Tolley®CPD

January 2014

Disclaimer

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

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

Contents

Autumn Statement (Lecture P811 – 14.48 minutes /Lecture P812 - 12.15 minutes) 4

Personal Tax 26
Transfers are taxable 26
Loan to employee 26

Capital Taxes 28
CGT: negligible value claim 28
Changes to Principal Private Residence Relief (Lecture P813 – 18.57 minutes) 28
Surplus Cash Problems and Solutions (Lecture P814 – 13.45 minutes) 31
Annual Tax on Enveloped Dwellings (Lecture P815 – 14.11 minutes) 34

Administration 36
PAYE Real Time Information: package of help announced for micro employers 36
No ground for discovery 37
Discovery assessment 38
Staffing problems 38
Reasonable excuse 39
Late monthly PAYE payments penalties partially mitigated 40
Careless inaccuracy in a self-assessment return 40
Jurisdiction of the tax tribunals to review penalties 41
Late notification of an appeal to the tax tribunal 42
Jurisdiction to cancel disproportionate penalties 42
Closure needed 43
LPP and separate proceedings 43

Business Taxation 45
Capital allowances on property - section 198 elections (Lecture B811 – 18.00 minutes) 45
Can a work of art be plant? (Lecture B812 – 12.18 minutes) 48
Partnerships – LLP employed partners (Lecture B813 – 10.18 minutes) 50
Profit sharing in mixed partnerships (Lecture B814 – 10.31 minutes) 57
Mixed partnerships – other issues (Lecture B815 – 9.01 minutes) 62
R&D Expenditure Credit 65
Conditions for the application of FA 2003 Sch 23 69
EIS and partnership interests 70
FII GLO: FA 2004 s 320 70
Van fuel charges 71

VAT **72**
VAT and construction services 72
VAT on goods paid for fraudulently 72
Incidental to the main supply 73
Agent or principal? 73
Nature of supply 74
VAT: amount of consideration 75
Is it possible to be an 'eligible body' in relation to some activities only? 76
Claim for VAT repayment 76
Odds on winning 77
Revenue & Customs Brief 38/2013: Intrastat changes from 1 January 2014 78

Autumn Statement **(Lecture P811 – 14.48 minutes /Lecture P812 - 12.15 minutes)**

Personal Tax

Rates and allowances

The Chancellor's statement confirmed various rates and allowances for 2014/15 that had already been announced, either at the Budget or in last year's autumn statement.

- the personal allowance will increase to £10,000 for 2014/15 (the Chancellor also confirmed that this allowance will be indexed by the Consumer Price Index from 2015/16 onwards)
- the higher rate threshold (personal allowance plus basic rate band limit) will increase to £41,865 (the Chancellor also confirmed that this threshold will rise by 1% per year from 2015/16 onwards)

From 6 April 2015, an individual will be able to transfer £1,000 of his personal allowance to his spouse or civil partner. In order to make the transfer both parties must not be higher rate or additional rate taxpayers (it is assumed that this will be assessed prior to the transfer of the £1,000). Therefore, this is only likely to be of benefit where one of the couple is not able to utilise the full personal allowance. The transferable amount will be increased in proportion to the personal allowance. Autumn Statement 2013, para 2.47

National insurance

NI rates

The NIC rates and thresholds for 2014/15 have been published. The Class 1 upper earnings limit and the Class 4 upper profits limit are aligned with the higher rate income tax threshold of £41,865. There is no change to the percentage rates of NIC, although the weekly rates of Class 2 and Class 3 NIC will be increased.

Abolition of employer NIC for U21 employees

In move to encourage employment of young people, the Chancellor announced a new NIC exemption for secondary National Insurance Contributions (NIC) in respect of payments to an employee who is under 21 years old. See para 2.48 of the Statement.

As things stand, an employer has to pay secondary Class 1 NIC at a rate of 13.8% on so much of an employee's earnings that exceed the secondary threshold (currently £148 per week). Under the new proposals, the employer would not pay any secondary contributions in respect of the earnings of an employee under 21 until that employee's earnings reach the Upper Earnings limit (currently £797 per week).

The legislation for this exemption will be included in the National Insurance Contributions Bill currently before Parliament (see the National Insurance Contributions Bill news article) and will take effect from 6 April 2015 onwards.

It seems likely that employers will still have to pay Class 1A contributions in respect of non-cash benefits paid to the under-21s.

Voluntary national insurance contributions by pensioners

Currently, people who are not liable to NICs are able to make voluntary Class 3 NIC in order to boost their state pension entitlement. Typically voluntary contributions are made by people working abroad.

Those over state pension age are prevented from making voluntary contributions, However from October 2015 a new class of contribution will be introduced to allow people who will reach state pension age before 6 April 2016 the opportunity to build up their entitlement. It seems likely that the Class 3A NIC will be set at a fixed weekly rate. Autumn Statement 2013, para 2.56

ISAs

The stocks and shares ISA limit will be £11,880 in 2014/15. The subscription limit for the Junior ISA and child trust fund will be £3,840 in 2014/15. Autumn Statement 2013, para 2.55

Also, the Government is exploring whether to widen the retail bonds eligible to be held in a 'stocks and shares' ISA. Autumn Statement 2013, para 2.151

Charities

Gift Aid

The government is looking at ways to encourage Gift Aid claims on eligible donations and to simplify compliance for donors. One of the plans is to allow intermediaries to co-ordinate Gift Aid Declarations, so that donors do not have to make a declaration for each charity they support. Autumn Statement, para 2.65

Charities will be able to make a joint registration with the Charity Commission and HMRC, facilitating their claims for tax relief. Autumn Statement, para 2.68

Community Amateur Sports Clubs (CASCs) will be able to claim tax relief on gifts from companies as they will become eligible for corporate Gift Aid from April 2014. Autumn Statement, para 2.67

Anti-avoidance

In a reaction to recently published avoidance schemes, notably the Cup Trust scheme, the government has announced that it will amend the definition of a charity for tax purposes so that entities which are established purely for tax avoidance will not be able to claim charitable tax reliefs. It is expected that the new definition will focus on the charitable actions of the entity as opposed to its purpose. The Cup Trust raised over £170 million but distributed only £55,000 to good causes. Autumn Statement, para 2.130

Pensions

State pension

The basic state pension will increase by 2.7% from 6 April 2014. As this translates to a rise of £2.95 per week, it is assumed that this will take the payment to £113.10 (the 2013/14 weekly amount of £110.15 plus £2.95). Autumn Statement 2013, para 2.73

State pension age

The Pensions Bill currently before Parliament includes a statutory requirement for the state pension age to be reviewed at least every six years. Assuming the provision is enacted as drafted, the first such review must be published before 7 May 2017.Pensions Bill, s 26

The Chancellor trailed this review in the Autumn Statement, suggesting that the increase in the state pension age to 68 could be brought forward and the state pension age could increase further to 69 or 70 in future.

This is likely to have a significant impact on employers as the state pension age tends to set the expected retirement age for most people. Indeed, many cannot afford to retire until they receive the state pension.

Therefore, employers may wish to consider:

- raising the retirement age in their occupational schemes in line with the state pension age
- contingency plans for alternative jobs for employees who are unable to continue to meet the physical or mental demands of their current jobs in their old age

Individual protection 2014

The Chancellor confirmed that the:

- lifetime allowance will go down from £1.5 million to £1.25 million from 2014/15
- annual allowance for contributions will go down from £50,000 to £40,000 from 2014/15
- Finance Bill 2014 will provide for individual protection 2014 for those with a pension pot already close to the level of current lifetime allowance. Autumn Statement 2013, para 2.53

Tax relief for purchased life annuities

Following the responses to the consultation, the Government has decided not to withdraw income tax relief for interest on loans taken out to purchase life annuities by people aged 65 or over before 1999. Autumn Statement 2013, para 2.54

Share ownership

Indirect employee share ownership exemptions

There is to be a package of three new tax reliefs to encourage wider use of indirect employee ownership structures, such as employee benefit trusts or employee share ownership trusts. Following on from a consultation in July of this year, the Chancellor confirmed in the Autumn Statement (see para 2.60) that Finance Bill 2014 will include legislation to provide three exemptions:

- from income tax on up to £3,600 per year in bonus payments made to employees of indirect employee-owned companies which are controlled by an employee ownership trust

(from October 2014)

- from capital gains tax for disposals of shares that result in a controlling interest in a company being held by an employee ownership trust (from April 2014)
- from IHT in respect of transfers of shares and other assets to employee ownership trusts

SIPs and SAYE schemes

Currently the rules for SIPs allow for a company to offer employees participating in SIPs £3,000 of free-shares each year, without attracting any tax liability. Employees can also apply up to 10% of salary in acquiring partnership shares in a SIP, subject to a maximum of £1,500 of shares per year. The Autumn Statement included an announcement that these limits will be increased to £3,600 for free shares and £1,800 for partnership shares, as from April 2014.

The Chancellor also announced that the maximum monthly amount that an employee can contribute to a Save As You Earn share scheme will increase in April 2014 from £250 to £500. See para 2.60 of the Statement.

Simplification of unapproved share schemes

Following from a consultation earlier this year, the Government now proposes to implement a package of simplifications in the area of unapproved employee share schemes. See para 2.112 of the Statement.

As yet, there has been no response document published in respect of the consultation, so it is not yet clear what the exact ingredients of the simplification package might be, but the main recommendations covered in the consultation were to:

- apply a consistent tax treatment for all employment-related securities in share-for-share exchange and rollover situations
- allow corporation tax relief where there is a takeover by an unlisted company
- align the position of inbound and outbound internationally mobile employees and allow a corporation tax deduction in cases where income tax is payable
- extend the time limit for the employee to 'make good' tax due on a notional payment arising under an unapproved share scheme before a charge under ITEPA 2003, s 222 applies
- change the method of valuation of listed company shares to use the simple measure of closing price on the day of trading

Benefits and expenses

Cars

The Chancellor announced that Finance Bill 2014 will include two measures to tighten up on the car benefit rules. These new measures will:

- make sure that taxable car benefits can only be reduced by payments for private use made in the relevant tax year

- ensure that where an employer leases a car to an employee at reduced rates, the benefit is taxed as a car benefit rather than as employment earnings

Autumn Statement 2013, para 2.131

Simplification of expenses and benefits

The Chancellor outlined the Government's response to the recommendations of the Office of Tax Simplification (OTS) in their interim report on employee benefits (see para 2.111 of the Statement). He reported that the Government has implemented 4 of the 'Quick Wins' identified in that report and announced that a further 9 would be delivered in January 2014, with consideration being given to another 10 by the end of the Parliament. He undertook to consider the OTS's final recommendations on receipt of its final report ahead of Budget 2014.

The OTS has published a table summarising the 'Quick Wins' and which ones fall within which tranche for implementation.

Exemption for occupational health treatment for employees

As trailed in a consultation in June this year, the Government is proposing to introduce an exemption for up to £500 paid by employers for medical treatment for employees where this is recommended by the new Health and Work Service. The Chancellor announced in the Autumn Statement (see para 2.49) that this exemption will also include treatment recommended by employer‑arranged occupational health services. The legislation will be included in Finance Bill 2014.

Apprenticeships

In an effort to encourage employers to take on more apprenticeships and to streamline and simplify the funding arrangements associated with apprenticeships, the Government is proposing to make a number of changes to the funding mechanisms for apprenticeships, which will include:

- a compulsory employer cash contribution for a significant proportion of the external training costs of an apprentice (excluding English and maths)
- an additional contribution to the costs of training for 16 to 17 year olds (the Statement includes a commitment, but no more, to consider the position of 18-year olds)
- caps on the maximum government contribution per apprentice, and
- a facility to withhold a proportion of the funding for a payment by results approach

There will be a consultation in early 2014 on the technical details of how to deliver apprenticeship funding direct to employers using HMRC's systems -- the most likely of those systems being the RTI system. See para 2.166 of the Statement.

Dual contracts

Another area where the rules on employment income will be tightened up is in the use of dual contracts. See para 2.126 of the Statement.

Entering into dual contracts is a tax planning device that has proved useful for certain employees eligible to be taxed on the remittance basis on overseas earnings. Where such an employee has an employment that has some duties in the UK and some elsewhere, it may be possible for the employee to enter into two contracts, one in respect of the UK duties and one in respect of the overseas duties, so that remuneration under the overseas contract is only taxable when remitted to the UK.

HMRC has treated dual contracts with a degree of suspicion for a long time, frequently challenging them on the grounds that they do not reflect commercial reality. The measure announced in the Autumn Statement will, under provisions to be included in Finance Bill 2014, override the effect of a dual contract arrangement which in reality represents a single employment, applying UK tax on the full employment income where a comparable level of tax is not payable overseas on the overseas contract.

The new legislation, due to take effect from 6 April 2014, will not outlaw dual contracts, but will remove the tax advantage often previously delivered through their use.

Venture capital trusts

Over the summer, the Government consulted on changes to the VCT rules to restrict the tax relief available for certain share buy-back and re-investment arrangements between VCTs and their investors. The aim of the changes is to limit income tax relief for investors to new investments in VCT shares, as opposed to relief on existing investments in a particular VCT. Legislation will be introduced to ensure that investments which are conditionally linked to a VCT share buy-back, or that have been made within six months of a disposal of shares in the same VCT, will not qualify for new tax relief. This change will take effect from April 2014.

The VCT rules will be amended so that investors can subscribe for VCT shares via nominees, in order to enable VCTs to be used by different types of retail investors.

A further consultation will take place into the VCT rules, focusing on the use of converted share premium accounts to return capital to investors, where that return does not reflect the profits on the VCT's investments. Autumn Statement 2013, para 2.52

Qualifying loan interest

Finance Bill 2014 will amend ITA 2007, ss 392, 396 to ensure that where interest is paid on loans taken out to invest in close companies or employee-controlled companies resident in the European Economic Area (EEA) it will qualify for income tax relief. Presumably this is because the existing rules are incompatible with the requirement of freedom of establishment enshrined in EU law. Autumn Statement 2013, para 2.50

Energy efficiency grants for landlords

Funds are to be made available to private landlords as grants to improve the energy efficiency of their properties. The Government estimates that 45,000 of the least energy efficient properties will be improved and, since the total amount available is £90m, this would suggest an average grant of £2,000 per property. The method of applying for the grant and the criteria of assessment are unclear. It is also uncertain whether commercial landlords will be able to benefit from the grants or whether the scheme will be limited to residential landlords only. Autumn Statement 2013, para 2.38

Residential landlords can already claim a revenue deduction against their rental income for capital expenditure on energy-savings items incurred before 6 April 2015 under ITTOIA 2005, s 312. No deduction would be available in relation to this expenditure to the extent it was funded by a Government grant.

Commercial landlords are able to claim capital allowances on plant and machinery or integral features. The amount of any grant must be deducted from the total expenditure incurred to ensure capital allowances are only granted on the net amount. CAA 2001, s 532.

Capital Taxes

Annual exemption

The Annual Exemption for capital gains tax will be increased to £11,000 in 2014-15, and to 11,100 from 2015-16. The exemption for trusts will be £5,500 and £5,550 respectively.

Private residence relief

The government will reduce the final period of exemption from 36 months to 18 months from April 2014. Legislation will be introduced in the Finance Bill 2014. Autumn Statement, para 2.58

Currently, when a property is sold which has qualified for private residence relief at any time during the period of ownership, the last 36 months of ownership is exempt, regardless of how the property has been used during that period. The provision was originally intended to help those who needed to move and had difficulty in selling their home, but it has become a widely used planning tool for those with two qualifying residences. Indeed MPs accorded the provision some notoriety with their custom of 'flipping' their London and constituency homes.

The published information indicates no other change to private residence relief other than a reduction in the final exemption period. All the other valuable principles of the relief will remain. Nevertheless, the curtailment of the exemption could have a fairly significant effect on the amount of tax payable on properties which have been owned and lived in for just a few years.

In order to avoid tax on their main residence, homeowners will need to accelerate their decision on whether to sell the property when they move to another part of the country or abroad. See also the comment on Non-residents below.

Extension of CGT regime to non-residents

As widely anticipated, the Chancellor announced that the government will introduce a charge to CGT on future gains made by non-residents disposing of UK residential property. Autumn Statement, para 2.59

The basic principle of CGT has always been that it is a charge on those resident in the UK. However with the popularity of the UK, and London in particular, as a property investment destination for the worldwide wealthy, the principle is now seen as a 'loophole' in the context of property. It is generally accepted that it is foreign investment in London property which is driving prices upwards to the disadvantage of those who are (or would like to be) resident in the city.TCGA 1992, s 2

Finance Act 2013 introduced the annual tax on enveloped dwellings and the related capital gains tax charge on residential property held by non natural persons -- typically companies. Those measures went some way towards addressing what was seen as unacceptable tax planning in relation to property, but they apply only to properties worth in excess of £2 million.

The current proposal adopts the rather more direct, and obvious, remedy of imposing a CGT charge on all residential property in the UK (subject to available reliefs such as private residence relief).

The change in the law is scheduled for April 2015 and the government will publish a consultation document on how best to introduce it in early 2014. Clearly, there will be a number of issues to address:

- **Compliance** HMRC will have to ensure that non-resident owners of residential property are aware of their reporting obligations.
- **Tax collection** HMRC will have limited powers of enforcement against non-residents and may be expected to instigate a tax collection scheme comparable to the Non-resident landlords' scheme. Under that scheme, agents and tenants are obliged to deduct income tax at basic rate from rental income unless the non-resident landlord complies with self assessment. By comparison, capital gains tax could be collected, as is Stamp Duty Land Tax for purchasers, when the transfer of property is registered.
- **Apportionment of gains** The Chancellor emphasised that tax would be charged on *future* gains. Where the period of ownership straddles April 2015, the gain will have to be apportioned to the chargeable and non-chargeable period. This could be done on a time apportioned basis as with private residence relief. Alternatively, chargeable gains could be based on a valuation of the property as at 6 April 2015.

