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Contents

Personal Tax

Whether dividend waivers constituted a settlement

The issue was whether dividend waivers executed by the appellants in favour of their wives constituted a settlement for income tax purposes. If they did, then under ITTOIA 2005 s 624, the dividends remained taxable in the hands of the appellants as settlors, unless the appellants were able to show that the waivers were 'outright gifts' (s 626).

Decision:

The tribunal rejected the appellants' contention that the waivers had been executed to maintain the company's reserves and cash balances, and found that the intention behind the waivers was tax-geared 'to bring about a near equalisation of the appellants' and their wives' dividend income thereby reducing their aggregate liability to income tax.'

Furthermore, applying Jones v Garnett [2007] UKHL 35, the tribunal noted that a tax purpose was not necessary in circumstances where an arrangement (and therefore a settlement for the purpose of the provisions) was established. This was clearly the case. The tribunal also took the view that the appellants had retained an interest in the shares, and that therefore the exception for outright gifts did not apply.

Finally, the appellants had argued that, as there was no HMRC witness to question, 'what was known by the HMRC officer was a matter of speculation' and so it was not clear whether the relevant information had been available to HMRC at the time the enquiry window had still been open. Consequently, the appellants contended, the discovery assessments raised by HMRC were invalid. Again, the tribunal found in favour of HMRC, noting that the dividend waivers had not been mentioned in the appellants' returns, and so could not have been known to HMRC.

Comments - The case is a useful reminder that 'settlement' for the purpose of ITTOIA 2005 s 624 is a very broad concept, making it extremely difficult to efficiently divert income to a spouse. This represents another case that HMRC have taken (remembering the Bird and Buck cases) since the Arctic Systems case where the arrangements appear to fall clearly within the settlement provisions and they have won at the FTT.

Donovan & McLaren v HMRC TC3188

Transferable tax allowances for married couples (Lecture P816 – 11.36 minutes)

At the launch of the Conservative Party’s annual conference in Manchester at the end of September 2013, the Prime Minister announced that married persons (and civil partners) with an income of less than the personal allowance will be permitted to transfer £1,000 of their allowance to their other half with effect from 6 April 2015. However, the relief will only be available if the person receiving the transferred allowance is paying income tax at the basic rate. To a limited extent, this delivers on a promise included in the Conservative Party's 2010 election manifesto, although that gave no details. Most party members would undoubtedly have hoped for a more generous arrangement and so they are likely to press for the relief to be extended and improved in future years.

The legislation is found in new Ss55A – 55F ITA 2007. Unfortunately, given the modest nature of the relief, the procedure for the transfer appears to be quite cumbersome as it involves:

(i) the better-off spouse making a claim; and

(ii) the individual surrendering the personal allowance making an election.

In these circumstances, the recipient is entitled to a reduction which is equal to the appropriate percentage (ie. the basic rate) of the transferable allowance, provided that:

(i) he makes a claim; and

(ii) the conditions set out below are satisfied.

These conditions are as follows:

(i) The recipient must be married to (or in a civil partnership with) their other half for the whole or part of the tax year and at the time when the claim is made. Note that the relief is therefore available in the year of marriage.

(ii) The recipient must not be liable to pay income tax at the higher or additional rates.

(iii) The individual transferring the allowance must make an election.

(iv) Neither party must be entitled to the married couple's allowance.

For 2015/16, the transferable amount is £1,000 and, for 2016/17 and subsequent tax years, it can be found by using the formula:

$$\text{£}1{,}000 \times \frac{PA2}{PA1}$$

where:

(i) PA1 = the personal allowance for 2015/16; and
(ii) PA2 = the personal allowance for the tax year to which the reduction relates.

If the formula amount does not turn out to be a multiple of £10, it must be rounded up.

S55C ITA 2007 sets out the rules for claims. A claim under these provisions must be made not more than four years after the end of the relevant tax year. Once made, a claim remains in force for later years, except that, if the claim is made after the end of the tax year to which it relates, it only has effect for that year. A claim can also be withdrawn by a notice given to HMRC by the individual who made the claim. Unless it arises by reason of a marriage coming to an end, such withdrawal does not take effect until the following tax year.

