald and Co Ltd (TC 00336) – retrospective change in flat rate category not allowed

This case related to a chartered accountant whose main activity was to provide tax advice to investment funds and management companies, supplemented by some exam marking. She joined the scheme in March 2007, and chose the flat rate category of 'Accountancy or bookkeeping'.

However, in 2009 she requested a retrospective change in her chosen category to 'Business services that are not listed elsewhere' (with a lower flat rate percentage) on the basis that she was not doing traditional accountancy work.

Her revised choice was sensible and, in my opinion, correct but HMRC refused to backdate her new category on the basis that her first choice was reasonable. The tribunal supported HMRC.

The message of the Archibald case is that an assertive approach is needed when users first join the scheme and choose their category. As long as a decision can be supported by a sensible written analysis, then no retrospective challenge should be made by HMRC.

AML Consulting Ltd (TC2151) – retrospective change in flat rate category allowed

The taxpayer set up in business in September 2007, with the intention of providing 'management consultancy' services to the NHS. She became VAT registered and joined the flat rate scheme (FRS) under the category for 'management consultancy' (at that time, the flat rate percentage for this category was 12.5%). However, her expected business plan did not materialise and her actual activity involved the provision of interim management services to various customers.

The taxpayer (Dr Lynch) changed her flat rate category with effect from October 2008 to 'other business services' with a lower flat rate of 11% at the time. There was no problem with this change moving forward but she sought to change the percentage on a retrospective basis by claiming overpaid tax of £1,522 in relation to periods 1/08 to 7/08. The VAT652 form she submitted was rejected by HMRC – the wording of the letter stated that it was not HMRC's policy to allow retrospective changes to FRS categories. However, this was not the correct policy, which is that HMRC will not allow a retrospective change if the initial choice was reasonable. As the officer rejecting the VAT652 had not considered whether Dr Lynch had made a reasonable or unreasonable change in her rate, but had just dismissed the request without further analysis, then the HMRC policy had not been followed and the appeal was allowed.

Comment:

This is a strange case and one that should not create an expectation that taxpayers can enjoy a windfall of tax if they think their past choice of flat rate category was incorrect and that they have paid too much tax.

It was the way that HMRC dealt with the taxpayer's request to change her flat rate category on a retrospective basis that led to the appeal being allowed, i.e. by not considering whether her initial choice was reasonable but just rejecting it without thought. If HMRC had considered the issues properly, and then reached the same decision to reject the taxpayer's claim for a rebate, then the taxpayer would almost certainly have lost the case because her original choice was reasonable.

Challenge 4….what about buy-to-let rental income?

As explained at the beginning of this section, all business income is included in the scheme calculations unless it is outside the scope of VAT. So is the rental income earned by Marie classed as relevant to her business?

An important principle of VAT law is that land income is always classed as business related – there is no such thing as 'private' land income (VAT Directive 2006/112/EC, Art 9(1) includes property income within the definition of 'economic activity' – the phrase 'economic activity' is the EU word for business).

Taking the situation a stage further, is the best solution for Marie to incorporate her tax consultancy business so that the buy-to-let income is not within the same legal entity? This should work in most cases but it is important to be aware of the anti-avoidance rules in place that prevent 'associated' businesses from joining the scheme in certain circumstances. Have a look at para 3.8 and 3.9 of HMRC's VAT Notice 733 for further details on this issue. In reality, I think it would be very hard for HMRC to apply the 'associate' rules in cases such as Marie. They require financial, economic and organisational links – this would appear to rule out a link between two completely different activities such as rent and accountancy.

Mr Hare T/A Ican Finance (TC00958)

Mr Hare traded as a finance broker and also had a business in residential property lettings. He used the scheme for his broking income but considered the rental income to be a separate business, even though all of the properties were in his own name i.e. no separate legal entity compared to his trading business, in which he was also a sole trader.

Following a routine visit by HMRC, Mr Hare was assessed for tax of £9,019 on the basis that as a sole proprietor, he should have included the rental income in his scheme calculations as well as the broking income. His appeal against the assessment was dismissed

Contributed by Neil Warren

Recent cases….. importance of the legal entity (Lecture B805 – 13.45 minutes)

A major challenge in the business world is to think about the VAT implications of a transaction or deal before it takes place – or before a new venture actually starts. The choice of legal entity is a major decision for any business – not just for VAT planning but commercial considerations and direct tax planning as well.