The popular image of a non-resident property owner is of a very wealthy foreign investor. Indeed the tax has already been dubbed the 'oligarch's tax'. It should not be overlooked that the tax will apply equally to British nationals, temporarily living overseas, and to those emigrating and retiring abroad. Currently, if a person leaves the UK without selling his home, the sale will be free of CGT if he does not return within five years. After April 2015, that exemption will be lost. Combined with the revision to the private residence relief rules, those leaving the UK will need to make an early decision on whether to sell their home.

The stated aim of the charge is to help create a fairer tax system. Part of the attraction for foreign investors is the capital gains tax free status of UK property. The loss of that benefit may encourage additional sales, thereby increasing the supply of available housing for residents.

Stamp duty

With effect from April 2014, Stamp duty and Stamp Duty Reserve Tax (SDRT) will be abolished on purchases of shares in Exchange Traded Funds (ETFs) where those ETFs are domiciled in the UK.

SDLT relief

The government will clarify the legislation relating to charity relief from stamp duty land tax in Finance Bill 2014. Where a charity purchases a property jointly with a non-charity, it is exempt from SDLT on its share. This is the current law established in June 2013 by the Court of Appeal in the case of The Pollen Estate Trustee Company Ltd and Kings College London v HMRC. Relief on joint purchases had previously been refused by HMRC and it is now inviting retrospective claims for overpaid tax.

Inheritance tax

There were no announcements in relation to the nil rate band or the rate of inheritance tax. As previously announced in Autumn Statement 2012, the nil rate band is expected to remain at £325,000 until it is increased to £329,000 from 6 April 2015 (an increase of approximately 1%).

Simplifying charges on relevant property trusts

The proposal to simplify charges on relevant property trusts has been on the agenda for at least two years. There have been two consultations and the government is now promising a third. It appears that changes will be postponed until 2015, although some proposals will be included in Finance Bill 2014. Autumn Statement, para 2.62

The charges at issue are the ten year or periodic charges made on 'settlements without qualifying interests in possession', together with the exit charges incurred when property leaves such a settlement. The calculations are complex and require information which may not be easily available to trustees, or their advisers. The most recent consultation had 3 key proposals:

1. To dispense with the requirement for historical information on the settlor's previous transfers and to compensate for this by splitting the nil rate band between all the settlor's trusts in existence
2. To apply a flat rate of 6% to all periodic and exit charges instead of the variable (lower) rates required by the calculations
3. To treat undistributed income as automatically accumulated (and therefore capitalised) after two years. The proposal is in conflict with trust law which allows for retention of income with distribution to income beneficiaries many years later. The accumulated income would become subject to IHT charges

The proposals received a great deal of criticism from the profession. The objections are set out succinctly in the CIOT response to the consultation.

The government is now promising a further consultation on splitting the nil rate band, so it appears that it has acknowledged the difficulties but is nevertheless intent on pursuing this measure. Aside from simplification, the recognised purpose in splitting the nil rate band is to extinguish the tax planning opportunities offered by Pilot trusts.

No comment has been made on the rate of tax to be applied to the chargeable property. Details may be published in the draft legislation on 10 December.

The Autumn Statement does include a definite proposal to treat income which remains undistributed for 5 years as part of the trust capital when calculating the 10 year charge. It has therefore moved from its initial position of 2 years, but it is still a long way from the ICAEW's proposal of 21 years in its response (Taxrep 39/13). No detail is available yet on whether the income tax consequences will be addressed.

IHT compliance

As suggested in the consultation, the government intends to simplify filing and payment dates for relevant property trust charges.

Even more useful is the proposal to provide an online service for IHT from 2015-16. Currently, all IHT returns are submitted on paper. HMRC does provide electronic versions on its website which can be filled in on-screen but they have to be printed, signed and posted. These forms are notoriously difficult to navigate. It is to be hoped that a change to an online service will provide an opportunity to streamline the requirements.

Vulnerable beneficiaries

The Chancellor promised further concessions in relation to vulnerable beneficiaries, indicating that it would broaden the definition of qualifying trusts and explore further ways of safeguarding property for vulnerable people. Autumn Statement, para 2.63

The only specific provision mentioned in the statement was an immediate application of the CGT 'uplift' provisions to apply on the death of a vulnerable beneficiary. Under TCGA 1992, s 62 the assets of a deceased person are deemed to be disposed of and re-acquired at market value at date of death. The same relief from capital gains tax applies in the case of trust assets in which a beneficiary has an interest in possession. As a vulnerable beneficiary's interest is often discretionary, a change to the law is required to give them the preferential treatment.

Administration

Self-employed NICs

The Government plans to use the Self-Assessment Tax Return to simplify the collection of Class 2 NIC.

By collecting Class 2 NIC after the end of the tax year once the trading profits are known, this could create two additional administrative advantages:

- the small earnings exemption application process could be abolished

- there will be no need to make an application to defer Class 2 NIC where the trader pays Class 1, 2 and 4 NIC

However, there are also a number of challenges which must be dealt with if the proposal is to be implemented, including:

- the small earnings exemption is based on accounting profits whereas Class 4 NIC are paid on taxable profits
- the Class 2 NIC legislation is broader in scope than the Class 4 legislation, meaning that some individuals are liable to Class 2 and not Class 4
- how to ensure the correct state benefit entitlement is recorded where Class 2 NIC is (potentially) not paid until 31 January after the end of the tax year

The consultation closed on 9 October 2013 and a summary or responses is to be published "in due course". There is no timescale provided for the implementation of the simplifications. Autumn Statement 2013, para 2.115

Anti-avoidance and compliance checks

HMRC has secured over £60bn in compliance yield since 2010 and had been projected to reach £120bn by the end of 2015/16. Based on this success, the Government has raised this by £3.7bn, revising the annual targets to £23bn in 2013/14, £24.1bn in 2014/15 and £25.1bn in 2015/16. To support this, HMRC is to be exempt from the departmental spending cuts. Autumn Statement 2013, paras 1.291, 1.292, 2.146

It seems likely that the HMRC campaigns and taskforces which have proved so successful will continue.

Use of avoidance schemes

As previously announced in Budget 2013, if HMRC is successful in challenging an 'avoidance case' in court, it will be able to send a notice to taxpayers / employers who have used the same avoidance scheme or similar **requiring** them to acknowledge that the judgment applies to them and either:

- amend their Returns accordingly, or
- confirm to HMRC that their cases can be distinguished from the litigated case and that they stand by their original Returns

A tax-geared penalty would be charged if the taxpayer /employer takes the latter action but is later found not to have a reasonable basis for that conclusion.

Following a consultation which closed on 4 October 2013, Finance Bill 2014 is expected to contain these provisions.

However, the Chancellor went further than this in Autumn Statement 2013 and announced that, in addition to the above, HMRC will also be able to issue 'pay now' notices. These notices will "initially" be used in relation to tax avoidance schemes which have already been defeated in the courts but there will be a consultation in 2014 to widen the criteria under which the notices can be issued.

See paras 2.138-2.139 of the Statement

It does not appear that HMRC will be required by the new legal provisions to accept a taxpayer's Tax Return as filed if another taxpayer is successful in a similar avoidance case.

High-risk avoidance promoters

As previously announced in Autumn Statement 2012, high-risk promoters of tax avoidance schemes are to be targeted with a raft of new measures including information powers, penalties and the power to publish the promoter's details. Following the consultation which closed on 4 October 2013, draft legislation is expected to be released next week which will include objective criteria which will determine whether promoters are considered to be 'high-risk'. Once a promoter is classified 'high-risk', their clients must identify themselves to HMRC. 'High-risk' promoters will find themselves subject to a higher standard of reasonable excuse and reasonable care. See para 2.137 of the Statement.

Given that clients of high-risk promoters will be required to identify themselves as such to HMRC, the likelihood is that these taxpayers will be under greater scrutiny by HMRC. This may lead to these taxpayers disassociating themselves from these promoters and, when combined with the provisions accelerating the tax payments in tax avoidance cases and requiring taxpayers to accept the ruling of a test case could put these promoters out of business if they do not moderate their behaviour.

There is a parallel here with the attitude that HMRC has been taking with regard to high volume agents. By seeking to get high volume agents to enter into a memorandum of understanding to apply specified standards of scrutiny concerning clients' business records and returns, HMRC is looking to change the behaviour of both the agent and the client.

Disguised employment

The third anti-avoidance measure specifically in the area of employment taxes is concerned with the use of Limited Liability Partnerships as part of an arrangement that HMRC describe as 'disguised employment'. Individual members of an LLP are taxed as if they are partners even if their membership terms are such that the individual would normally be regarded as being in an employer - employee relationship, ie where the individual has a fixed salary, no exposure to risk, has no substantive role in the management of the business and with no right to profits or assets if the partnership ends.

The new measure announced in the Autumn Statement (see para 2.129) will be included in Finance Bill 2014 so that an LLP would need to apply PAYE to payments to a member that meets one of two conditions:

- he would be regarded as an employee, or
- he has no economic risk, entitlement to share of profits and entitlement to assets on winding up

At the time of the consultation there were concerns expressed that the measures, as described, could affect many commercial arrangements beyond the intended 'abusive' arrangements. There has not yet been a formal response document following the consultation, but the Finance Bill clauses, when published, should show whether this concern has been taken on board.

Beneficial ownership of companies

As previously announced by the Prime Minister, the UK is to create a publicly accessible central registry of company beneficial ownership information. The aim of the registry is "to help prevent the misuse of companies for tax evasion, money laundering and other crimes". This register may be useful to tax practitioners in complying with the client identification requirements of the money laundering regulations. Currently it can be arduous to ascertain exactly who the beneficial owners are, for instance for certain partnerships and trusts. Autumn Statement 2013, para 1.314

Information exchange

The Chancellor reported that the government has expanded the network of jurisdictions with which it exchanges information to tackle offshore tax evasion. It now includes many of the Crown Dependencies traditionally thought of as offshore havens such as Guernsey, Jersey, and the Cayman Islands.

Agreements with Switzerland and Liechtenstein continue to be pursued.

Business Taxation

Partnerships

From 6 April 2014, excess profits allocated to a non-individual partner can be reallocated to an individual partner if the non-individual’s share is excessive and the individual partner may benefit from those profits. Alongside this rule, from 5 December 2013 certain Income Tax and Capital Gains Tax reliefs are denied for a loss allocated to an individual partner where the individual is party to arrangements, the main purpose of which is to secure that some or all of the loss is allocated to the individual, with a view to the individual obtaining relief.

Business rates

The Autumn Statement includes a package of measures targeting business rates. This includes the following measures:

- a 12 month extension of Small Business Rate Relief (SBRR) doubling
- capping business rates increase at 2% for the year from 1 April 2014
- introducing a 50% reoccupation relief for 18 months on business rates where premises have been empty for more than a year
- providing an annual £1,000 discount on business rates on properties with rateable value below £50,000, for 2 years from 1 April 2014
- relaxing the SBBR rules to allow business in receipt of SBRR to take on another property without losing entitlement, and

- improving administration through a consultation in the spring, allowing payment over 12 months and clearing the backlog of appeals

It is worth noting that the proposed discount, reoccupation relief and SBBR may constitute state aid and contribute towards the EU cap on de minimis aid in accordance with Article 2 of Commission Regulations (EC) No 1998/2006. This should be clarified when draft legislation for Finance Bill 2014 is published on 10 December 2013.

The maximum amount of de minimis aid that a business can receive in a rolling three-year period is EUR 200,000, which is currently £166,430 according to the official euro exchange rate. If a business is already in receipt of de minimis aid, they may therefore not be eligible.

The Regional Employers National Insurance Contributions Holiday is also de minimis aid, as is the Seed Enterprise Investment Scheme.

More importantly, the business rates reliefs will have an impact on the eligibility of a company for SEIS.

The amount of de minimis aid received by the business will reduce the potential amount of SEIS qualifying shares that a company can issue.

The amount of aid will be deducted from the maximum qualifying investment in the company of £150,000. See the Seed Enterprise Investment Scheme (SEIS) guidance note.

Business premises renovation relief

HMRC is in the process of conducting a technical review of business premises renovation allowances (BPRA) prompted by notifications under the disclosure of tax avoidance schemes (DOTAS) regime.

The areas of concern include:

- the definition of 'qualifying expenditure'
- financing of the expenditure via circular loans
- the availability of BPRA at a time when the building is not a qualifying building or where the work may not commence for several years
- use of BPRA in the manipulation of profits and losses of partnerships with a corporate partner (note the taxation of partnerships and the use of corporate partners is being reviewed in a separate consultation and is being examined by the Office of Tax Simplification)

BPRA Technical review, para 1.16

Whilst the aim of the review is to make the rules simpler and ensure that taxpayers can be more certain of its application, it seems that a targeted anti-avoidance rule will be introduced and some of the definitions will be tightened up so it remains to be seen whether this will result in simplification. The draft legislation will be released next week. Autumn Statement 2013, para 2.117

Corporation tax rates

The Chancellor announced in the Budget that the main rate of corporation tax would reduce to 20% from 1 April 2015. Planned corporation tax rates, and those that have been in operation in recent years, are now as follows:

FY	2012	2013	2014	2015
Small profits rate	20%	20%	20%	20%
Main rate	24%	23%	21%	20%
Standard fraction	1/100	3/400	1/400	0
Marginal rate	25%	23.75%	21.25%	20%

Low salary / high dividend remuneration strategies will continue to prove most effective for owner-managed companies.

Social investment relief

At para 2.51, the Autumn Statement document confirms the introduction of a new tax relief for equity and certain debt instruments in social enterprises.

The relief was the subject of a consultation in June 2013 and the proposal was modelled on the Enterprise Investment Scheme. See the Is a new tax relief for investment in social enterprise on the horizon? news item for details.

This relief will be available from April 2014. Draft legislation for the relief may be published on 10 December 2013. Alternatively, it may be published along with the Government's road map for social investment in January 2014.

As a result of the consultation, Social Impact Bonds will now be included within the scope of the relief.

The Autumn Statement document also announces changes which relate to anti-avoidance that will come into effect from April 2014. The key anti-avoidance announcements are as follows.

Close company loans to participators

As well as new rules announced in Budget 2013 extending the scope of the close company provisions and introducing new anti-avoidance rules, a consultation was launched at Budget 2013. (LNB News 09/07/2013 102).

The options for the alteration of the rules which were proposed in the consultation were:

- Maintain the current regime
- Increase the tax rate but retain the structure and operation of the regime

- Replace the current repayable charging system with a lower rated but permanent charge which arises annually on amounts outstanding at the end of each accounting period until the extraction is repaid to the close company; and
- Replace the current repayable charging system with a lower rated but permanent charge which arises annually on average amounts outstanding during the accounting period

The government has announced in Autumn statement 2013 that it does not intend to make any immediate changes "to the structure or operation of the tax charge on loans from close companies to individuals who have a share or interest in them."

Anti-avoidance measures

According to the Autumn Statement document, the anti-avoidance measures and measures to tackle tax evasion announced "will raise more than £6.8 billion of new revenue over the forecast period and protect billions of pounds of revenue, making it the largest avoidance and evasion package announced this Parliament.

This commitment is underlined by the announcements that the government will further strengthen HMRC's capacity to assess the tax risks posed by large multinational companies and that HMRC will be required to secure an additional £3.7 billion in compliance yield by the end of 2014/15 whilst being exempt from government spending cuts.

The Statement reiterated that the government will continue to work with the G20 and OECD in tackling tax avoidance by multinational companies by progressing the 15 Action Points identified in the OECD's Action Plan on Base Erosion and Profit Shifting.

In addition, the following targeted anti-avoidance measures for UK corporation tax were announced:

- Amendments to the worldwide debt cap rules to limit the ability of multinational groups to allocate excessive debt to UK companies. These rules have immediate effect from 5 December 2013.
- Measures closing down corporation tax avoidance schemes exploiting the use of intra-group derivatives.
- Amendments aiming to prevent abuse of the Controlled Foreign Company (CFC) rules by the transfer of profits from offshore intra-group lending. These rules have immediate effect from 5 December 2013.
- Amendments to the Business premises renovation allowance to simplify and clarify the rules and their application and to reduce the risk of exploitation.
- Rules to prevent offshore contractors who lease equipment to oil and gas operators from minimizing their UK tax liabilities by using associate companies in tax havens

- Amendments to double tax relief rules to reinforce the government's policy that relief for foreign tax should only be given where income has been taxed twice - once in the UK and once in the foreign territory. These changes have immediate effect from 5 December 2013.

The Autumn Statement document also reiterated the changes that were made in Finance Act 2013 to the corporate loss buying rules, specifically that the rules would not apply where there is a common understanding on the principal terms of the transaction between the parties.

Amendments to Controlled foreign companies (CFCs) rules

Also with immediate effect from 5 December 2013, amendments have been announced to the CFCs rules aiming to tackle offshore transfers of profits arising from UK intra-group lending (LNB News 05/12/2013 158).

The new legislation prevents a creditor relationship of a CFC from being a Qualifying Loan Relationship (QLR) for the purpose of the full or 75% financing exemption in TIOPA 2010, s371IB or section 371ID. The new provision will apply if the creditor relationship arises as a result of any arrangement which has a main purpose of transferring out of the UK profits from a loan made by a UK company connected with the CFC.