S55D ITA 2007 specifies the conditions which an individual must meet in order to make an election to surrender entitlement to the transferred amount. The procedure for an individual to make an election is detailed in S55E ITA 2007 and effectively mirrors that in S55C ITA 2007 which applies to claimants. An additional point is that an election becomes ineffective where a claimant does not obtain a tax deduction (eg. because his tax liability is insufficient).

Currently, the tax benefit for eligible couples is £200. It is estimated that some 4,000,000 couples should be able to take advantage of the relief.

Contributed by Robert Jamieson

Discount loans to employees and tax consequences

The issue was whether the benefit of loans granted to employees and directors under discount loan agreements (the 'discount agreements') should be taxed as emoluments (under ICTA 1988 s 160 and later ITEPA 2003 s 175) as no interest was paid for the relevant years of assessment, or whether the fact that a sum described as a discount was due at the end of the term took the arrangements outside the charge to tax. The discount element was calculated by reference to LIBOR plus 2% on a compounding basis, on the amount of the loan for every complete year of the loan.

Decision:

The tribunal considered (applying Lomax v Dixon [1943] 1 KB 671) that 'a payment which contains no element other than a LIBOR based return, which is differentiated from interest only because it paid at the end, rather than during the term, of the loan, cannot properly be said to be anything other than interest'. Furthermore, there was no element of capital risk which could have pointed towards a discount.

The loans to the two directors had been refinanced during the year of assessment and effectively continued beyond the original term. Applying Minsham Properties [1990] STC 718, the tribunal held that interest added to existing outstanding indebtedness should not be treated as paid. The loan to the employee was repaid in a later year of assessment. The tribunal noted (citing McNiven [2001] STC 237) that the courts consider the payment of interest to be a commercial concept and that a legalistic approach is not appropriate.

Finally, the tribunal stressed that the taxpayers could have claimed under ICTA 1988 s 160(4A) or ITEPA 2003 s 191, that the later payments were actually 'for' earlier periods and so there was no reason to give the later payments retrospective effect.

Comments - The line between interest and discount is often blurred, particularly because (as confirmed by the judge) some discount payments can be calculated by reference to LIBOR and still be discounts as they relate to capital risks. The case is therefore both a useful guide and a reminder that the tax legislation in this area may be in need of updating.

Leeds Design Innovation Centre v HMRC TC 3150

Company car changes (Lecture P817 – 12.19 minutes)

Payment for private use

S144(1) ITEPA 2003 provides for an employee to reduce their tax liability on a car benefit if that employee makes a payment for the private use of the car.

With effect from 6 April 2014, any cash payment must be made before the end of the tax year in which the private use was undertaken. Hitherto, it was possible to make a payment for private use to reduce a taxable car benefit after the end of the tax year – see, for example, the First-Tier Tribunal decision in *Marshall v HMRC (2013)*. For 2014/15 onwards, this will no longer be possible.

S158(1) ITEPA 2003 has been similarly amended in respect of company vans.

Another recent First-Tier Tribunal case

In *Apollo Fuels Ltd v HMRC (2012)*, it was successfully argued that, where the provision of a car for an employee can be treated as earnings outside the normal benefit in kind code (eg. under S62 ITEPA 2003), this charge takes precedence over the benefit in kind tax rules. This follows from the wording in S114(3) ITEPA 2003.

Because the decision could allow an employee to pay less tax on his car (or van) benefit, S114(3) ITEPA 2003 is being repealed with effect from 6 April 2014. The full amount of any car benefit will in future be subject to tax under the rules in Chapter 6 of Part 3 ITEPA 2003. HMRC have confirmed that 'protection from double taxation is already provided by other provisions in ITEPA 2003'.

Appropriate percentages

The appropriate percentages for petrol-engined car benefits are being increased by 2% for 2016/17 onwards. For example, the 5% starting rate in 2015/16 becomes 7% in the following tax year. This continues all the way through the rate bands so that 35% becomes 37% (which will then be the new maximum).

With effect from 6 April 2016, the 3% diesel supplement in S141 ITEPA 2003 is being abolished so that diesel-engined cars will be taxed on the same basis as their petrol-engined counterparts.

The special rules in S142 ITEPA 2003 relating to cars first registered before 1 January 1998 are also being increased in line with the changes described above.