Example 1

A sole trader accountant is not VAT registered – annual fees are £72,000 i.e. below the current threshold of £79,000. He also earns annual rental income of £12,000 from other accountants who store their records in a warehouse he owns.

Income from land related storage supplies became standard rated with effect from 1 October 2012 – until that date, the income was VAT exempt unless the business providing the storage facility had opted to tax the building in question (not our accountant). In the latter situation, the income would be standard rated anyway because of the option.

The accountant needs to include the warehouse income when he checks the VAT registration threshold after 1 October because it is now taxable rather than exempt. The basic registration test is that his turnover needs to be reviewed on a rolling 12-month basis.

Unless action is taken, he will need to VAT register at some point in the future because the £12,000 of storage income has the same legal entity as his trading business.

A solution for the accountant in Example 1 could be to transfer the freehold of the warehouse into joint ownership with his wife or another person i.e. to create a partnership arrangement

HMRC Notice 742 – para 7.2: Joint owners of land or buildings

Where more than one person owns land or buildings, or receives the benefit of the proceeds from the grant of an interest in land or buildings, we treat them as a single person making a single supply for VAT purposes.

If the joint owners are making taxable supplies above the registration threshold they will have to register for VAT as a partnership, subject to the normal rules, even if no legal partnership exists. The joint owners may also request voluntary registration where the value of taxable supplies is below the registration threshold. For more information on VAT registration please read Notice 700/1 Should I be registered for VAT?

Different legal entities

Just to summarise, here are the main legal entities that we recognise in the mysterious world of VAT:

- Sole trader
- Partnership
- Limited company
- LLP
- Charity, club or association

GEORGE CHRISTODOULOU (TC2819) – one or two businesses?

The taxpayer traded as a sole trader in relation to a hairdressing business (which was VAT registered) but maintained that a restaurant owned between 2003 and 2011 was a separate legal entity (partnership with his wife) that always traded below the VAT threshold.

HMRC maintained that he was also a sole trader in the restaurant business (and assessed output tax of £78,235) on the basis that:

- The business bank account for the restaurant was in his single name;
- Self-assessment tax returns were also declared as a sole trader;
- He told an HMRC office at a meeting in 2008 that he was a sole trader in the restaurant

The taxpayer maintained that a partnership arrangement was evident because:

- The liquor licence was in joint names – as was the licence to run the premises as a restaurant
- His wife worked very long hours in the business and was never paid a salary – so she was not an employee and must therefore be a partner
- He had not understood what HMRC had meant at the meeting with phrases such as 'sole trader' and 'partnership' (he was from Cyprus with some translation problems)
- The bank account being in a single name was not relevant because his wife trusted him with the family finances – and there was no profit to share because the restaurant lost money

The Tribunal had to make a decision and concluded that Mrs Christodoulou was a partner in the business and allowed the appeal.

Comment:

The taxpayer did well to convince the tribunal that there was a separate legal entity for the restaurant. There was evidence pointing both ways so the conclusion had to be reached based on the balance of probabilities.

The fact that joint names were relevant to both the restaurant and liquor licences was considered to be more relevant than bank account information and self-assessment tax returns, which is somewhat strange. The tribunal allowed the appeal but made the comment that the balance of probability was 'only just' in favour of the taxpayer.

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

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

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

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

Comment:

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

Is there a business splitting problem?

Is there a risk that HMRC could still collect output tax in the above situations by using their powers to issue directions to the different legal entities to treat them as one business as far as the VAT registration threshold is concerned?

HMRC have the power to issue a direction in cases where two businesses are closely connected by 'financial, economic and organisation links' through legislation at VATA1994, Sch 1, para 1A (note the word 'and' ie all three have to be proved for HMRC to issue a direction, not just one or two out of three).

The key point is that in all of the examples considered above, the linked businesses have very different activities, use different fixed assets and buying sources, with difference circles of customers and different people involved in the various entities. The structures are very different to the situation of eg a plumber who tries to split his business so that he has an unregistered entity for his domestic work (where customers cannot claim input tax on his charges) and a VAT registered entity for his commercial projects where customers can reclaim input tax. In reality, a plumber usually has only one van to carry out all of his work; he buys his materials from one main builder merchant and also has only one set of tools – he might have a big VAT problem if he tries to split his activities.

Contributed by Neil Warren