The rule will apply on a loan by loan basis and will prevent the full or 75% exemption provisions from applying to the creditor relationship of the CFC. It will ensure that further arrangements cannot be entered into to circumvent its effect. Amendments will also be made to TIOPA 2010, ss 371IH(10) to ensure the rules on the definition of QLRs work as intended.

For further guidance on the current rules see the Controlled Foreign Companies (CFCs) -- from 1 January 2013 guidance note.

Amendments to the debt cap provisions

Two changes have been announced to the debt cap provisions, to TIOPA 2010, s 345 and TIOPA 2010, s 353A (LNB News 05/12/2013 152). With immediate effect from 5 December 2013, the grouping rules in the debt cap provisions are amended. The changes ensure that a UK tax-resident company that does not have ordinary share capital, for instance a company limited by guarantee, can be a relevant group company for the purpose of the debt cap. The definition of a 75% subsidiary for debt cap purposes will also be amended in order to ensure that indirect ownership of a company can be traced through intermediate entities without ordinary share capital. The changes put it beyond doubt that the ultimate parent of a worldwide group may be regarded as beneficially entitled to 75% of the profits or assets of a UK group company for the purposes of the debt cap grouping rules even taking into account intermediate companies which do not have ordinary share capital.

The regulation-making powers have also been amended in order to enable regulations to include conditions to be met by companies making an election to transfer debt cap liabilities to another group company.

For further guidance on the current rules see the Worldwide debt cap - main provisions guidance note.

Anti-avoidance measures targeting Total Return Swaps scheme

With immediate effect as of 5 December 2013, rules have been introduced to close down a loophole which enabled companies to avoid paying corporation tax on profits paid to an overseas group company.

For further guidance see the Derivative contracts guidance note.

Amendments to the double tax relief rules

The government has announced two changes to the double tax relief rules, effective immediately, with the aim that relief for foreign tax is only available where income has been taxed twice - once in the UK and once in a foreign territory.

The first change targets those avoidance schemes which seek to exploit mismatches between the amounts of UK and foreign income. It therefore requires the amount of relief for foreign tax on non-trading credits from a loan relationship or intangible fixed asset to be limited to the amount of UK tax on the net amount of the credit after deducting related debits.

The second change is designed to reduce any credit allowed or deduction given to the taxpayer, where arrangements in place enable a repayment made by a foreign tax authority to be received by a person other than the taxpayer.

For further information see the Tax Information and Impact Note (TIIN), draft legislation and explanatory note issued by HMRC.

For further guidance on double tax relief see the Double tax relief guidance note.

Modernising the taxation of corporate debt and derivative contracts

Following consultation on the review of the legislation governing the taxation of corporate debt and derivative contracts (LNB News 06/06/2013 75), legislation has been announced clarifying and rationalising the taxation of corporate partners where loan relationships and derivative contracts are held by a partnership.

Legislation will be introduced to further enhance the existing anti-avoidance provisions at CTA 2009, s 492 preventing abuse of the 'bond fund' rules in CTA 2009 Chapter 3, part 6. Under the amended rules

corporate investors will be able to make a claim to disapply the bond fund rules in certain circumstances.

Change in ownership rules

Two changes have been announced which ease restrictions on the availability of corporation tax losses imposed by the existing 'change of ownership' rules.

The first change allows for "a holding company to be inserted at the top of a group of companies" (presumably this means without the rules having effect).

The second change is to the definition of 'a significant increase in capital' when a change of ownership occurs in a company with investment business. Following this change in the definition, a significant increase in capital will occur where the capital in the company after the change of ownership (amount B) exceeds that before the change (amount A) by both £1m and 25%. Under the existing rules the increase is significant if B is either £1m (or more) greater than A, or B is at least twice A.

These measures will be included within Finance Bill 2014 and we await the publication of the draft Finance Bill clauses on 10 December 2013 to understand how these changes will be presented and when they will come into effect.

For further guidance on the change of ownership rules see the Change in ownership provisions guidance note.

Associated companies rules

The Autumn statement has announced that the associated companies rules will be simplified in April 2015, to be based on 51% group. The main and small profits rate will also be unified at 20% at the same time, as already announced.

Further details should be available with the publication of Finance Bill 2014.

For further guidance on the current rules associated companies rules see the Associated companies guidance note.

Bank levy amendments

The bank levy was introduced in Finance Act 2011. It is payable by UK banks, banking groups and building societies, and foreign banking groups operating in the UK through a permanent establishment. The tax is levied on the total chargeable equity and liabilities reported in the relevant balance sheets of affected banks at the end of the chargeable period. The rate of the bank levy has been increased from 0.13% to 0.156% from 1 January 2014, with a view to offsetting the benefit banks would otherwise obtain following the reduction in the rate of corporation tax.

In addition to the change in the bank levy rate announced today, the government has announced legislation following its review of operational aspects of the Bank Levy in 2013. The consultation responses will be published alongside the draft legislation on 10 December 2013. The proposed new legislation includes measures for the following:

- The protected deposit exclusion will be limited to amounts insured under a deposit protection scheme
- All derivative contracts will be treated as short-term
- Relief for a bank's High Quality Liquid Assets will be restricted to the rate applicable to long term liabilities
- The Bank Levy definition of Tier One capital will be aligned with the new Capital Requirements Directive. This measure will have effect from January 2014
- Liabilities in respect of collateral that has been passed on to a central counterparty will be excluded from January 2014
- The legislation-making powers within the Bank Levy will be widened to ensure it can be kept in line with regulation. This measure will have effect from the date of Royal Assent.

These changes will have effect from January 2015, unless stated otherwise.

Onshore oil and gas allowance

Existing corporation tax rules subject ring fenced profits arising from a company's onshore oil and gas activities to a supplementary charge and offer field allowances to reduce those profits.

The new allowance announced today, and having immediate effect, provides for a deduction from adjusted ring fenced profits subjected to the supplementary charge, equivalent to 75% of capital expenditure incurred in relation to an onshore site. This is likely to benefit companies involved in onshore exploration, appraisal and development projects (including shale gas and other hydrocarbons) at an early stage and which are economic but not commercially viable.

For further information on the allowance please see the Tax Information and Impact Note (TIIN), draft legislation and explanatory note issued by HMRC.

Oil and gas exploration

A package of measures has been announced to support oil and gas exploration in the UK and UK Continental Shelf, including the following:

- The ring fence expenditure supplement will be extended for all onshore ring fence oil and gas losses and qualifying pre-commencement expenditure incurred on or after 5 December 2013. This will be included in Finance Bill 2014.

- The Government will review options to mitigate the impact of the profit transfer targeted anti-abuse rule on oil and gas exploration and appraisal and similar activity in other sectors.

The following changes have also been announced which will have effect from the date that Finance Bill 2014 receives Royal Assent:

- Reinvestment relief will be extended to prevent a chargeable gain being subject to corporation tax where a company sells an asset in the course of exploration and appraisal activities and reinvests the proceeds in the UK or UK Continental Shelf. For the current rules see the Rollover reliefs guidance note.
- The scope of the substantial shareholding exemption will be extended to treat a company as having held a substantial shareholding in a subsidiary being disposed of for the required 12 month period before the disposal to scenarios where the subsidiary is using assets for oil and gas exploration and appraisal that have been transferred from other group companies. For further guidance on the current substantial shareholding exemption see the Introduction to the substantial shareholdings exemption and main conditions guidance note.

Energy tax: contracts for difference

The definition of 'contracts for difference' in the corporation tax derivative rules will be amended to include the terms 'investment contracts' and 'contracts for difference' introduced in the Energy Bill.

This change will be enacted through secondary legislation once the Energy Bill has received Royal Assent.

Film tax relief

Film production companies are subject to special tax rules in CTA 2009, part 15. These determine how taxable profits of the film production activities are to be calculated and special loss rules. Subject to meeting specified conditions, some films may also qualify for film tax relief. This relief can increase the amount of expenditure that is allowable as a deduction for tax purposes or, if the company makes a loss, can be surrendered for a payable tax credit.

A number of changes have been announced to enhance film tax relief. Relief will be available at 25% on the first £20 million of qualifying production expenditure, and 20% thereafter, for small and large budget films from April 2014.

The government will also reduce the minimum UK expenditure requirement from 25% to 10% and the cultural test will also be modernised.

The change in the rate of relief is subject to State aid approval. When renotifying film tax relief in 2015 the government will seek state aid clearance to increase the rate of relief to 25% for all qualifying expenditure.

New corporation tax relief for theatres

The government has announced today that it will consult in early 2014 on the introduction of a new limited tax relief for commercial theatre productions and a targeted tax relief for theatres investing in new works or touring productions to regional theatres to have effect from 2015.

VAT

VAT return filing

The Chancellor did not announce any further changes to existing VAT legislation in the Autumn Statement and he only announced that the Government was intending to issue a consultation document regarding the possible amendment of existing legislation, in respect of the VAT return filing requirements, for organisations that are not able to complete online VAT returns.

This consultation has most likely been announced as a result of the recent ruling in *Blackburn (T/A Cornish Moorland Honey)* [2013] UKFTT 525 (TC), [2013] All ER (D) (subscription sensitive).

Personal Tax

Transfers are taxable

A company, H, set up a funded unapproved retirement benefits scheme for the taxpayer who was its controlling shareholder. In March 2005, the company transferred two properties into the scheme and in its accounts described the transfer as “director's pension contributions”. The taxpayer did not declare these in his tax return. When they discovered the omission, HMRC issued a discovery assessment on the basis that the contributions had been made to provide a benefit to the taxpayer and were therefore taxable benefits. The taxpayer appealed.

Decision:

The First-tier Tribunal said that, according to the evidence, including a report of the trustees of the FURBS, the taxpayer was the sole beneficiary of the scheme. There was no documentation to support the taxpayer's assertion that the contributions were not made with a view to his benefit.

The tribunal judge noted that the taxpayer's “memory of events was poor and he appeared to attach … little importance either to exactitude or to compliance with his legal obligations”.

The taxpayer's appeal was dismissed.

Comments – Compliance with the legislation in taxation is important. This is particularly true with pension schemes and pension transfers. The taxpayer’s lack of attendance to the compliance aspects and his behaviour were unlikely to result in a successful conclusion to his appeal.

D McWhinnie TC2977

Loan to employee

Mr Boyle had been granted loans by his employer in rapidly depreciating currencies. Arrangements with Credex, a company connected with his employer, ensured that Mr Boyle effectively received English pounds. The first issue was whether the monies paid to Mr Boyle under the loans should be taxable as emoluments under ICTA 1988 s 160.

Decision:

The FTT noted that Mr Boyle was not a 'straightforward' witness and that he must have been aware of the tax advantages triggered by the loans. He also must have known that he would not have to repay the loans. He effectively turned a 'blind eye'. Referring to tax avoidance case law, the tribunal determined that a 'realistic view' should be adopted when determining whether a loan was an emolument. The tribunal held that the loans were not genuine. Credex was not independent and the repayment terms of the loans did not relate to the full advances. Furthermore, exchange rates were manipulated and no foreign currency was actually supplied or exchanged. The tribunal concluded that the difference between the advances and the amounts repaid constituted emoluments taxable under

ICTA 1988 s 160. In the event that the loans were not emoluments at the outset, they were never repaid and so, at the time they were written off, they represented earnings under ITEPA 2003 s 188. The tribunal added that, if the loans were not taxable as emoluments or earnings, the transfer of assets provisions applied to make the loans taxable as income under ICTA 1988 s 739. Charter (Insp. of Taxes) v Brackett [1986] STC 521 was authority for the proposition that an employment contract can be a transfer of assets. Here, the asset transferred was Mr Boyle's work. As his employer was resident outside the UK, the provisions applied. Furthermore, the taxpayer had not established that the arrangements were implemented for bona fide commercial reasons without a tax avoidance purpose. Finally, the taxpayer had argued that the discovery assessments, raised by HMRC to assess him after the enquiry window had closed, were not valid. This was on the basis that the relevant information had been available to them at the time the enquiry window was still open (TMA 1970 s 29). The tribunal simply noted that the scheme implemented by the taxpayer pre-dated DOTAS and that therefore the taxpayer's return had not included an SRN number, making it impossible for the 'hypothetical officer' to infer any tax avoidance activities from the return.

Comments - The tribunal established that a loan to an employee was taxable as income under three independent provisions of the tax legislation. Clearly, similar schemes involving loans to employees are unlikely to succeed. This case demonstrates the importance of understanding the correct treatment of loans made between a company and its employees – the understanding of exactly what provisions apply is even more important when the company in question is a close company and the employee is also a participator.

Philip Boyle v HMRC TC3103

Capital Taxes

CGT: negligible value claim

The taxpayers had purchased shares in a company owned by their daughter, Miss Dyer, a renowned fashion designer. The shares had been issued by way of debt capitalisation. The company had since then been wound up and the taxpayers had claimed relief under TCGA 1992 s 24(2) on the basis that their shares had become of 'negligible value'. HMRC had denied the claim on the ground that the shares had not become of negligible value; they had been of negligible value from the time of their acquisition by the taxpayers. It was accepted that Miss Dyer had established a solid reputation in the fashion world and that the various intellectual property rights attached to her brand were very valuable. However, she had never entered into a formal employment contract with the company in which her parents had invested and had neither assigned nor licensed any of her intellectual property rights to it.

Decision:

The tribunal referred to Lord Hoffman's statement in Gray v IRC [1994] STC 360: 'The hypothetical buyer is assumed to have behaved reasonably, making proper inquiries about the property and not appearing too eager to buy.' The tribunal concluded that no buyer would have purchased the company without a firm commitment from Miss Dyer and a legal entitlement to the intellectual property rights attaching to her brand. The FTT therefore held that, at the time of its purchase by the taxpayers, the company had already been of 'negligible value'.

Comments - Negotiations had taken place with various potential investors and it was clear that the intention was to formalise Miss Dyer's commitment to the company to make a deal happen. However, the tribunal simply focused on the fact that the taxpayers bought the shares without this commitment and therefore at a time when the company had no intrinsic value.

Roger and Jean Dyer v HMRC TC3073

Changes to Principal Private Residence Relief (Lecture P813 – 18.57 minutes)

When you sell your home the gain will be covered by PPR to the extent you have resided in the property. Historically, if you have resided in the property at any point you are always deemed to occupy the property for the last 3 years. The Autumn Statement contained a surprise announcement that the "last 3 years" exemption will be reduced to 18 months for disposals on or after 6 April 2014.

Key dates

Exchange date is key for CGT so any clients wishing to secure the 3 year exemption must exchange contracts before 6 April 2014 and complete before 6 April 2015.

Disabled persons

A new S.225E TCGA 1992 ensures that the last "3 years rule" is retained for disposals by disabled persons (see schedule 1A FA 2005) or persons in care homes provided that one of two conditions is met **at the time of disposal**:

1. The individual is a disabled person or a long term resident in a care home and does not have any other relevant right in relation to a private residence.
2. The individual's spouse or civil partner is a disabled person or a long term resident in a care home, and neither the individual nor the individual's spouse or partner has any other relevant right in relation to a private residence

Condition 2 effectively extends the relief to spouses or civil partners of a qualifying person.

S.225E(7) extends the three year rule to trusts where the individual occupying the property meets the same conditions.

To qualify as a care home, the home must provide accommodation together with nursing or personal care. An individual is a long term resident in a care home at the time of disposal if at that time the individual is resident in the care home, and has been resident there, or can reasonably be expected to be resident there for at least three months.

The timing of disposals will be key where an individual is relying on the care home condition. If they move out of their home to live with relatives, the 18 month rule will apply if the property is sold whilst residing with relatives.

However, if after 30 months of living with relatives, they went into a care home and then sold their old home they would then be entitled to the 3 year rule.

The timing of disposal is critical. It is tested at the time of disposal. If the intention is to move from residing with relatives and into a care home after more than 18 months, the property should either be disposed of within 18 months of residing with relatives or once they have moved to the care home if they want the benefit of the 36 month rule.

Impact on letting exemption

Where a home has been let as residential accommodation then letting relief applies to the lower of

- the amount of the PPR relief
- the gain arising by reason of the letting
- £40,000

By reducing the deemed period for PPR relief from 36 to 18 months, you may also reduce the letting relief available.

Example

Let's see how the reduction of the deemed period of ownership could impact on the letting exemption.

Sam bought a property 8 years ago for £200,000 and lived in it for a year before letting it out for 7 years. He sold the property in January 2014 for £296,000 giving a gain of £96,000 before PPR and letting relief.

- PPR relief is £48,000 (96k x4/8) - 1 year of actual residence plus the last 3 years

- Letting exemption is restricted to the £40,000 fixed amount as this is lower than the PPR given and the gain arising by reason of the letting.

That leaves a reported chargeable gain of £8,000.

How would this change if the sale was on or after 6 April 2014?

The gain before PPR and letting relief would still be £96,000 but PPR relief would now only be available for 2.5 years (1 year of actual residence plus the last 18 months) so the relief available would fall to £30,000 (£96k x 2.5/8) where previously it was £48,000.

The PPR relief of £30k is lower that the gain arising by reason of letting and the statutory £40,000 and so the letting relief is reduced from £40,000 to £30,000.

In total the reported gain is now £36,000; that's £28,000 higher!

PPR nominations

If you have two residences at any one time, the facts will dictate which property is your PPR. HMRC will look at a number of factors to decide where the main family home is (time spent in each property, location of children's schools, family doctor, dentist etc).