Contributed by Robert Jamieson

Employee travel and subsistence (Lecture B817 – 16.38 minutes)

Business travel is deductible under s.337 ITEPA where either:

- The employee is obliged to incur and pay the cost, and
- The expenses were <u>necessarily</u> incurred on travelling in the performance of duties

Or:

- The employee is obliged to incur and pay cost, and
- It is attributed to the employee's <u>necessary</u> attendance at any place in performance of duties

Excluding 'ordinary commuting' – i.e. travel from home (or other place which is not a workplace) to permanent workplace (s.338 ITEPA)

The cost of business travel includes any necessary subsistence and accommodation costs attributable to the journey. This will apply even if the employee is away for some time as long as he is not at a permanent workplace.

A permanent workplace is a place the employee regularly attends in the performance of duties that is not a temporary workplace.

A temporary workplace is a place the employee attends to perform a task of limited duration or for some other temporary purpose.

If the employee attends regularly in the performance of duties, it will be a permanent workplace if it forms a base from which duties are performed or tasks to be carried out in performance of duties are allocated there

A workplace is not regarded as temporary if employee's attendance is in the course of a period of continuous work of a significant extent (≥ 40% of working time) lasting

1. More than 24 months or
2. Comprising all or almost all (≥ 80%) of the period for which employee is likely to hold the employment

It becomes permanent at the time that it is reasonable to assume one of the above is true. This could be at the start of the work, or during it.

Example:
Jack works for a firm of lawyers at its Manchester City Centre branch. He is sent to work full-time at the branch in Burnley for 18 months at the end of which he will return to the Manchester branch. Burnley is approximately 30 miles west of Manchester.

Although Jack is spending all of his time at the Burnley branch it will not be treated as his normal workplace as his period of attendance will be < 24 months.

Therefore Jack can claim a deduction for the costs of travel to and from his home to the Burnley branch.

As the travel is deductible any reasonable subsistence costs will also be deductible.

Note that if Jack was recruited for 18 months and sent straight to Burnley then this would be his permanent workplace and no travel nor subsistence would be deductible.

Employees working in an area are treated as having a permanent workplace consisting of an area if their duties of employment are defined by reference to an area, and

1. In performance of duties, the employee attends different places in the area, and
2. None of the individual places is a permanent workplace

In this case the whole area would be his permanent workplace so there would be no deductibility for travel, subsistence and accommodation costs. It is therefore important for people such as areal managers, area sales staff to establish a permanent workplace in the area.

The allowable travel is from the employee's home (or other starting point) to the temporary workplace, even if this is shorter than the journey to his permanent workplace, or if he drives past his permanent workplace to get there. Some employers reimburse only the difference in mileage – in this case the employee can claim a deduction for the difference.

Late night taxis home for work can be an exempt benefit if paid for by the employer but only where the employee is required to work after 9pm (and this is not a feature of the job), the late working is irregular and it is not feasible to use public transport. The feasibility of using public transport is a function of availability and reliability, not safety. The exemption is for a maximum of 60 journeys per year.

Incidental overnight expenses such as laundry, phone calls, newspapers will be deductible if the employer pays or reimburses actual cost and no more than £5 per night on average (£10 per night if overseas) for the length of the stay.

Travel to work-related training reimbursed by employer is also deductible (including incidental overnight expenses) but if the employee pays with no reimbursement, there is no deduction.

Directors acting on behalf of a professional practice can claim deduction for reasonable travel expenses as long as the professional practice disallows them in computing its trading profits

Unpaid directors of NFP companies can claim deduction for payments received to cover reasonable travel and subsistence.

Contributed by Malcolm Greenbaum

Artificial Dual Contracts – New Rules

The Autumn Statement referred to the introduction of legislation to deal with what HMRC perceived as artificial dual contract arrangements but stated it would be issued separately.

Draft legislation has been published to counter the artificial use of dual contracts by non-UK domiciled individuals. The legislation will insert new ss.24A & s.24B into ITEPA.