However, the client can nominate his "factual" second residence as his PPR. This is normally done for a short period after which the client would nominate their main home as their PPR. By nominating the second home for a day (say) the client was looking to secure the last three years of ownership as PPR on their second home

Planning with nominations is still valid but the 18 months rule will affect the amount of the tax savings at stake.

Example

Joan bought second home five years ago for £400,000. The property has never been let and acts as her second home. Her accountants advised her to nominate the property as her main residence for one day shortly after purchase.

The property was sold in March 2014 for £500,000 giving a gain of £100,000 which is reduced by a PPR claim of £60,000. (One day of nominated residence plus the last 3 years = 3 years, 1 day of PPR; approximately £100k x 3/5 = £60,000). The reported chargeable gain is therefore £40,000, ignoring the one day for simplicity.

How would this change if the sale was on or after 6 April 2014?

Let's change the sale date to May 2014.

The PPR claim is now only £30,000. (One day of nominated residence plus the last 18 months = 1.5 years PPR; £100k x 1.5/5= £30,000). The reported chargeable gain is therefore £70,000 i.e. £30,000 higher.

If Joan is thinking of selling she should sell prior to 6 April 2014

Separating couples

The 36 month rule provided considerable relief for couples separating. Not only did it benefit the marital home but also properties where the couple have previously resided but now let. These will also be affected by the 18 month rule.

As advisors, we need to explain and quantify the tax position on the couple's properties when separating.

Our calculations would be based on two scenarios:

- Resolving within 18 months
- Resolving outside 18 months

Whether they can meet the 18 month rule and enjoy the lower tax charge is another matter.

Conclusion

Practitioners need to aware of the change to 18 months and the contact the client's affected by the change in good time. If the reduction in PPR is significant then clients will need to consider crystallising gains prior to 6 April 2014 – maybe by way of a settlor interested trust if an outright sale is not an option.

Surplus Cash Problems and Solutions (Lecture P814 – 13.45 minutes)

Background

Business property relief (BPR) is a valuable form of inheritance tax (IHT) relief. It applies to various form of 'relevant business property', including shares in an unquoted company.

The shares are not relevant business property if the company wholly or mainly carries on certain excluded activities, i.e. dealing in securities, stocks or shares, land or buildings or making or holding investments (IHTA 1984, s 105(3)). These exclusions are subject to certain exceptions (in s 105(4), (4A)), including where the company's business consists wholly or mainly in being a holding company of a group of companies whose business does not consist of excluded activities.

The 'wholly or mainly' requirement in s 105(3) is an 'all or nothing' test. For example shares in an unquoted company which is carrying on 51% trading activities and 49% investment business activities qualify for BPR in full. However, the company's shares will be eligible for no BPR at all if its business activities are 49% trading and 51% investment.

Excepted asset 'tests'

If BPR is available, it is subject to restriction in respect of excepted assets.

The legislation in s 112 ('Exclusion of value of excepted assets') provides that an asset is an 'excepted asset' unless it satisfies at least one of the following two general tests (in s 112(2)):

"(2) An asset is an excepted asset in relation to any relevant business property if it was neither—

(a) used wholly or mainly for the purposes of the business concerned throughout the whole or the last two years of the relevant period defined in subsection (5) below, nor

(b) required at the time of the transfer for future use for those purposes;"

However, there is a relaxation of the excepted asset rules in respect of group companies:

"…but where the business concerned is carried on by a company which is a member of a group, the use of an asset for the purposes of a business carried on by another company which at the time of the use and immediately before the transfer was also a member of that group shall be treated as use for the purposes of the business concerned, unless that other company's membership of the group falls to be disregarded under section 111 above."

There is a separate rule for excepted asset purposes in respect of land or buildings, or machinery or plant, used wholly or mainly for the purposes of a business carried on by a company of which the transferor had control, or by a partnership of which he was a partner (in s 112(3)).

The 'past use' test

The test in s 112(2)(a) above broadly requires that the asset must have been wholly or mainly used for business purposes throughout the whole of the 'relevant period'. This period is either the two years immediately preceding the transfer of value in question, or the whole period of ownership if less than two years.

Thus (for example) a trading company may use surplus cash to acquire assets wholly or mainly for business purposes (e.g. plant and machinery), even if the acquisition takes place shortly before a transfer of shares in the company (on which BPR is claimed).

The 'future use' test

Taking the example of a trading company with a large credit balance on its bank account, how much (if any) of that cash balance is 'surplus'? The 'future use' test in IHTA 1984, s 112(2)(b) can cause difficulties in practice.

In *Barclays Bank Trust Co Ltd v IRC* [1998] STC (SCD) 125, the deceased held 50% of the shares in a company carrying on an old established trade of selling bathroom and kitchen fittings. It had a strong cash position. At the time of the deceased's death, the company held over £450,000 in cash. The Inland Revenue (as it was then) accepted that £150,000 was needed by the company at that time, but maintained that the remaining £300,000 was an excepted asset.

The Special Commissioner upheld the Revenue's view, rejecting the argument that the cash was required for the future purposes of the businesses. The appeal was dismissed.

Is it 'surplus'?

Whether cash is 'surplus' will depend on the particular circumstances in each case. Factors to consider include the following:

1. Every trading company needs working capital. The *Barclays Bank Trust* case arguably provides a useful 'rule of thumb' as the undisputed amount of cash needed by the company represented roughly 25% of its turnover.

2. Seasonal businesses will often hold substantial cash at certain times of the year.

3. Business owners may retain a higher proportion of funds during difficult trading conditions (not least due to the reluctance of banks to provide working capital in some cases).

4. To the extent that cash is surplus, the business may apply those funds in (for example) paying trade creditors or discharging other liabilities of the business.

5. The surplus cash could be used towards separate investment business activities.

   However, continuing the above trading company example, care should be taken to ensure that the investment business activities do not predominate (IHTA 1984, s 105(3)).

6. If cash has been earmarked for future business use, clear evidence should be maintained of its intended use.

   In *Barclays Bank Trust Co Ltd*, the special commissioner stated that whether cash is held for future business use is a question of fact, and commented:

   > *"I do not accept that 'future' means at any time in the future nor that 'was required' includes the possibility that the money might be required should an opportunity arise to make use of the money in two, three or seven years' time for the purposes of the business.* ***In my opinion and I so hold that 'required' implies some imperative that the money will fall to be used upon a given project or for some palpable business purpose"*** (emphasis added).

Other points

- *Land and buildings* - The excepted assets provisions contain an apportionment rule where part of the asset is not used mainly in the business (s 112(4)). This will commonly apply in relation to mixed-use buildings, such as farmhouses.

- *Personal use* - If the asset was used wholly or mainly for the personal benefit of the transferor or a person connected with him (e.g. a private yacht or a holiday home) it is deemed not to have been used wholly or mainly for the purposes of the business concerned (s 112(6)).

Contributed by Mark McLaughlin

Annual Tax on Enveloped Dwellings (Lecture P815 – 14.11 minutes)

The legislation

Legislation was introduced in Finance Bill 2013 to introduce a new tax charge – the Annual Tax on Enveloped Dwellings (ATED). The ATED is a tax payable by companies (and certain other corporate entities – see below) that own high value residential property with effect from 1 April 2013.

The rules are contained in section 94 Finance Act 2013 and can be broken down into three main areas:

- What is chargeable
- Who is chargeable
- How much is the charge

What is chargeable?

The ATED applies to residential properties in the UK. A dwelling is a building or part of a building which is used or suitable for use as a single dwelling or is in the process of being constructed or adapted for such use. A dwelling includes gardens and grounds.

Sometimes a dwelling is part of a mixed use property for example a building may consist of a shop on the ground floor and a flat on the first floor. The ATED will only apply to the flat (the residential part). The flat will need to be valued. If it is worth more than £2 million the ATED applies.

If the property consists of a block of flats, each flat should be valued separately.

The valuation will be used for the first five ATED return periods beginning 1 April 2013 and based on the valuation at 1 April 2012, or the date of acquisition, if later.

Who is chargeable?

The ATED is payable where the property is owned by a:

- Company,
- Collective investment scheme, or
- Any partnership that has such persons as partners.

How much is the ATED charge?

The amount of ATED is worked out using a banding system based on the value of the property.

Property Value	Annual Charge
£2m - £5m	£15,000
£5m - £10m	£35,000
£10m - £20m	£70,000
£20m+	£140,000

Contributed by Priya Dutta, Gabelle LLP

Administration

PAYE Real Time Information: package of help announced for micro employers

Existing employers with nine or fewer employees who need more time to adapt will be able to report PAYE information on or before the last payday in the tax month until April 2016.

More than 99 per cent of PAYE records are now successfully being reported in real time. Almost 93 per cent of active employers are now using the new processes to send PAYE information about their employees.

The vast majority of employers are finding reporting in real time straightforward, however HM Revenue & Customs (HMRC) recognises that a small proportion of micro employers and their agents still need more time to adapt.

HMRC has therefore agreed that existing micro employers (and, where appropriate, their agents) who need more time will have up to two years to adapt their processes to ensure they are ready to report all payments in real time before April 2016.

All employers will be required to report PAYE each time they pay their employees by April 2016 (unless an exception applies - for example, in some limited circumstances employers have a week to report payments to casual workers). HMRC will be encouraging micro businesses to adapt their processes sooner to ensure that they are ready to report all payments each time they pay their employees by April 2016.

This is narrower than the current relaxation which comes to an end in April 2014. The new relaxation will only apply to existing employers with nine or fewer employees.

HMRC extended until April 2014 its temporary relaxation of the real time reporting rules for businesses with fewer than 50 employees. This relaxation, which allows small businesses to send PAYE information to HMRC by the date of their regular payroll run, but no later than the end of the tax month, was due to end on 5 October 2013. The extension means that businesses will not be required to change their approach halfway through the tax year. From April 2014, all employers need to plan to be reporting in real time.

All employers starting to operate PAYE after 6 April 2014, as well as existing employers with 10 or more employees, will need to report each time they pay their employees from April 2014. HMRC wants to encourage new employers to start off on the right foot and help them avoid the need to change their reporting processes at a later date.

All employers, regardless of size, who are already using payroll software products or HMRC's Basic PAYE Tools to report PAYE on or before the date they pay their employees should continue to do so.

Payroll software developers will not be required to change the way their products work, although some minor changes to text may be needed to allow employers to tell us that they are using the relaxation. We appreciate this is late notice for them, and have worked closely with representatives from the industry on this change.

This decision forms part of a package, developed with employers, agents, payroll software providers, representative bodies and the Department for Work and Pensions (DWP), to help micro employers as they move towards full reporting of PAYE information in real time.

The package also includes:

- improved guidance, including best practice scenarios - see the link 'Situations where employers will not have to report PAYE information 'on or before' the time they pay their employee' at the end of this page
- ongoing work with the software industry to harness technology to develop new ways to report PAYE information on or before the date they pay their employees - for example, by exploring use of mobile apps

Universal Credit and PAYE in real time

HMRC has worked closely with the DWP in developing this package to ensure that it balances the needs of Universal Credit claimants and micro employers.

Reporting PAYE information in real time is vital to ensure that all employees claiming Universal Credit receive what they are entitled to. It is therefore important that micro employers make best use of this time, so that they are reporting on or before the date they pay their employees by April 2016 and before Universal Credit is fully rolled out.

No ground for discovery

In 1997, the taxpayer exchanged 969,000 shares in his company for 3,637,462 loan notes. He redeemed £1,035,000 loan notes in 1999 and 2000, correctly including the transactions in his tax returns for the relevant years because such loan notes did not at the time qualify for taper relief.

In December 2002, the taxpayer redeemed loan notes worth £2,602,462. In his 2002/03 tax return, he claimed taper relief in relation to their redemption, saying that the loan notes were not a qualifying corporate bond.

HMRC raised a discovery assessment in relation to December 2002 redemption. The taxpayer appealed.

Decision:

The First-tier Tribunal ruled that an HMRC officer looking at the return in 2002/03 would know that loan notes were qualifying corporate bonds, that no taper relief was due, and that more tax would be due.

The conditions for raising a discovery assessment were not satisfied.

The taxpayer's appeal was allowed.

Comments – Many cases on discovery in recent times have gone in favour of HMRC as the taxpayer has not always made it clear that a particular issue enabled the hypothetical inspector to be aware of the insufficiency. It is refreshing to see a Tribunal decide in favour of a taxpayer albeit in a relatively straightforward case.

M Freeman TC2885

Discovery assessment

Mr Sanderson challenged the validity of a discovery assessment. His tax return for the year 1998/99 disclosed chargeable gains of £1.8m and capital losses of more than £2m. The losses were attributed to a 'beneficial interest in the Castle Trust'. Castle Trust was the vehicle of a capital loss scheme implemented by many taxpayers. In 2004, the officer investigating the trust scheme had become aware that Mr S's 1998/99 return had been filed and had issued a discovery assessment as the enquiry window was closed. Mr S's case was that HMRC had been aware of his participation in the trust scheme before he had even submitted his tax return and that, by the time he did so, HMRC considered that the scheme did not achieve its objectives. Consequently, the conditions of TMA 1970 s 29 were not satisfied as an HMRC officer could have been aware of the tax insufficiency at the time the enquiry window was still open.

Decision:

Referring to Corbally-Stourton, the tribunal held that the tax return might have alerted the hypothetical officer to the fact that Mr S had implemented the scheme, but it did not contain enough information to make the officer aware of an 'actual insufficiency' of tax. The tribunal added that information that HMRC generally held about the trust scheme could not be attributed to the hypothetical officer. The tribunal rejected HMRC's argument that the taxpayer's advisers had been negligent when recommending that he 'do nothing' following the filing of his return when it had become clear that the trust scheme had failed. The taxpayer was under no duty to inform HMRC in such circumstances.

Comments - Alerting HMRC to the implementation of a scheme is not sufficient to make the relevant officer aware of a 'tax insufficiency' for the purposes of TMA 1970 s 29.

Sanderson v HMRC (FTC/46/2012)

Staffing problems

The taxpayer received a penalty for submitting its 2011/12 employer annual return late. The company claimed that it sent the form electronically on 20 April 2012 and received an acknowledgement for it. HMRC said the return had been submitted in test mode and the receipt would have alerted the taxpayer to that.

Decision:

The First-tier Tribunal noted that both sides accepted that a submission had been made on 20 April and, on the balance of probabilities, it had been in test mode. However, because of the lack of evidence, the tribunal could not make any finding with regard to the message received by the taxpayer. Two days after the submission, the company suffered various staff problems which put pressure on the remaining staff, and might have prevented them checking the acknowledgement. The tribunal concluded that the unexpected staffing difficulties constituted reasonable excuse.

The taxpayer's appeal was allowed.

Comments – This is yet another case demonstrating the potential problems with HMRC's filing systems and the importance to the taxpayer of retention of the appropriate evidence. Also the Tribunal are likely to take into account extenuating circumstances as they have done in this case as they are realistic in assessing what is reasonable.

TRM Electronics Ltd TC2989

Reasonable excuse

The taxpayer claimed to have filed his tax return online well within the deadline but HMRC insisted that it had not received it and that therefore a penalty was due.

Decision:

Rather than deciding what had actually happened, the tribunal pointed out that the taxpayer's belief that the return had been filed could constitute a reasonable excuse. The factual issue the tribunal had to establish was therefore whether the taxpayer had really believed that he had submitted his return. In doing so, the tribunal gave some weight to the reasonableness of the taxpayer's belief. The tribunal went on to disagree with Coales v HMRC [2012] UKFTT 477, which it found to have been wrong in law when it had asked itself whether an honest belief had been reasonably held. In the first stage, objectivity is helpful in establishing whether a belief is reasonable and therefore whether it is likely that the taxpayer held that belief. Once the tribunal has come to the conclusion that the belief was held by the taxpayer, asking whether it was held reasonably is tantamount to 'emasculating the concept of an honest belief being capable of amounting to a reasonable excuse'. Finally, the tribunal found that HMRC had failed to discharge the onus of proving, on the balance of probabilities, that the return had not been filed by the taxpayer.

Comments - An honest belief can constitute a reasonable excuse, whether or not it is reasonable.

David Wake-Walker v HMRC TC3097

Late monthly PAYE payments penalties partially mitigated

In 2011/12, HMRC considered that the taxpayer did not make the monthly payments of PAYE and National Insurance on several occasions. In March 2013, HMRC wrote to the taxpayer notifying a penalty for late payment, but included the details of another trader. They sent a correct notice a few weeks later.

The taxpayer appealed. It argued that it had posted all the monthly payments three to six days ahead of the due date.

Decision:

The First-tier Tribunal said that some of the cheques had been posted too close to the due date to be certain of receipt on time. As to the payment due by 19 December 2011, the cheque was dated 13 December and, if it had been posted on that day, should have reached HMRC in time. Although the department said it received it on 31 December, the tribunal decided to give the benefit of the doubt to the taxpayer in this instance and accepted that it had posted the cheque in time.

The tribunal found it “most regrettable” that the penalty notice relating to another business had been sent to the taxpayer, but said this could not constitute a reasonable excuse for the late payments.

The taxpayer established reasonable excuse in respect of one month, but not for the others. The appeal was allowed in part.

Comments – This case demonstrates that in order to succeed in with reasonable excuse the circumstances must be continuing and in this case that was not the situation as decided by the Tribunal. The Tribunal described the HMRC failure as most regrettable the failure which was a failure of their key duty of confidentiality.

TBD Morris Environmental Ltd TC3009

Careless inaccuracy in a self-assessment return

The taxpayer had received a 'severance payment' as compensation for the early termination of his employment, but had failed to record it in his self-assessment return. Although he now accepted that the payment was subject to income tax, he argued that he should not have been imposed a penalty for careless inaccuracy under FA 2007 Sch 24.

The appellant alleged that, at the time of filing his return, he had reasonable grounds to believe that the payment was not taxable. The compromise agreement duly recorded that it was the understanding of the parties that the payment was not subject to tax, and he had read an article on the Wolters Kluwer website confirming that no tax was payable on such a severance payment.

Decision:

The Upper Tribunal dismissed the appeal, noting that the taxpayer was an 'intelligent person' occupying a 'senior position' in a company which formed part of a 'leading accountancy practice' (KPMG). The wording of the compromise agreement suggested at the very least that there was a possibility that tax would be payable and the article the taxpayer referred to was in no way unequivocal on the topic. Indeed, it suggested very clearly that a severance payment may be taxable in specific circumstances. Furthermore, the short tax return which the taxpayer had completed contained a note that such a return should not be used in circumstances where the taxpayer had received a lump sum payment from his employer.

Comments - The case confirms that a taxpayer is under the duty to make some enquiries when his tax position is not clear.

Timothy Harding v HMRC (FTC/56/2013)

Jurisdiction of the tax tribunals to review penalties

The taxpayer had incurred penalties for the late payment of PAYE (FA 2009 Sch 56). However, he argued that 'the assessment of penalties in a single block some six months after the year end provides no help and no encouragement to compliance'. He also insisted that the penalties were disproportionate, as the returns had only been filed a few days late on each occasion.

Decision:

The FTT (referring to Hok [2012] UKUT363) explained that the ground of appeal was outside its jurisdiction — which is limited to deciding whether, 'on the proper application of the words of the statute, a penalty is in fact due and, if so, what, in accordance with the statute, its proper amount should be.' The tribunal also noted that the position is slightly different in relation to VAT penalties, as VAT has 'its roots in the EU Directive' and 'is suffused with EU legal principles such as proportionality'. By contrast, the penalties under Sch 56 have a 'purely UK genesis': 'The doctrine of proportionality can affect them only if that doctrine can get in through the door of the Human Rights Act 1998.' The tribunal added that FA 2009 Sch 56 imposes penalties in a form which is 'mechanical and precise', leaving no room for qualifications based on proportionality.

Comments - This is yet another case in which the taxpayer failed in arguing that penalties should be set aside on the ground of unfairness and disproportionality. Clearly, following HMRC v Hok [2012] UKUT 363, the jurisprudence of the tax tribunals is now well established in this respect.

P&H Cleaning Company v HMRC TC3051

Late notification of an appeal to the tax tribunal

The taxpayer sought permission to notify HMRC two years late of his intention to appeal under TMA 1970 s 49. HMRC had sent 'somewhat confusing' letters to the taxpayer's accountants; however, those letters did make it clear that a 'speedy' reaction was required if an appeal was to be lodged. The taxpayer argued that he had been abroad during the time when an appeal could have been lodged and was under the misapprehension that his accountants were dealing with the issue. Furthermore, given the amount of tax at stake, he would suffer a real prejudice if permission was denied in circumstances where all the evidence was still available.

Decision:

The tribunal denied permission to notify the appeal late. The degree of prejudice to the taxpayer was established by the strength of his substantive case. He had engaged in an 'adventure in the nature of a trade' and so should not have suffered CGT. However, this prejudice could be offset by a claim for damages against his accountants if they were responsible for the delay. If the delay was the taxpayer's fault, 'he should bear the consequences of his actions'. Furthermore, no good explanation for the two year delay had been given.

Comments - The length of the delay seems to have influenced the tribunal's decision. It is also interesting that the taxpayer's ability to obtain damages from his accountants was taken into account in assessing his potential prejudice.

Folarin Bamgbopa v HMRC TC3046

Jurisdiction to cancel disproportionate penalties

Penalties had been imposed on the taxpayer for the late filing of returns under the construction industry scheme (CIS). The First-tier Tribunal (FTT) had held that the European Convention on Human Rights ('the convention') (s 3), permits the tribunal to read the word 'incorrect' in relation to penalties in TMA 1970 s 100B(2)(a)(iii), as including a reference to disproportionate penalties therefore in breach of the convention.

The FTT had consequently reduced to zero some of the fixed penalties imposed by HMRC. HMRC had appealed against the decision.

Decision:

Disagreeing with the FTT, the Upper Tribunal stressed that the legislation does not provide for a right of appeal against a decision of HMRC on the mitigation of a penalty, so that the only avenue open to the taxpayer is judicial review. Moreoever, it rejected arguments as to the cost and complexity of judicial review proceedings, noting that these proceedings 'represent an adequate and effective way to protect the taxpayer's rights'. The tribunal insisted that the fact that such proceedings are costly does not amount to a 'denial of access to justice' for the purposes of the convention.

The Upper Tribunal added: 'We have no doubt that the unambiguous meaning of the language used in s 100B(2)(a)(iii) is that the word 'incorrect' means not of the correct fixed amount as prescribed by the legislation: it does not include penalties which are incorrect by virtue of being disproportionate and breach the taxpayer's rights under … the convention.'

Finally, the Upper Tribunal robustly rejected arguments that all the tax penalties imposed on the taxpayer should be assessed as a whole which would then be found to be disproportionate.

Comments - The case is a reminder that the tax tribunals do not have jurisdiction to decide whether a penalty imposed by HMRC is fair. This is the jurisdiction of the Administrative Court under the judicial review process.

HMRC v Anthony Bosher (FTC/3/2013)

Closure needed

In January 2010, HMRC opened an enquiry into a taxpayer in relation to properties he owned. The taxpayer provided the information requested by the Revenue and applied for the enquiry to be closed. He claimed that he had satisfied HMRC's demands but they had "continually extended the scope of the enquiry without good reason" and that the delay in completing the enquiry was unreasonable.

Decision:

The First-tier Tribunal said that there were "limited items of information outstanding" which HMRC were justified in obtaining. However, it seemed that these matters were in hand and there was no reason, once they had been resolved, for the enquiry not to be closed. On this basis, the tribunal judge directed that HMRC issue a closure notice within 30 days.

The taxpayer's appeal was allowed.

Comments – Much of the procedure through the Tribunal system relates to HMRC taking action. This is an excellent demonstration of where the taxpayer can use the system to close a continuing enquiry.

K Bloomfield TC2982

LPP and separate proceedings

Mr Lewis refused to comply with an information notice issued by HMRC under FA 2008 Sch 36, claiming legal professional privilege (LPP) in relation to documents concerning the negotiation of a compromise agreement with his former employer.

Decision:

Referring to Three Rivers District Council [2004] UKHL 48, the tribunal stressed that LPP 'covers all documents brought into being for use by a party in litigation that is in progress or in contemplation'.

However, the tribunal added — referring to Winterthur Swiss [2006] EWHC 839 — that documents created 'as part of negotiations in an attempt to compromise the proceedings' will only be protected by LPP for the purpose of the proceedings they are aimed at avoiding. Such documents are not privileged from disclosure in other, unrelated proceedings. The taxpayer also claimed 'common interest privilege', but it was held that a common interest privilege could not exist here as the taxpayer had not established the existence of a privilege which could be extended to a group.

Comments - LPP is not transferrable between litigations.

Mark Lewis v HMRC TC3102

Business Taxation

Capital allowances on property - section 198 elections (Lecture B811 – 18.00 minutes)

Disposal receipts

When an asset upon which capital allowances has been claimed is disposed of (for example, sold), an amount must be subtracted from the pool that the qualifying expenditure was recorded in, to reflects the value of the plant and machinery at that time. This is a disposal receipt, or disposal value.

When a property containing plant and machinery fixtures changes hands, by default the disposal value is a 'just and reasonable apportionment' (CAA 2001 s 562) of the sale price for the whole property. But this is capped at the qualifying expenditure pooled by the seller (CAA 2001 s 62)

However, the seller and buyer may opt out of using this approach by agreeing an election under CAA 2001 s 198 or s 199 (the latter, if dealing with a leasehold interest).

Circumstances for an election

An election may be used in two circumstances:

1. a market value sale of the property, or
2. a cessation of trade, followed by sale of the property.

Importantly, an election may only be made for fixtures (not chattels), upon which the seller has claimed plant and machinery allowances.

The election allows the seller and buyer to negotiate and agree the amount of the seller's disposal value, and the qualifying expenditure incurred by the buyer on the fixture (or fixtures) in question. Making an election has no effect on the capital gains computation.

However, even if an election has been agreed, it is likely that many buyers will still require an apportionment to value assets which fall outside the election. First, this will be needed to value any fixtures upon which a claim has not been made previously. Most commonly, this relates to 'pre-commencement integral features', such as cold water, general electrical power and lighting, and external solar shading. These are assets upon which capital allowances usually could not be claimed before April 2008 (because the assets were not generally considered to be plant). However, since then they have been deemed to be plant or machinery (by virtue of being integral features). They cannot be included in an election because the seller has not claimed. So the buyer can only establish its qualifying expenditure using an apportionment. Second, if any chattels have been conveyed these cannot be included in an election, so the only permissible approach is an apportionment.

Election amount

The election amount must be quantified at the time the election is made. It cannot exceed:

- the qualifying expenditure incurred by the seller on the fixture (that is, the amount pooled by the seller), or
- the total sale price for the whole property.

There is no minimum election amount. But if a low election is intended, normal practice would be for £1 (if there is only one class of fixtures, such as main pool plant) or £2 (if there are two classes of fixtures, such as main pool and special rate pool plant).

Tax written-down value is commonly proposed by sellers to be a 'fair' or 'neutral' compromise because the seller keeps the allowances that accrued during its period of ownership and the buyer receives the remainder going forward. That sounds superficially persuasive, but fails to acknowledge that capital allowances are intended only to be kept to the extent of any economic loss suffered. If the property has held its value or appreciated, then allowances claimed by seller are meant to be clawed-back and pass to the buyer by default.

An election is irrevocable. So once one has been made this sets the maximum amount any future owner can claim for the fixture (or fixtures) in question. But it is possible to elect for a *lower* amount if the property subsequently changes hands.

Conditions

An election must be submitted to HMRC no later than two years from the Completion date of the transaction. A copy must accompany each party's tax return for the first period affected by the election - which is usually the period when the transaction took place.

An election must state the following:

1. the amount;
2. the seller's and buyer's names (the beneficial/ equitable owners);
3. information sufficient to identify the plant and machinery fixtures;
4. information sufficient to identify the relevant land (that is, the title number and address);
5. particulars of the interest acquired (that is, the tenure - for example, freehold)
6. the seller's and buyer's Unique Taxpayer Reference (UTR) issued by HMRC (or if a person does not have a UTR the election should say so).

HMRC will accept one election per property. But not a single election for a portfolio.

Information sufficient to identify the plant or machinery

The statutory requirement is to identify only fixtures (not chattels) that the seller has claimed capital allowances upon. This is because those are the only fixtures upon which the seller is required to account for disposal proceeds.

The plant and machinery fixtures rules are written in the singular tense (that is, 'a fixture'). So they work on an asset-by-asset basis. However, pragmatically, HMRC will accept a degree of amalgamation where this does not distort the tax computation. This means that, where relevant, an election must distinguish between main pool and special rate pool plant. Also, it is good practice to identify the fixtures at 'elemental' level. For example: cold water systems, hot water systems, lifts and so on.

Many purported elections are arguably flawed. For example:

- the description 'all fixtures', 'all fixed plant and machinery' or equivalent, or
- a standard list of every plant or machinery fixture which might typically be found in a building, but which may, or may not, be present in the actual property (sometimes including words to the effect of '... including but not limited to')

This type of approach is lazy and imprecise and arguably does not satisfy the statutory requirement. It either purports that the seller has submitted an perfect claim for every conceivable plant and machinery fixture (which is improbable), or the description probably fails to identify just the fixtures upon which the seller claimed allowances. If the election is for one amount, with a description that includes fixtures upon which the seller may, and may not, have claimed allowances on, how can the amount be said to be fixed for just the assets upon which the seller has claimed. Furthermore, if the seller cannot (or will not) provide an accurate description of the assets upon which it has purportedly claimed, then this does little to inspire confidence that the election basis can be correct.

Some purported elections identify fixtures *and chattels* (sometimes in an attached inventory). An election cannot include chattels because it is a fixtures election. Where there is one amount (so the amount allocated to the fixtures, rather than the chattels, is not clear) then it is again difficult to see how the amount can be said to be set for the fixtures.

Similar problems exist when purported elections identify assets which are not plant (for example, windows) or assets which clearly do not exist (for example, a lift in a single storey building).

Tactics

A seller's and buyer's interests are opposed. What is good for the seller is usually bad for the buyer and vice versa.

If the buyer is amenable, it is in a seller's interests to agree as low an election amount as possible. This allows the seller to dispose of the qualifying assets, but still keep some, or all, of the tax relief.

However, an election is normally best avoided by a buyer unless the amount reflects (at least broadly) the full qualifying expenditure originally incurred by the seller, or the buyer is otherwise compensated under the terms of the deal. If there is no election, a buyer is automatically in the *best possible position* because the underlying disposal value mechanism means that the capital allowances will in most cases automatically transfer to the buyer by default. The trouble with discussions about elections is that they introduce strong pressure on a buyer to give away something that they would otherwise automatically be entitled to receive. Many buyers feel obliged to make a negotiated 'compromise', which in reality means giving away some or all the tax relief which should rightfully be theirs. So it is important to recognise that there can be such a thing as a bad election - it simply depends upon whether the amount is 'fair' (that is, reflects the seller's qualifying expenditure).

Downside of elections

As discussed earlier, elections are generally inadvisable for buyers because they are already in the best possible position if there is no election. So any negotiated 'compromise' can only be to their detriment.

Also, elections are often entered into in the hope of providing certainty and peace of mind that capital allowances have been dealt with. However, for the reasons given earlier, many purported elections are arguably flawed and fail to meet the statutory conditions. So that certainty is an illusion. The flexibility to negotiate over an election amount also means, regrettably, that disagreements can ensue which sometimes risk delaying or jeopardising transactions.

It is also commonplace for elections to be used by large, well-resourced and well-advised sellers to manipulate smaller, less well-informed buyers into signing away some or all of the capital allowances without fully appreciating the true cost of what they have agreed to do.

Contributed by Steven Bone

Can a work of art be plant? (Lecture B812 – 12.18 minutes)

The recent decision of the Upper Tribunal in *Lord Howard v HMRC (2013)* had a surprising outcome. However, when one examined the background of the relevant legislation, the position became rather more clear-cut.

Lord Howard’s personal representatives claimed that an 18th century picture entitled ‘Omai’ painted by Sir Joshua Reynolds, which had been sold at auction for more than £9,000,000, was a wasting asset and therefore exempt from CGT.

It is well known that wasting assets, ie. assets which have a predictable life of less than 50 years (see S44 TCGA 1992), do not attract CGT. Typical examples include motor cars and clocks, given that mechanical

objects generally cease to function within 50 years of being manufactured. Durable assets, on the other hand, like buildings, antiques and paintings are usually chargeable to CGT, if sold at a profit.

Since the painting was nearly 230 years old at the time of its sale, it might be thought that the personal representatives would have an uphill struggle to establish that it constituted a wasting asset. As it turned out, their argument was a particularly ingenious one. They claimed that 'Omai', which had been hanging in one of the public areas of Castle Howard and was recognised to be a significant visitor attraction, should be regarded as 'plant and machinery' on the basis that it had been exhibited there for nearly 50 years and therefore met both the 'functional' and the 'permanence' tests. Because S44 TCGA 1992 provides that plant and machinery is regarded as having a predictable life of less than 50 years 'in every case', irrespective of its actual characteristics, such items are automatically classified as exempt wasting assets.

The case gave rise to this comment from one eminent tax expert:

'So this case was nothing to do with CGT or wasting assets – it was another case about plant and machinery and all those famous cases regarding the meaning of plant and machinery were analysed in depth. The upshot was that the Upper Tribunal felt that the painting was used for the promotion of the trade carried on at Castle Howard and was sufficiently permanent (even though it could be taken away at any moment) to be regarded as plant.'

Accordingly, it qualified for the CGT exemption.

It should be noted that S44 TCGA 1992 is overridden by S45 TCGA 1992 which withdraws the exemption in cases where the asset is used for the purposes of a trade. In this particular instance, however, S45 TCGA 1992 did not apply due to the fact that the business of opening Castle Howard to the public was carried on by a company (Castle Howard Ltd), whereas the painting was owned by Lord Howard personally. Since the exemption in S44 TCGA 1992 does not stipulate that the owner of the asset must also be the person who carries on the business, the override did not apply here – an important technical detail which was accepted by both sides.

The decision is likely to be seen as a significant boost to landed families who own valuable collections of art or antiques but are engaged in what one commentator has called 'a perennial fight to maintain their inheritance against the depredations of capital taxes'. It seems very possible that a similar scenario to that of 'Omai' could exist elsewhere, ie. a painting or item of furniture which has long been exhibited in a stately home open to the public. It remains to be seen whether this extraordinary case will irritate HMRC sufficiently to prompt them to push for a change in the CGT rules in the near future.

Article by Robert Jamieson

Partnerships – LLP employed partners (Lecture B813 – 10.18 minutes)

The two main changes to the taxation of partnerships were consulted on during 2013. However, the next version of the planned changes is considerably more aggressive than the proposals in the first consultation draft, and part of the measures will take effect from 5 December 2013, to prevent partnerships changing their arrangements to avoid the new rules in the run up to the change.

The material released on 10 December covers several areas of change to partnership tax rules, but the two areas of most concern to practitioners are:

- Salaried or fixed profit share partners (referred to as "disguised employment"), and
- Profit and loss sharing arrangements in mixed partnerships.