The effect of the new s.24A is that the overseas employment income (including income from employment-related securities) of a UK resident non-domiciled individual (P) will be taxed on the arising basis and not on the remittance basis if four conditions are satisfied. The conditions are:

1. an individual has both a UK employment and one or more foreign employments;
2. the UK employer and the foreign employer are 'associated' with each other;
3. the UK employment and the foreign employment are 'related';
4. The foreign tax rate that applies to income in respect of a foreign employment, (calculated in accordance with the amount of foreign tax credit relief which would be allowed against income tax if the income were not taxed on the remittance basis) is less than 75% of the UK's additional rate of tax, currently 45%. For example, if the UK's additional rate of tax is 45% in 2014/15, then condition 4 will apply if the rate of foreign tax credit relief that would be given in relation to the relevant employment income would be less than 33.75% (75% of 45%).

Employments will be 'related' where P has a senior position in at least one of their UK or overseas employments or with an associated employer. To hold a senior position, P must either be a director or be in the highest tiers of seniority or remuneration compared to other employees. The explanatory notes provide the following scenarios below where HMRC would consider a UK employment and a foreign employment to be related to one another, where:

- It is reasonable to suppose that P's UK employment would cease if the foreign employment ended.
- P has two employments and undertakes client meetings, entertainment or marketing under the foreign employment and manages investments for the same clients under the UK employment.
- P is employed in the UK and P's contract specifies that P cannot work outside the UK. P is also employed in France, and P's contract specifies that P can only work in France. P does the same type of work under the French contract as under the UK contract, so although these duties are separated geographically, the work is of the same type.
- P provides financial advice to an individual under both a UK and foreign employment.)

For employment-related securities, the new rules will apply from 6 April 2014 where the date of the acquisition of the securities or the option is before 1 September 2014.

Contributed by Tony Jenkins

Share loss relief: were shares bought or subscribed for?

The issue was whether Mr McLocklin had acquired shares by subscription or by purchase from another shareholder. Under TCGA 1992 s 131, share loss relief (on the sale of shares) could only be available if the shares had been acquired by subscription (as the shares did not qualify for EIS relief). At the time of the share issue, Mr McLocklin had not had the funds to participate in the subscription and Mr Winter (a fellow shareholder) had subscribed for the shares, on the basis of an agreement that he would later sell them to Mr McLocklin.

Decision:

The tribunal noted that the agreement was akin to a loan under which shares were issued to Mr Winter as security, pending reimbursement of the subscription monies. The tribunal pointed out that Parliament has decided that relief should not be available where an individual acquires existing shares in a company, as 'the price paid in those circumstances does not necessarily represent money that has flowed into the company itself'. However, in this case, the taxpayer had agreed to participate in the issue from the outset. The tribunal concluded that the arrangement should be treated in the same way as a bare trust and allowed the appeal.

Comments - The tribunal adopted a very literal interpretation of the legislation to give effect to Parliament's intention, in circumstances where a bare trust had not been created. HMRC may decide to appeal the decision. It is well known that there are conditions that apply in respect of the loss relief available for losses on shares subscribed for in a trading company – the Tribunal took a very lenient interpretation.

Neil McLocklin v HMRC TC3182

Chargeable event gains in trusts **(Lecture P819 – 20.00 minutes)**

In practice, when accountants come across an investment bond, it is just as likely that it will be held in trust as held by an individual directly; this throws up a number of areas of potential confusion (and possibly unexpected tax liabilities).

I will mainly discuss bonds held in either an interest in possession (IIP) trust or a discretionary trust. For the benefit of Scottish readers, IIP trusts are what you would know as 'liferent' trusts, with the life tenant being the 'life renter' and the remainderman being the 'fiar'. I will restrict my comments to UK resident trusts, with UK resident and domiciled settlors and beneficiaries.

Why hold investment bonds in trust?

There are many advantages to trustees investing in a life assurance investment bond (onshore or offshore), including:

- it is an easy way to ensure that the requirements of Trustee Act 2000 regarding diversification of investments are met,
- simplified administration for the trustees, and

- the ability to switch the underlying investments held in the life assurance tax wrapper without incurring tax charges.

However, the most common use of bonds held in trust is normally as part of an inheritance tax (IHT) planning strategy, typically a 'gift and loan' trust or a 'discounted gift' trust.

Who is liable for the tax on a chargeable event gain arising in a trust?

Answering this question correctly is very important, not only in terms of planning for likely tax charges, but also for making sure that liabilities are declared correctly on self assessment returns.

Bare trusts

Where investment bonds are held on bare trust, any chargeable event gains are chargeable on the beneficiary of the trust, with any top slicing available being based on the beneficiary's own income tax position in the year the chargeable event arises for tax purposes.

Other trusts

The default position is that such gains are taxed on the settlor, not the trustees. However, where the settlor cannot be charged to income tax on the gain (for example, if he is dead or non-resident), the trustees become liable under the anti-avoidance provisions introduced in FA98.

There are, however, some circumstances where neither the settlor nor the trustees are chargeable, namely:

The policy was taken out before 17 March 1998; and

- it has not been 'enhanced' on or after 17 March 1998 by paying additional premiums or in any other way; and
- the trust was created by
    - an individual who died before 17 March 1998, or (if created by more than one person)
    - at least one of those persons was an individual who died before this date

Trustees' tax position

If a chargeable event gain is chargeable on trustees, it must be declared on the trustees' tax return (SA900) in boxes 9.29 - 9.31. Note that, unlike the personal tax return, there is no box for putting in the number of years for which the policy has been held. <u>This is because no top slicing relief is available for trustees.</u>

Even if held in an interest in possession trust (which normally only suffer income tax at basic rates), the gains are taxed to income tax at 45% (2013/14 rates). If it is a UK investment bond, 20% credit is given for corporation tax suffered in the fund, as it would be for an individual.

Assigning a bond held in trust

If a bond has been set up in a discretionary trust or a flexible IIP trust, and the trust is to be wound up after the tax year of the settlor's death, it may be more tax-efficient for the trustees to assign the bond to the beneficiary, rather than cashing it in and paying out the proceeds. This assignment does not produce a chargeable event, as it is not an "assignment for money or money's worth".

If the bond is assigned, the tax on any subsequent chargeable event gain will fall on the beneficiary, which will save tax if they are anything other than an additional rate taxpayer. If the bond were cashed in within the trust, it would incur tax at the trustee rate of 45%.

Example 1

In December 2013, the trustees of an IIP trust created 10 years earlier surrender an offshore bond that they have owned for 10 years. The chargeable event gain arising is £45,000. The settlor is alive and has taxable income of £85,000.

The chargeable event gain is taxable on the settlor, who will be taxable at his marginal rate of 40%. In addition, the settlor will lose his income tax personal allowance (PA) as the full £45,000 gain is included as income for PA abatement purposes. (At income of £118,880 this year the full PA (£9,440) is lost.)Thus the total income tax charge arising on the settlor is

- (£45,000 @ 40%) plus (£9,440 @ 40%) = **£21,776**.

Example 2

Assume the same facts as example 1, but the settlor has died prior to encashment of the bond.

In this case the chargeable event gain is taxable on the trustees at 45%, i.e. a tax charge of **£20,250**.

(Note that if it was a much older trust, where the policy had been taken out before 17 March 1998 and the settlor had died before that date, the gain would not be taxable on anyone.)

Example 3

Assume the same facts as in example 2, but this time, the trustees do not encash the bond. Instead, they assign it to the remainderman, who himself surrenders it and makes the chargeable event gain of £45,000 in 2013/14. His other income this year is £25,000 (after personal allowance).

The beneficiary is chargeable on the gain, but there will be no abatement of personal allowance due to the level of his income. The gain will use up the rest of his basic rate band and then be taxed at 40%, giving an income tax liability as follows:

- (£7,010 @ 20%) plus (£37,990 @ 40%) = **£16,598**.

Tax trap in IIP trusts

Those familiar with the income tax rules for trusts will be aware of the tie up between the income tax position of the trust and that of the beneficiaries who have income passed on to them. For IIP trusts, where a life tenant has an automatic right to the income, the life tenant is (broadly) given credit for the basic rate tax suffered by the trust on the income being distributed to them, before being taxed at their own marginal rates.

The problem with the income tax charge on a chargeable event gain in an IIP trust is that the tax has arisen on a capital profit rather than income. Thus there is no income to pass on to the life tenant, so no recovery by the beneficiary of the tax suffered in the trust. With the trust tax rate 45%, this situation is clearly something that trustees should avoid if possible.