Partnerships – LLP partners with fixed profit share

It is HMRC's view that many members of LLP's are not in fact true partners, and therefore should be taxed as employees. This situation has been allowed to develop partly as a result of the Limited Liability Partnership Act which deemed members to be self employed for tax purposes.

It was clearly HMRC's desire to change the status of these individuals for tax purposes, and the consultation over the summer of 2013 was really just a study of how this should be done.

The consultation suggested that the normal employment status tests should be used in the first instance, and then a modified test to establish whether the members really had equity rights in the LLP. However, the use of the employment status test was unpopular with respondents, so has been dropped in favour of tightening up the alternative test, which comprises three aspects. The net effect of failing the test is that the individual concerned is brought within PAYE, and Class 1 NIC is due on earnings which have previously been taxed as a profit share. There may also be consequences for members of LLP's previously provided with company cars, as these will now be taxed as a benefit in kind. The "profit share" will be treated as a salary payment for the LLP (and for corporation tax purposes if relevant) and will therefore be a deduction in arriving at the taxable profits of the entity.

The test

The proposed legislation will form new Ss 863A to 863C ITTOIA 2005, which deem an individual M to be an employee of the LLP rather than a member of the partnership. It should be noted that the consultation response document accepts that this imposes employment tax provisions on the individual, but that M will have no employment rights as he is not an employee for employment law purposes. The provision is triggered when conditions A to C in new s 863B are met:

Condition A : there are arrangements in place as a result of which M is to perform services for the LLP in his capacity as a member of the partnership, and it is reasonable to expect that the amounts payable by the LLP in respect of M's services will be wholly or substantially wholly "disguised salary".

Disguised salary is defined as an amount which is

(a) fixed,

(b) if it is variable, it is varied without reference to the overall profits or losses of the LLP, or

(c) is not, in practice, affected by the overall amount of those profits or losses

Condition B: the mutual rights and duties of the members of the LLP, and of the partnership and its members do not give M significant influence over the affairs of the partnership.

Condition C: At the relevant time, M's contribution to the LLP is less than 25% of the total amount of disguised salary which it is reasonable to expect will be payable in the relevant tax year by the LLP in respect of M's performance of services as a member of the LLP. Normally the relevant time is the start of the tax year; where M joins the partnership it will be at that date for that tax year only.

All three of conditions A to C must be met to trigger the PAYE rules, so if any one of them is not met then M remains taxed as if he were a self employed member of the partnership. There follow some anti avoidance rules which are designed to ensure that the legislation bites where intended.

- No regard is to be had to any arrangements, the main purpose of which (or one of the main purposes of which) is to secure that the provisions do not apply to one or more individuals (new S863C(1))
- There is a provision which is designed to prevent M from routing his services through a limited company. This is triggered when an individual (X) performs his services when not a member of an LLP, though Y, who is not an individual but is a member of the LLP. Y is paid amounts which would amount to employment income of X were X an employee of the LLP. In these circumstances, S 863C(4) deems X to be a member of the LLP and the amount receivable by Y in respect X's services as employment income of X.

Finally new s863C(5) excludes this provision where arrangements have been put in place to avoid the new rules on profit sharing arrangements in mixed partnerships in new S850C ITTOIA 2005 (see below). This therefore ranks s 850C before s863A.

Consequential amendments allow for the deduction of the salary and related costs from the profits of a partnership or limited company in arriving at the taxable profits.

Illustrative examples from HMRC guidance

The examples form part of the guidance notes supporting the legislation, and a selection is reproduced here to aid understanding.

Condition A

<u>*Example 1*</u>

The B LLP is formed between the B family and a local developer to develop a plot of land. Kate B is a member of the B LLP, but under the LLP agreement, she does not need to work for the B LLP.

Kate B is an architect and engaged by B LLP to draw up plans in her capacity as an architect, for which she is paid an arm's length fee under a separate contract.

In this case, Condition A is not satisfied. Whilst Kate B is a member who performs services for the LLP, she does not perform those services as a member of the LLP. The B LLP has contracted for her to provide services as part of her profession as an architect and her reward from the LLP all arises to her in that capacity.

Disguised salary

<u>*Example 1A*</u>

J works for the ABC LLP. He will receive a salary of £100,000 plus a bonus determined by a remuneration committee, at their discretion.

For the purposes of this legislation, the question is what are the terms governing the remuneration committee's exercise of its discretion in determining the bonus payable. If the bonus is paid out of shares of the profit, then that is a share of the profit for the purposes of the legislation. In this case, more information is needed - what are the terms of reference for the committee? How realistic is it that any profit share will be 25% or more than the fixed salary of £100,000 (such that 80% of the total rewards will be).

<u>*Example 2*</u>

W LLP operates sites offering "hand car washes". The individuals who wash the cars are members of the LLP rather than being given contracts of employment. Member D washes cars at one of these sites. Member D is paid on a piece work basis; the more cars washed, the more he receives.

Member D will earn more if more cars come to be washed. However his income is based on his work, not the success of the business as a whole. Member D receives a disguised salary and Condition A is satisfied.

<u>*Example 2A*</u>

The XYZ LLP decides to expand into a new business area. A new member, P, is recruited to run the new business area. As it is expected that the new business area will initially make a loss, P will receive a guaranteed profit share of £100,000 plus a percentage of the turnover of the new business area.

Neither the guaranteed profit share nor the payment based on a percentage of the turnover of that business area is based on the profits of the LLP as a whole. Condition A is satisfied.

Profit share

A disguised salary includes both fixed amounts and amounts that are determined without reference to the level of profits or losses for the LLP as a whole. As a result, a disguised salary includes any sum that the member is reasonably expected to receive whether or not the LLP makes sufficient profit.

The key point is not how the payment is described; rather that it is a sum that the member expects to receive and will not in practice vary with the profit even if it is expressed to be linked to profit. It may be

theoretically possible that a member is required to repay part of their drawings, or that the firm may make a loss, but if these are unlikely events, they will be ignored.

Here are some examples of arrangements which will be regarded as guaranteed profits:

- *Member A is entitled to draw a salary of £10,000 a month.*
- *Member B is entitled to draw £10,000 a month. Under the terms of the agreement, he cannot be required to repay the money once drawn.*
- *Member C has a guaranteed profit of £120,000 a year.*
- *Member D is entitled to draw £10,000 a month. Realistically D will not be asked to refund this sum.*

The reality is that all four members are entitled to £120,000; the level of profits does not affect this part of their reward package.

Example 3

A is a member of the ABC LLP. Part of his reward package is that he is allowed drawings of £10,000 a month. Under the terms of the agreement he does not have to refund this, even if the LLP makes a loss.

A is treated as receiving a disguised salary of £120,000 as he will receive this irrespective of the profit of loss.

B is also a member of the ABC LLP. B can draw £10,000, but this is only an advance on his profit share. If the profit, after payment of non-refundable drawings of other members, is insufficient he will need to repay money to the LLP. If his share of profit is in the end more than £10,000 he will be entitled to a further payment.

B's drawings are not a disguised salary. The timing of payments is not relevant to Condition A.

Reasonable likelihood

Example 5

Four people decide to set up a cafe together. Members A, B & C do not have any capital to invest so only put in £100 each. The fourth, Member D, provides the funding for the venture. They agree that Members A, B & C will each have a salary of £25,000 a year. The agreement is that these are not repayable even if the profits are under £75,000.

Any loss would fall to Member D, who will receive the first £125,000 of profits after payment of salaries. Profits above that will be divided equally.

Members A, B & C all potentially have a share of the profits, the question is how realistic is that possibility? For Members A, B & C to receive a profit share at all, the profits need to be in excess of £200,000. If the business plan is based on an expectation of profits of between £100,000 and £150,000, then there is no reasonable expectation that the income of Members A, B & C will be significantly affected by the level of profits and Condition A is satisfied.

Condition B

Condition B is in essence looking at the role played by the individual in the business. Put simply, can it be said that the individual is the business rather than merely working for the business? The affairs of the partnership to be considered are more than voting for the managing committee or the firm's accounts and look at whether there is significant influence over the business, as a whole, rather than individual components of the business. Condition B is likely to be particularly important for the members of smaller LLPs.

Example 6

The Family Farm LLP has as members, a couple, A & B, and their adult son, X. The LLP Agreement has not been amended since before X was admitted. The way that the LLP operates in practice is that A, B and X all have a say in the running of the business, with A having a casting vote.

Although the written agreement was not amended when X was admitted, the implied terms of the agreement under which X was admitted was that he would have a significant say in the business. As a result, Condition B is not satisfied and X is not a Salaried Member. It is unlikely that this Condition will exclude many members of very large partnerships, since, in such cases, it is likely that only a minority of individuals have significant influence over the affairs of the whole partnership.

Management committee

Some LLPs delegate management to a part of the membership. The LLP Agreement usually indicates what and how powers are so delegated. If the members of the management committee effectively run the LLP, then Condition B will not be satisfied in respect of those members. Condition B will be satisfied for the remaining members, who are potentially Salaried Members.

Example 7

Up until 1 June 2014, E was the managing partner of GH LLP, a large professional services firm. Upon reaching the age of 60, E decided that she wanted to retire. F was appointed as the new managing partner but F and the other members were keen to retain E's experience in order to mentor F and provide a smooth transition.

E agreed to carry on as a member for a further year, becoming the firm's chairperson. She would continue to be an integral member of the management committee in this period, providing direction to F and the other members, albeit reducing her hours at work. E would withdraw her capital from the firm over the course of the year in order to purchase a second home in the south of France. It was also agreed that her profit share would largely be fixed for this period, even though it had been entirely variable up until 1 June 2014.

Will E be a salaried member in her final year with the firm?

Although it seems that Conditions A and C of the test could be met in light of her move from a variable to a fixed profit share and the withdrawal of her capital, the circumstances are that she will clearly have significant influence over the affairs of the partnership for the whole of this period. Therefore, Condition B will not be met, meaning that Conditions A and B will not need to be considered; E will not be treated as a salaried member.

Condition C

Condition C looks at the level of investment in the LLP by that member. Has the member made a significant investment in the business so they have a real risk resting on the success or failure of the business?

The test is whether the amount contributed is less than 25% of the disguised salary expected to be payable for the whole tax year. If the member has contributed less than 25%, then Condition C is satisfied and that member may be a Salaried Member.

Contributions

The amount of capital contribution is based on the amount that the individual has invested as capital at that time in accordance with the LLP Agreement.

- It does not take into account sums that the individual may be called upon to pay at some future date.
- It does not take into account undrawn profits unless by agreement they have been converted into capital.
- It does not take into account sums that are held by the LLP for the member, for example, sums held in a taxation account.
- It does not take into account amounts of capital that are part of arrangements to enhance the amount of capital to enable the individual to "avoid" being a Salaried Member where there is no intention that they have permanent effect or otherwise give rise to no economic risk to the member.

Example 10

P has:

- *£10,000 contributed as capital in accordance with the LLP Agreement;*
- *£50,000 long term "loan". Interest is paid on this but otherwise the amount is held on terms comparable to the capital, e.g. the loan is only repayable when P resigns, or the LLP is wound up. The amount is treated for tax purposes as a share of the profit;*
- *£30,000 as a short term loan for a two year term;*
- *£25,000 undrawn profits – that can be withdrawn at any time; and*
- *£25,000 in a tax reserve current account to pay the tax on P's profit share.*

P is entitled to withdraw the short term loan, undrawn profits and the sum in the tax reserve current account, whilst he remains a member. These are not part of the capital contributed (ITA/S108(5)(C)). P cannot withdraw either the sum described as capital or that described as a "loan". These are both intended for the long term financing of the firm. P has capital of £60,000.

General examples

<u>*Example 12*</u>

50 people currently work for the A LLP, of whom forty-five are listed as members. The A LLP business plan is inclusive, recognising that everyone working for the business is contributing to the success of the business; hence once it is clear that the individual is going to stay with the business, they are invited to become a member.

Of the forty-five members, 15 are professionally qualified, five of whom qualified in the last 5 years whilst 3 other members are working for their professional qualifications. The remainder have no intention of becoming professionally qualified.

The Salaried Member test is **not** concerned with experience or professional qualifications. It looks at the role that individual plays in the business.

Under the LLP agreement each member is entitled to an equivalent to statutory sick pay, maternity/paternity leave, holiday entitlement and termination rights.

Although these may make the partner look like an employee, they are **not** taken into account in the Salaried Member test.

Each member receives a profit share. The proportion varies from member to member, but everyone knows that if the business makes less profit they will have less income and if it makes a loss they get nothing.

All the members, from secretary to the founders know that their income from year to year depends on the level of profit. If the firm makes a loss, then they have no income for the year. This means that Condition A is not satisfied. No member of the A LLP is a Salaried Member and no further action is needed.

<u>*Example 13*</u>

B LLP is similar to A LLP, but only the 5 senior members receive profit shares, the rest have non-refundable drawings and a nominal profit share, so that 90% of their income is disguised salary and they will meet Condition A.

The B LLP is largely a people business using rented accommodation. However, it does need capital. Each of the members has made a contribution, varying with their position in the firm, but starting at £1000.

Whether Condition C is satisfied depends upon the amount contributed by the member. Condition C will be satisfied unless the capital is at least 25% of the expected reward package for the tax year. In the case of B LLP, all members satisfy Condition C.

Each of the members has a share of the proceeds in the event of winding up.

This is not a factor in the Salaried Member test.

Management of B LLP is delegated to a Management Board, consisting of 9 members who are professionally qualified (these include the 5 senior members who receive profit shares), and the Office Manager, also a member of the LLP, who has no professional qualifications. The other members have no real say in the business.

The 10 members of the Management Board do not satisfy Condition B. They are not Salaried Members. The fact that the Office Manager is not professionally qualified does not matter; the key is that the role gives the individual significant control. So in two similar businesses, no member of A LLP is a Salaried Member as all receive only profit shares. Only 10 members of B LLP are not Salaried Members, the five who both receive profit shares and have control and five others who have significant control .

Example 14

C LLP was founded by two individuals, A & B. A & B are entitled to the residual profits, make all the major decisions and they have invested all but a nominal amount of the capital. The other members receive a fixed monthly sum plus an annual discretionary bonus, typically 20% to 30% of the first charge.

The other members are all Salaried Members, satisfying Conditions A, B & C. Whilst the bonus is sometimes more than 20% of the reward package, this is a discretionary bonus, not linked to the profits. In addition, the individuals have no real influence and no capital contribution.

After a while, as had been the intention, C & D, two of the junior members, start to take on elements of the work done by A & B.

As their terms have changed, the test needs to be applied again to C & D.

Contributed by Rebecca Benneyworth

Profit sharing in mixed partnerships (Lecture B814 – 10.31 minutes)

This measure is intended to deal with partnerships where there is a member not subject to UK income tax (normally a limited company). HMRC is concerned that these structures are being used to avoid tax on a significant scale.

Once again, the proposed changes have moved on since the consultation during the summer of 2013. However, the broad effect of the proposals is unchanged – that in the majority of cases profits routed through a partnership owned by a member of the partnership will be taxed on the partner concerned rather than the company through which the profits are routed.

The new legislation is introduced as ss 850C to 850E ITTOIA 2005.

Detailed provisions

The legislation seeks to attribute profits to a member of a partnership (whether an LLP or any other type of partnership) where it is considered that those profits have been sheltered in a non – individual member (usually a company, but in fact any member of the partnership that is not an individual, so this would include a trust) for tax purposes.

The provisions attack the allocation of profit as follows :

- A, an individual member of a partnership has been allocated a share of the profit, or a zero result (but not a loss) for an accounting period, and
- There is a non individual member (B) of the partnership, which has also been allocated a share of the profit for the period, and
- Condition X or condition Y is met.

Condition X

It is reasonable to suppose that amounts representing A's deferred profit are included in B's profit share, and in consequence, A's profit share and the relevant tax amount are lower than they would otherwise have been.

Deferred profit is defined by new s850C(8) means any remuneration, benefits or returns the provision of which to A has been deferred, whether conditionally or otherwise.

The relevant tax amount is defined by s850C(9) is the total amount of tax which would otherwise be charged on A and B's income apart from this section.

Condition Y

- B's allocation of profit is in excess of the appropriate notional profit, and
- A has the power to enjoy B's profit share (referred to as A's power to enjoy), and
- It is reasonable to suppose that the whole or any part of B's profit share is attributable to A's power to enjoy, and both A's profit share and the relevant tax amount are lower than they would have been had it not been for A's power to enjoy.
- The result is a saving in tax.

If Condition X or Y is met, the s850C(4) requires that A's profit share is increased by so much as B's profit share as it is reasonable to suppose is attributable to A's

- Deferred profit share, or
- Power to enjoy.

The amount reallocated to A will be determined on a just and reasonable basis, but cannot reduce B's allocation below the "appropriate notional profit". The operation of the allocation first applies deferred profit share, and then A's power to enjoy.

The legislation deals with (at the same point) allocations of profit in relation to alternative investment fund managers, which are not considered further here.

B's appropriate notional profit

The legislation allows B (the non individual member of the partnership) to be allocated a share of profits without disturbing them. This share is capped at the sum of:

- A return on capital equivalent to a commercial rate of interest on the capital contributed by B to the firm (less amounts paid in respect of this which are not part of B's profit allocation), plus
- A return for services provided to the firm by B (but not involving any other partner of the firm in addition to B) priced on an arm's length basis.