No such problem arises in discretionary trusts, where the 45% tax payable by the trustees goes into the 'tax pool' that is available to frank any income distributions to beneficiaries.

With the equivalence that there now is in the IHT treatment between lifetime IIP trusts and discretionary trusts, the scope for a beneficiary to receive credit for tax suffered on an investment bond gain gives a distinct advantage to a discretionary trust over an IIP trust, if the bond is going to be the only or main investment in the trust. As a result, gift and loan or discounted gift arrangements are often based on discretionary trusts these days.

Example: *The Wanyama Trust*

The Wanyama trust was created on the death of Harold in 2011 and contains a range of investments that he held at death, worth close to £1m. There is an interest in possession for Harold's widow (aged 82 currently) and there are ten remaindermen of the trust.

Two different investment managers have been asked to tender for the investment management of the trust. One of them has suggested investing mainly in an offshore bond, as a way of avoiding ongoing income tax and CGT charges on the trustees, simplifying trust administration and providing diversification of the trust assets. The trustees have therefore approached you for advice about the tax treatment of investment bonds held in trust.

The first point to emphasise is that, unless properly authorised to conduct investment business, you must restrict your advice to an explanation of the tax rules. Saying whether or not you think an offshore bond is a suitable investment is giving more than tax advice.

In this particular scenario, with a dead settlor, any encashments of the bond will potentially produce chargeable event gains on the trustees, taxable at the top rate of tax (currently 45%); no credit for this will be available to the remaindermen when capital is appointed to them.

Alternatively, assuming the bond is written in segmented form, individual whole segments could be assigned out to particular remaindermen at different times, enabling them to subsequently make their own chargeable event gains in due course, where (perhaps with the aid of top slicing relief) lower rates may be incurred. However, the prospect of all the individual remaindermen having to deal with these complex tax rules is unlikely to be something that the family would welcome.

Tax advice to the trustees should also of course mention that there will be no relief for losses on investment bonds, other than under the 'deficiency relief' rules.

Conclusion

The taxation of life assurance bonds and the taxation of trusts are both complex areas in their own right. When both issues have to be considered at the same time, it increases the complexity. Try to make sure that clients discuss the tax position with you before decisions are taken regarding investment bonds, whether when they are first being considered as an investment, or prior to a surrender/assignment. The fact that the tax position was unanticipated won't be grounds to 'unwind' transactions once they have taken place, as the Supreme Court confirmed earlier this year when considering the scope of the *Hastings-Bass* doctrine in the *Futter* and *Pitt* cases.

Contributed by Kevin Read

Moving funds between pension funds lost in Court of Appeal

In April 2000, HMRC gave notice that they intended to withdraw approval from the John Mander Ltd Director's Pension Scheme with effect from 5 November 1996. In July, they issued an assessment for 2000/01 under TA 1988, s 591, on the trustees of the scheme who acted as administrators.

The trustees appealed saying that the tax charged related to 1996/97 and the assessment was invalid because it was for 2000/01.

The First-tier Tribunal and the Upper Tribunal dismissed the taxpayer's appeal.

Decision:

The Court of Appeal said according to the wording in TA 1988, s 591D, the relevant date for the purposes of the tax charge was the date withdrawal was notified, not the date specified in the notice. Lord Justice Patten explained:

"The date of the notice determines the relevant year of assessment. The fact that the notice may and often does specify an earlier date of cessation by reference to when the conditions for approval ceased to be satisfied is irrelevant for this purpose."

The taxpayer's appeal was dismissed.

Comments - This is potentially the last instalment of a case where there had been a deliberate plan 'to export funds out of an approved scheme into another scheme" and the couple have failed again in the Court of Appeal after having failed in both of the lower courts.

John Mander Pension Scheme Trustees Ltd v CRC, Court of Appeal

Capital Taxes

Family company share transfers (Lecture P818 – 11.08 minutes)

Passing shares down generations

In family companies, shares frequently pass down generations, for example from father to son. Father may be approaching retirement, and getting ready to make way for his son to take control of the company. Very often, the son will already be an employee of the company.