A's power to enjoy

A has the power to enjoy B's profit share if:

- A is connected with B under s993 ITA 2007 (definition of connected persons) with the exclusion of the connection arising from mutual partnership, or
- Any of the following enjoyment conditions are met, here treating A as A and any person connected to A other than B, so this would certainly include spouse of A:
    - Some or all of B's profit share is in fact so dealt with by any person as to be calculated at some time to enure for the benefit of A, whether in the form of income or not
    - The receipt of B's share of the profits operates to increase the value of assets held by or for the benefit of A
    - A receives or is entitled to receive at any time any benefit provided out of B's profit share
    - A may become entitled to benefit from B's profit share by the exercise3 of one or more powers of any person, or
    - A is able to control (*directly or indirectly) the application of B's profit share.

Anti avoidance – A is not a partner in the firm

In order to prevent avoidance in the run up to the implementation of these provisions, new s 850D applies the same rules where A is not a partner in the firm, but performs services personally for the firm, and it is reasonable to suppose that A would have been a partner in the firm, had it not been for new s 850C. This is extended to include where A is a member of another partnership associated with the firm (i.e. it is a member of the first firm).

Where this condition is met, A is treated as a member of the first firm and the above provisions are applied in the same way.

Illustrative examples form HMRC's guidance

Mixed partnership – non individual members

<u>Example 20</u>

The INV LLP has a property business. It has 15 individual members, including X. In addition to being an individual member, X is also a member as Trustee of the XXX Settlement.

The INV LLP is a mixed membership partnership as it has 15 individual members and X in his capacity as trustee of the XXX Settlement.

Appropriate notional profit – return on capital

The appropriate notional return on capital is simply a commercial rate of interest on the capital contributed. This is not a specific rate as the appropriate commercial rate will vary:

- The commercial rate will reflect the level of risk involved.
- Where the level of capital varies during the relevant period of account, the notional return must be calculated from time to time and on these varying amounts.

<u>Example 21</u>

B Ltd has invested £10,000 in the ABC LLP. It receives no return on this other than its profit share.

ABC LLP is paying 2% on loans on the commercial market, reflecting its good credit rating. This represents a commercial rate, so B Ltd has an appropriate notional return on capital of £200.

Appropriate notional profit – payment for services

In almost all cases, this notional consideration should be no more than the cost to the company in providing the services plus a modest mark-up.

<u>Example 22</u>

Continuing with the example 21 above, B Ltd is a member of ABC LLP and provides advertising services for ABC LLP. The work is carried out by A, who is also a member of ABC LLP. B Ltd provides no other services to ABC LLP.

B Ltd is treated as providing no services as the only service provided involves another member of the LLP. Therefore, the appropriate notional consideration for services is nil.

Power to enjoy – connected

A is connected to B if it meets the general definition in tax law, apart from being a member of the same partnership.

Example 23

A and A Ltd are the members of A LLP. A controls A Ltd.

As A controls A Ltd, A and A Ltd are connected and, as such, A has the power to enjoy any profits of A LLP which are allocated to A Ltd.

Example 24

A and B Ltd are the partners in the AB partnership. A has no interest in B Ltd, which is wholly owned by B, who is not connected to A.

A and B Ltd are only connected by being fellow partners in the AB partnership. As such, they are not connected and the excess profit allocation rules do not apply.

Other examples

If the particular facts show that any economic connection between the individual and non-individual members does not result in profit being shifted from the individual partners to the non-individual, the mixed membership partnership legislation will not apply. One example is where the non-individual partner has been carrying on the trade for many years before it is transferred into an LLP.

Example 27

Oldco Ltd had been trading for many years. A few years ago P, the owner of Oldco Ltd decided that he wants to retire He set up an LLP, whose members are P, Oldco Ltd and a number of individuals whom he hoped would take over the business.

Oldco Ltd receives the profit share agreed when the business was transferred to the LLP. This share reflects its founding role in the business and is based on the fact that it contributed the business to the LLP. P receives a small personal profit share that is commensurate with the work he does.

The facts show that Oldco Ltd receives a profit share reflecting the fact that it transferred its business to the LLP (and that the same profit share would have been received by Oldco Ltd if P fully withdrew from the business, including as an LLP member). Looking at these facts, the legislation would not apply.

Example 31

The membership of ABC LLP consists of three individuals, A, B and C, who decide that they want to retain funds in the LLP for working capital. In order to avoid the retained profits being taxed at higher income tax rates, they introduce a corporate member, ABC Ltd, which is fully owned by A, B and C.

ABC Ltd does not provide any services and only a nominal amount of capital. A, B and C work out what they wish to draw personally and allocate the balance of the profit to ABC Ltd.

The profit share allocated is invested or retained in the partnership by the company member as additional partnership capital or advances.

The individual members are in a position to enjoy the sums allocated to their company. The three individual members are taxed on an additional profit, split on a just and reasonable basis, equal to the profit share allocated to ABC Ltd, less a sum that represents an appropriate notional return on the nominal amount of capital introduced by ABC Ltd.

Example 32

D is a member of DEF LLP. With the agreement of the other members, D introduces as a member, D Ltd, a company that is owned by his wife. D continues as a member, only now he does some work for the LLP through D Ltd. D Ltd provides only a nominal amount of capital.

The only change is that the profit share, previously allocated to D, is now allocated partly to D himself, but mainly to D Ltd.

D Ltd is owned by the wife of D, so a connected person is in a position to enjoy the profits of D. D is taxed on an additional profit equal to the profit share allocated to D Ltd. Whilst D Ltd is providing services to DEF LLP, the reality is that the work is such services as are being provided by D, another member. These services are ignored in determining the appropriate notional consideration for services. D Ltd provides no other services, so the appropriate notional consideration for services is nil.

Contributed by Rebecca Benneyworth

Mixed partnerships – other issues (Lecture B815 – 9.01 minutes)

Alongside the measures to deal with profit allocation in mixed partnerships, there are further changes to prevent loss of tax through partnership structures. Some of these are effective from 5 December 2013 in order to prevent avoiding action being taken by partnerships affected by the profit sharing measures dealt with in another session.

Excess loss allocation

The rules apply once again to mixed partnerships when there are trading or business losses allocated to individual members of a mixed partnership. The rules do not apply where the partnership comprises only of individuals and there is no intention to introduce a non individual partner.

New ss 116A and 127C identify the situation where the new loss restriction applies. S 116A applies to trading losses, and 127C to property business losses (including overseas property businesses).

In both cases, the loss is not available for relief where A (an individual) incurs a loss as a member of a partnership, and A's loss arises wholly or partly:

- Directly or indirectly in consequence of, or
- Otherwise in connection with

relevant tax avoidance arrangements.

Here, relevant tax avoidance arrangements is defined as arrangements to which A is party, and the main purpose or one of the main purposes of which is to secure that losses are allocated or otherwise arise in whole or in part to A, rather than a person who is not an individual, with a view to A obtaining relevant loss relief.

In the case of both trading and property losses, the relief is barred both as sideways relief (and against capital gains for trading losses) and carry forward relief, so no relief is available at all for these losses.

The measure comes into force in relation to 2014-15, with a straddling period split on a time basis.

HMRC Example

<u>*Example 35*</u>

An LLP has 100 individual members and 1 company member. Each of the individual members introduces capital of £40,000 and the company member provides capital of £60m (total capital £100m). The LLP spends the £100m on an asset that qualifies for 100% upfront tax relief generating a £100m tax loss (but not an accounting loss) in the first year of business but with a significant income stream in later years.

The profit sharing agreement provides that:

- *In year 1, all the profits or losses are allocated to the individual members; and*
- *In year 2 onwards, all or most of the profits are allocated to the company member.*

The LLP agreement is written so that the individuals can claim the loss relief. It is clearly one of the main purposes. The excess loss allocation legislation (S127C) prevents the individual obtaining relief for these losses.

<u>Excess profit allocation – reduction to corporate partners only</u>

One of the options for a mixed partnership affected by the new profit allocation rules is to remove the individual partners and run a firm comprising of limited company members only. For example, A, B and C (individuals) who are members of an LLP together with their own companies A Ltd, B Ltd and C Ltd might decide to reduce the LLP to the three companies only, so that it is no longer a mixed partnership.

The legislation (through new s 850D) cover this situation by looking at individual A who performs services for a firm at any time in a period of account which period produces a taxable profit, some of which is allocated to a non individual member of the firm (B).

Where it would be reasonable to suppose that A would have been a partner in the firm in the current or a preceding accounting period were it not for s 850C, and either condition X or Y is met, the legislation deems A to be a partner in the firm for the purposes of s 850C and thus the reallocation of profit bites.

Condition X:

- It is reasonable to suppose that amounts representing A's deferred profit shares are included in B's profit share.

Condition Y:

- B's profit share exceeds the notional appropriate profit, and A has the power to enjoy B's share of the profit, and it is reasonable to suppose that the whole or part of B's profit share is attributable to A's power to enjoy.

HMRC Examples

<u>*Example 33*</u>

X, Y, Z and XYZ Ltd are the members of the XYZ LLP. In response to the new legislation, they decide that all the individual members should cease to be members of the LLP with effect from 6 December 2013 being replaced by their personal service companies.

X, Y & Z continue to work for the XYZ LLP, it is reasonable to suppose that they would have continued to be members but for the introduction of the legislation.

Under S850D, X, Y & Z are treated as members and the mixed membership partnership legislation applied accordingly. Their share of the firm's profit, determined under the mixed membership rules, is chargeable to income tax for the tax year in which the relevant period of account ends.

Assuming this period straddles the 6 April 2014 (the date the legislation comes into effect), then this period is split into two notional periods with the latter having a commencement date of 6 April 2104. Only the profits attributable to this latter period will actually be re-allocated to X, Y & Z.

Example 34

M, N, O and MNO Ltd are the members of the MNO LLP. In response to the new legislation, they decide that from 1 April 2014 all the individual members should become members of the MNO New LLP. From 1 April 2014, the members of MNO LLP will be MNO Ltd and MNO New LLP. Whilst M, N & O are the members of the MNO New LLP.

Under S850D (8), it is assumed that M, N & O would have been members of the MNO LLP. The mixed membership partnership legislation applies on the basis that they are deemed to have been members of the MNO LLP.

Excess profit share – payments to A by B

Where profits have been allocated to A (an individual) as a result of the application of s 850C(4) or 850D(4) and A and B have an agreement in relation to B's profit share, as a result of which B makes a payment to A which does not exceed the increase allocated to A as a result of the operation of Ss 850C or 850D, then this payment is ignored for income tax purposes and not treated as a distribution.

HMRC Example

Example 30

A and his company A Ltd are members of the ABC LLP. A has been taxed on £50,000, which had initially been allocated to A Ltd. A Ltd makes a payment of £45,000 to A.

The sum is paid from the profits allocated to A Ltd; it is less than the sum on which A was taxed. The sum is ignored for tax purposes; it is not treated as A's income.

Contributed by Rebecca Benneyworth

R&D Expenditure Credit

HMRC has issued draft guidance on the new R&D expenditure credit (RDEC) and has provided useful numerical examples to show how the new R&D expenditure credit works.

Example 1: Profit-making company in receipt of RDEC

Step 1

The set off amount is to be applied in discharging any liability of the company.

Turnover		£16,600,000
R&D expense	£10,000,000	
Other expenses	5,000,000	(15,000,000)
Profit		1,600,000
RDEC (at 10%)		1,000,000
Profits		£2,600,000

CT at 23%	£598,000
RDEC	(1,000,000)
Payable credit after discharging CT liability	£402,000

Step 2

If the amount remaining after step 1 is greater than the net value of the set-off amount, that amount is to be reduced to the net value of the set-off amount. Compare the amount remaining after step 1 with the net value of the credit i.e. after deducting the potential corporation tax on the credit. Therefore, compare the amount remaining from step 1 £402,000 with net RDEC (£1m less 23%) £770,000. Carry forward the lesser of the two i.e. £402,000.

Step 3

Amount brought forward from step 2	£402,000
Relevant PAYE/NIC	(300,000)
Carried forward to next accounting period and added to expenditure credit for that period	£102,000
Capped amount carried forward to Step 4	£300,000

Step 4

The amount remaining after step 3 is to be applied in discharging any liability of the company to pay corporation tax for any other accounting period.

Brought forward from step 3	£300,000
Other period CT liability	(100,000)
Balance c/f to Step 5	£200,000

Step 5

If the company is a member of a group, it may surrender the whole or any part of the amount remaining after step 4 to any other member of the group.

Brought forward from step 4	£200,000
CT liabilities of the group	nil
Balance c/f to step 6	£200,000

Step 6

The amount remaining after step 5 is applied in discharging any other liability of the company to pay a sum to HMRC.

Brought forward from step 5	£200,000
Set off against any other liability	nil
Amount remaining	£200,000

Step 7

The amount remaining after step 6 is payable to the company.

Payable to company	£200,000

Summary

Discharge against current liability	£598,000
RDEC credit c/fwd	102,000
Company liability for another accounting period	100,000
RDEC paid	200,000
Total	£1,000,000

Example 2: Loss-making company in receipt of RDEC

Step 1

The set off amount is applied in discharging any liability of the company.

Turnover		£6,000,000
Expenses		
R&D	£10,000,000	
Other	5,000,000	(15,000,000)
Profit/(loss) before credit		(£9,000,000)
RDEC		£1,000,000
Adjusted Loss		(£8,000,000)

CT due	NIL
RDEC	£1,000,000
Amount remaining	£1,000,000
(no liability to be discharged)	

Step 2

Compare amount remaining from Step 1 £1,000,000 (1) with net RDEC (£1,000,000 less 23%) £ 770,000 (2). Carry forward the lesser of (1) and (2) to step 3 i.e. £ 770,000

The restricted amount is not available as a payable credit now or in future but can discharge later year's company liability. £230,000 carried forward to following years and brought in at step 1 in preference to a later year's payable credit.

Step 3

Brought forward from step 2	£770,000 (3)
PAYE/NIC liability	(400,000) (4)
	£370,000

If (4) is less than (3) – capped, £400,000 c/fwd to Step 4.

£370,000 is no longer potentially payable for this period but is carried forward to the following accounting period and added to any expenditure credit for that period and subject again to steps 1 to 7.

Step 4

The amount remaining after step 3 is to be applied in discharging any liability of the company to pay corporation tax for any other accounting period.

Brought forward from step 3	£400,000
Other period CT liability	(200,000)
Balance c/fwd to step 5	£200,000

Step 5

If the company is a member of a group, it may surrender the whole or any part of the amount remaining after step 4 to any other member of the group (see s.104R).

Brought forward from step 4	£200,000
CT liabilities of the group	nil
Balance c/fwd to step 6	£200,000

Step 6

The amount remaining after step 5 is to be applied in discharging any other liability of the company to pay a sum to HMRC.

b/fwd from step 5	£200,000
Any HMRC liability	nil
Amount remaining	£200,000

Step 7

The amount remaining after step 6 is payable to the company.

Payable to company	£200,000

Summary

Tax withheld available to set off against next years liability	£230,000
PAYE capped credit c/fwd	370,000
Company CT liability of other accounting period	200,000
Paid to company	200,000
Total	£1,000,000

Example 3: Profit-making company but RDEC exceeds liability.

Step 1

The set off amount is to be applied in discharging any liability of the company.

Turnover		£15,000,000
Expenditure		
R&D	£10,000,000	
Other	2,500,000	(12,500,000)
Profit		£2,500,000
Expenditure credit (at 10%)		1,000,000
Profits		£3,500,000
CT @ 23%		£805,000
RDEC		1,000,000
Amount remaining after discharging liability		£195,000

The £195000 is the amount of payable credit remaining after discharging the company liability for the period.

Step 2

Compare the amount remaining after step 1 with the net value of the credit i.e. after deducting the potential corporation tax on the credit.

Amount remaining from Step 1	£195,000 (1)
Net expenditure credit (£1m less 23%)	£770,000 (2)
c/fwd lesser of (1) and (2) to Step 3	£195,000

Step 3

b/fwd from step 2	£195,000 (3)
Relevant PAYE/NIC	£400,000 (4)

If (4) is less than (3) then amount is capped to that relevant PAYE/NIC.

£195000 c/fwd to step 4.

Step 4

b/fwd from step 3	£195,000
Other period CT liability	(50,000)
Balance c/fwd to step 5	£145,000

£50,000 has been used to settle another year's company liability.

Step 5	
b/fwd from step 4	£145,000
CT liabilities of the Group	nil
Balance c/fwd to step 6	£145,000
Step 6	
b/fwd from step 5	£145,000
Set off against any other liability	nil
Amount remaining	£145,000.
Step 7	
Payable	£145,000
Summary	
Discharge against current liability (step 1)	£805,000
Set off against company liability for another period (step 4)	50,000
RDEC paid (step 7)	145,000
Total	£1,000,000

Conditions for the application of FA 2003 Sch 23

Metso was appealing against HMRC's decision to deny relief from corporation tax under FA 2003 Sch 23. The provisions grant relief from corporation tax by way of a deduction from business profits when share options are granted to employees. The deduction is equal to the difference between the market value of the shares at the time of the exercise of the option and the actual price paid by the employee under the option. For the provisions to apply, the shares must be granted 'by reason of employment'.

- Mr Ritchie held an unpaid directorship in a company 'UK SubHoldco', but had no employment contract.
- The company was directly and indirectly owned by his family.
- As part of a management buy out of UK SubHoldco, Mr Ritchie had been granted share options in the acquiring vehicle, UK Buy-out. He had later surrendered his options and been granted new ones.
- Finally, in July 2007, the share capital of UK Buy-out had been sold to a Finnish conglomerate called Metso Paper. In anticipation of the sale, Mr Ritchie exercised his options, purchased the shares and then sold them to Metso Paper.

Metso Paper argued that it should be entitled to relief under FA 2003 Sch 23, suggesting that the provisions should be interpreted widely so as to include the grant of shares to a director.

Decision:

However, the tribunal refused to go beyond a literal interpretation of the provisions. The stated purpose of Sch 23 had been to encourage employee ownership and the interpretation suggested by the appellant was not compatible with this purpose. The acquisition of the options 'by reason of employment' is 'the foundation on which the schedule rests'.

Comments - Companies wishing to avail themselves of FA 2003 Sch 23 should ensure that the recipients of share options have employment contracts.

Metso Paper Bender Forrest Ltd v HMRC TC3056

EIS and partnership interests

The taxpayer company (H) appealed against a decision by HMRC to deny an enterprise investment scheme (EIS) claim. H had raised monies by an issue of shares, in order to increase its interest in a trading partnership in which it was co-partner. The monies had therefore been paid to the other partners. Under the EIS regime, taxable gains can be set against amounts paid for shares in a 'qualifying company' for the purpose of a 'qualifying business activity'.

Decision:

According to the tribunal, this meant that the monies must be raised and employed for the 'activities of the trade'. The tribunal pointed out that, under the Partnership Act 1890 s 5, the trade of a partnership is carried out by each partner. As the partnership was trading, so was H. Furthermore, if the monies were used in the trade of the partnership, they were used in the trade carried out by H. However, 'getting a bigger share of the trade' was not an activity of the trade, so the conditions for EIS relief were not satisfied.

Comments - The case is yet another example of the difficulty of identifying what constitutes a trading activity. In holding that 'getting a bigger share of a trade' is not an activity of the trade, the decision may have implications beyond the scope of EIS.

Harvey's Jersey Cream Ltd v HMRC TC3045

FII GLO: FA 2004 s 320

The CJEU had to decide whether FA 2004 s 320, which curtailed the availability of 'Kleinwort Benson' claims in relation to taxation matters, was compatible with the principles of effectiveness, legal certainty and legitimate expectation. Kleinwort Benson claims permit the restitution of sums paid under a mistake of law.

In 2003, the High Court ruled that these claims could apply to tax. The advantage of these claims was that they benefited from an extended limitation period; six years from the date on which the claimant discovered the mistake of law or could with reasonable diligence have discovered it. FA 2004 s 320 provides that the extended limitation period does not apply to claims for restitution of sums paid under a mistake of law where the claim relates to tax. The provision had retroactive effect when it was enacted in June 2004. The UK government argued that the provision was compatible with EU principles as a claimant applying for a repayment of tax had a choice between a Kleinwort Benson remedy and a Woolwich remedy (which is an action for the recovery of tax unlawfully levied). The limitation period for a Woolwich claim is six years from the payment of the tax.

Decision:

The CJEU disagreed with the UK, finding that the principles established by the ECJ in the Marks & Spencer case (C-62/00) still applied where taxpayers had a choice between two remedies. The introduction of s 320 without any transitional provisions and with retroactive effect breached the principle of effectiveness. Furthermore, the CJEU found that the provision was also in breach of the principles of legal certainty and the protection of legitimate expectation as, before the enactment of s 320, taxpayers were entitled to claim a Kleinwort Benson remedy. Finally, the CJEU held that the fact that the House of Lords had only recognised the availability of Kleinwort Benson remedies to taxpayers after the enactment of s 320 did not change the position. What mattered was that taxpayers could rely on a Kleinwort Benson remedy at the time s 320 came into force.

Comments - The decision is excellent news for taxpayers wishing to rely on a Kleinwort Benson cause of action in relation to claims made around the time s 320 was enacted. However, the question is what steps, if any, the UK government will take to render s 320 compatible with EU law.

Test Claimants in the Franked Investment Income Group Litigation v HMRC (C-362/12)

Van fuel charges

The limits for van charges changes with effect from 31 December 2013 and has effect for 2014-15 and later years

The car fuel: calculating the cash equivalent of 21,100 becomes £21,700.

The cash equivalent of the benefit of a van of £3,000 becomes £3,090.

For van fuel, the cash equivalent of £564 becomes £581.

VAT

VAT and construction services

The issue was whether a new building built on a college campus and attached to an existing building was an annex. If it was an annex, construction services received in relation to the building were zero rated; if the new building was only an 'enlargement' or 'extension', the construction services were standard-rated (VATA 1994 Sch 8 Group 5 item 2).

Decision:

The tribunal held that the new building was an annex, having made the following observations: the two buildings were not physically separate as they shared a wall. Furthermore, the new building was substantially larger than the original building and so was not 'supplementary'; although there were differences in appearance both externally and internally between the two buildings, they were not sufficient to make the new building an annex. They simply suggested that the new building was an extension rather than an enlargement to the new building; and the two buildings were designed in layout as a 'single and unified' entity which operated horizontally across each floor. Finally, the tribunal noted that, even if it had been wrong in holding that the new building was not an annex, the new building would still have failed the legislative test as it could not function independently (the plant room was shared between the new and the original building) and the main access to both buildings was via the new building.

Comments - The case is a useful example of the way the tribunal will review the designs and layout of buildings in order to decide whether construction services should be zero-rated.

Leyton Sixth Form College v HMRC C03042

VAT on goods paid for fraudulently

Dixons appealed against HMRC's refusal to reimburse output VAT charged by Dixons on electrical goods supplied to customers — and paid by Dixons to HMRC. The basis for Dixons' claim for reimbursement was that the customers had paid for the goods with credit cards 'used in a fraudulent manner'. Under the agreement between Dixons and the card companies, Dixons was obliged to accept payment by card and the companies undertook to pay the price after deduction of a charge. Although the agreements gave the card companies recourse against Dixons in the case of fraudulent use of cards, they did not exercise this right. The appeal raised two issues: had Dixons made a taxable supply, and if so, what was the consideration.

Decision:

The court noted that whether a supply had taken place was an objective test and so the intention of the parties to the transaction was irrelevant. Dixons, as the owner of the goods, could transfer them in a manner that entitled those acquiring the goods to dispose of them as their owner.

The transactions were therefore supplies regardless of the fraud. As for the consideration, the fact that the purchaser paid the price not directly but through a card issuer did not change the taxable amount, in circumstances where both a legal relationship between supplier and recipient and a direct link between the goods supplied and the consideration received were established. The fact that the credit cards had been used fraudulently did not change the analysis.

Comments - In the light of the decision, retailers may wish to review the way they have accounted for VAT on transactions paid with credit cards used fraudulently.

Dixons Retail PLC v HMRC (C-494/12)

Incidental to the main supply

The taxpayer installed central heating systems in residential properties. Some components of the systems fell within the definition of energy-saving materials under VATA 1994, Sch 7A group 2 note 1. The business accounted for VAT at 5% on these components.

HMRC argued that, because the energy-saving components were installed as part of a larger system, the whole supply should standard rated. The taxpayer agreed that the installation of a central heating system was a single supply but said it was subject to VAT at mixed rates: the standard rate for the main supply and the reduced rate for the energy-saving components.

Decision:

The First-tier Tribunal said the taxpayer's argument was “too extreme”. The judge concluded that, when the taxpayer installed a central heating system which included energy-saving parts, it was making a standard-rated supply of which those parts were elements.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: “There have been some strange mixed supply tribunal decisions in the past 12 months but this one appears to be correct because the customer is paying for one overall supply of a new central heating system in his house and any specific elements such as thermostatic radiator valves can only be incidental to this main supply. It would be artificial to split the job into different elements. The court followed the thinking established in 1999 by the ECJ in the landmark case of Card Protection Plan Ltd (Case C-349/96) [1999] STC 270.”

AN Checker Heating & Service Engineers TC2865

Agent or principal?

The taxpayer traded as Spot On!, offering housekeeping services for owners of holiday properties in north Cornwall. After visiting the business in 2007, HMRC decided the taxpayer should have been registered for VAT since 1999. They registered her compulsorily.

The taxpayer claimed that she was acting as an agent in arranging services for the owners of the properties she managed. The supply was between the owner and the cleaner or tradesman. HMRC argued that the taxpayer had a contract with the owners to provide services. Cleaners were engaged and supplied by the taxpayer to the owners for a consideration.

Decision:

The First-tier Tribunal looked at the terms and conditions issued by the taxpayer to the property owners and found these to contain "inconsistencies and ambiguities". The tribunal therefore considered the facts as a whole. It noted in particular that cleaners did not work directly for or receive payment from the property owners and that, in the event of damage caused by a cleaner, the owner would be likely to complain to Spot On!, rather than the cleaner.

On balance, the tribunal concluded that the "economic and commercial reality" was that the taxpayer supplied the property owners with cleaning services and did not engage the cleaners. She acted as principal rather than an agent.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said VAT might not be straightforward when there were three or more parties involved in a transaction. He said: "In this case, an overall analysis of the facts clearly demonstrated that the commercial arrangement was between the taxpayer and the homeowners."

Neil added that it is important to remember that "HMRC can go back up to 20 years to correct a belated VAT registration".

W Lane TC2909

Nature of supply

The taxpayer supplied locum anaesthetists to NHS hospitals and received fees for the provision of those individuals based on the number of hours worked. The doctor was paid by the taxpayer. The taxpayer claimed that it provided an exempt supply of services of medical care under VATA 1994, Sch 9 group 7 item 5. HMRC said the supply was a taxable one of employment agency services.

Decision:

The First-tier Tribunal said that the medical care was provided by the medical professional. The locum worked under the direction and control of the relevant NHS trust and, as far as the patient was concerned, he received the services of a doctor working under the supervision of the hospital, not the taxpayer. Therefore, the taxpayer was supplying a service of an employment agency.

Item 5 had to be interpreted in accordance with article 132(1)(c) of the Principal VAT Directive. The taxpayer's services did not amount to medical care within article 132(1)(c), so item 5 had to be given "a conforming construction so that it is consistent with the UK's obligation not to grant an exemption which goes beyond the permitted scope of the exemption in article 132(1)(c)".

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: "This case reaffirms the view of HMRC that the services of a doctor supplied to a medical institution by an employment agency are standard rated, even though the doctor is providing medical services to patients with a view to improving the health of the individual in question. The tribunal was sympathetic to the taxpayer because of the misleading wording in the legislation (VATA 1994, Sch 9 group 7 item 5) but felt that the exemption in both UK and EU law should apply only to medical services provided directly by the institution dealing with patients."

Rapid Sequence Ltd TC2826

VAT: amount of consideration

Cabvision had sold software to an LLP (Taxi) and had paid output tax on the consideration received from Taxi. The issue was whether this output tax had actually been due on the whole contractual price.

Taxi's purchase of the software was funded 25% by subscriptions from investors (wishing to boost their investment with the use of capital allowances), and 75% by a loan that Taxi took out with Lloyds TSB Bank PLC, which was guaranteed by Bank of Scotland and which in turn was secured by a deposit made by Cabvision. The arrangements were similar, but not identical to those in Tower MCashback [2011] UKSC 19. There was no suggestion that Cabvision had any VAT avoidance purpose in entering into the arrangement.

Decision:

The tribunal first rejected Cabvision's interpretation of the Sixth VAT Directive article 11(C): 'the taxable amount shall be … everything which constitutes the consideration which has been or is to be obtained'. In particular, the tribunal rejected the notion that 'is to be obtained' referred to contingent consideration, insisting that the provision referred to certain but future consideration. Referring to case law, the tribunal noted that 'consideration is the amount which is actually received. But, in looking at what is actually received it is clear that it is necessary to look at whether there are restrictions on what is received such that the amounts are not at a person's free disposal'. The reality of the situation (ignoring the contractual provisions governing the sale of the software) was that the software would not have been purchased without a loan, the loan would not have been entered into without a guarantee, nor the guarantee without Cabvision's security. It was therefore not possible to isolate one particular transaction. Consequently, Cabvision could not be regarded as receiving the full amount and output tax was not due on the full amount. In case it was wrong on the first issue, the tribunal went on to consider whether there had been an agreement to waive rights in relation to Taxi's licences in return for Cabvision paying Taxi's loan, leading to a reduction in price. As a matter of fact, the tribunal found that such a waiver had been agreed.

Comments - The case is a useful reminder that the consideration for VAT purposes can be inferred not only from the sale contract, but also from other legal arrangements surrounding the sale.

Cabvision v HMRC TC3101

Is it possible to be an 'eligible body' in relation to some activities only?

A company provided educational services under arrangements with the University of Wales. Under VATA 1994 Sch 9 Group 6 item 1, the provision of educational services by an 'eligible body' is exempt from VAT. The taxpayer company therefore wished to claim the exemption, on the basis that it was an eligible body in relation to the services provided under the arrangements with the University of Wales. There was no doubt that the University of Wales was an eligible body. The issue was whether Finance & Business Training was a 'college or institution' of the University of Wales, in relation to courses provided under arrangements with the university.

Decision:

The tribunal noted that article 132 of the Sixth VAT Directive asks two separate questions: is the body claiming the exemption a body covered by the words of the exemption; and is the supply by that body exempt? Consequently, if the answer to the first question is 'no', the second question does not arise. There is no suggestion in the drafting of the Directive that the answer to the first question depends on the activities of the body. VATA 1994 works in the same way.

Furthermore, it is an accepted principle of VAT interpretation that exemptions should be interpreted strictly. The tribunal concluded that a body cannot be eligible in relation to some of its activities only.

Comments - Bodies that provide services, some of which may come within the scope of a VAT exemption if they are provided by an eligible body, should set a up a separate legal entity for the provision of those services.

Finance & Business Training Ltd v HMRC (FTC/82/2012)

Claim for VAT repayment

HMRC had denied a claim for the payment of a VAT repayment supplement on the ground that the claim for repayment had not been made in a return. It was agreed between both parties that the taxpayer was entitled to a VAT credit and HMRC accepted that, on a literal interpretation, all the conditions of VATA 1994 s 79 were satisfied.

However, HMRC argued that s 79 should be interpreted as applying only to claims made in returns. This turned on the interpretation of the expression 'return or claim' in s 79(2A).

Decision:

The Upper Tribunal found in favour of HMRC, on the basis that:

- the whole scheme of s 79 revolves around the return;
- it would be very odd for the words 'return or claim' in s 79(2A) to have a wider meaning than the same words in s 79(2), which clearly concern returns only; and
- the limit of 5% (or £250) contained in s 79(2)(c) only applies to 'the amount shown on that return or claim', that is to say, the requisite return or claim referred to in s 79(2)(a).

Comments - VAT traders wishing to submit repayment claims should endeavour to do so in their returns, as they may not be entitled to a repayment supplement if they do so by letter.

HMRC v Our Communications Ltd (FTC/87/2012)

Odds on winning

The director of the taxpayer company was a professional gambler who made his living from betting on horse races. In 2004, the bookmakers closed his accounts, which the director claimed was because of his success. This led to the director placing bets using third parties. He would contact the third party and ask him to place an amount on a horse. If the horse won, the director claimed all the winnings; if it lost, he reimbursed the third party for the stake. The benefit to the third party was that he received advance knowledge of horses that the director, an experienced gambler, and could place his own bets on the horse if he wished.

HMRC said that the company was supplying tipster information to its clients. There was a direct link between the supply of information and payment for that information. The client placed a bet based on information supplied by the director and accounted to the director. The taxpayer argued that the third party was supplying a service to it by placing bets and collecting and remitting the winnings.

Decision:

The First-tier Tribunal said HMRC's argument was “illogical”. When the third party placed the bet, there was no guarantee that the horse would win. There was no consideration if the bet did not succeed because, in that case, the third party would not pay the director. The tribunal concluded that the supply was made by the third parties to the company.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: “This case highlights the importance of two of the most common questions encountered in the world of VAT. What is the supply of goods or services? What is the consideration? This case also became trickier because it involved three parties in the arrangement.

The tribunal considered that the consideration was not dependent on the value of any particular services provided by the company, but whether the chosen horses won or lost the race in question."

Victorangle Ltd TC2994

Revenue & Customs Brief 38/2013: Intrastat changes from 1 January 2014

Arrivals threshold

EU legislation requires the UK to collect information on intra-EU trade in goods for statistical purposes and sets minimum requirements for the quantity of trade covered.

Council Regulation (EC) No 638/2004 (as amended by Council Regulation (EC) No 222/2009) requires EU Member States to collect data on a minimum percentage of the total value of their EU trade in goods. This regulation has been amended by Council Regulation (EU) No 1093/2013 which reduces the minimum requirement which Member States are to collect for their arrivals (intra-EU imports) from 95% to 93%.

These requirements determine the level at which the exemption thresholds, which are applied independently to arrivals and dispatches, are set in the UK. If your annual intra-EU trade in goods is above the specified exemption thresholds you are required to provide monthly statistical returns (Intrastat declarations).

The exemption thresholds are set at a level that ensures the UK obtains the percentage coverage of the value of intra-EU trade required by EU legislation, whilst at the same time ensuring that the number of businesses which are required to submit monthly information is kept to a minimum.

The threshold for arrivals has been increased as a result of the reduction in the coverage requirement to 95%. From 1 January 2014, the Intrastat arrivals threshold doubles from £600,000 to £1,200,000;

Delivery Terms threshold

EU legislation requires the UK to collect information to enable the accurate calculation of statistical value. These requirements determine the level at which the Delivery Terms threshold is set in the UK. The same threshold for Delivery Terms applies to arrivals and dispatches.

If your annual EU trade is above the Delivery Terms threshold you are required to supply additional information relating to Delivery Terms on your Intrastat declarations.

From 1 January 2014, the delivery terms threshold increases from £16 million to £24 million.