There may be potential capital gains tax and inheritance tax issues for father to consider in making the gift.

In addition, the question arises: does the gift result in income tax (and National Insurance contributions (NIC)) implications as well?

Employment income

Income tax is charged on employment income (ITEPA 2003, s 6). 'Employment income' includes general earnings such as salary, wages or gratuities (under s 62), amounts treated as earnings (such as benefits in kind), and any amount which counts as employment income, such as share-related earnings (s 7).

For NIC purposes, 'earnings' includes 'any remuneration or profit derived from an employment' and the definition of 'earner' is construed accordingly (SSCBA 1992, s 3).

Thus the acquisition of shares by an employee in the employer company can give rise to income tax (possibly under PAYE, if the shares are a 'readily convertible asset') implications in a number of ways, including.

- As general earnings (*Weight v Salmon*, HL 1935, 19 TC 174);
- Under the 'employment related securities' provisions (ITEPA 2003, s 421B(1)); or
- The 'disguised remuneration'(Employment income provided through third party) provisions (ITEPA 2003, Pt 7A).

By reason of the employment?

However, for family companies in particular, it is necessary to consider whether shares are received by reason of the recipient's employment with the company (if applicable), or because of the relationship between the family members.

General earnings

HMRC guidance (at EIM00600) states in the context of the general earnings charge under ITEPA 2003, s 62:

> "An employee may receive something that is clearly a 'profit' to them and which is therefore capable of being earnings. For example, most money payments are, potentially, earnings. But a payment will not count as earnings under Section 7(3) and Section 62 ITEPA 2003 if it comes to the employee from a source other than the employment."

But HMRC also warns (at EIM00610):

> "Taxable earnings may be paid by a person who is not the employer. A payment may be from the employment and therefore taxable as earnings within Section 62, even if it is paid by somebody other than the employer. What matters is that the payment is made because the recipient holds the employment, or as a reward for services provided in the employment, and not for any personal reasons."

With regard to gifts, HMRC confirms that a gift does not count as earnings (within s 62) if it is made on personal grounds, or as a mark of personal esteem for appreciation, but adds: "it is not possible to list factors that will determine with certainty whether or not a gift is taxable as earnings" (EIM01460).

Employment related securities

ITEPA 2003, s 421B(3) states that an opportunity to acquire shares is to be regarded as by reason of the employment unless the person by whom the opportunity is made available as an individual, and is in the normal course of domestic, family or personal relationships.

In the context of family members, HMRC guidance states (at ERSM20220):

> "We take a common-sense view of this exception. It would clearly apply if a father, on reaching retirement, hands over all the shares in his family company to his son and daughter simply because they are his children, even if they are both also employees of the family company.
>
> However, it is a question of fact, and it is possible for the employment, rather than the family relationship, to be the reason for the gift, and where that is the case the shares will be employment-related securities.
>
> This may well be the case where large numbers of employees were given shares and they included a son and a daughter of the proprietor."

Disguised remuneration

The provisions dealing with employment income provided through third parties (in ITEPA 2003, Pt 7A) includes a 'gateway test' to determine whether the rules are capable of applying. One of the gateway conditions is that "a relevant step is taken by a relevant third person" (s 554(1)(d)).

HMRC confirms that an individual can be a 'relevant third person', but points out (at EIM45035):

> "where a relevant step is taken by an individual, remember that in contrast to other categories of person, an individual may take a step in the normal course of domestic, family or personal

> relationships and not as a means of providing rewards, recognition or loans in connection with employment. Where this is the case, the step will not come through the Section 554A gateway".

If in doubt…

Whether shares are being transferred because of family relationships, or by reason of the employment, is a question of fact. Factors to consider in determining whether family company shares are being gifted (e.g. from father to son, as in the above example) by reason of the family relationship as opposed to the son's employment with the company include:

- Is there a history of shares in the company passing down the generations?
- Is the son receiving remuneration from the company at a commercial rate?
- Is the father transferring shares only to be son, or is he transferring shares to other (non-family) employees as well?

Particularly in borderline cases where the facts are not conclusive one way or the other, a non-statutory clearance application to HMRC should be considered.

Contributed by Mark McLaughlin.

PPRR - Character of land retained

The taxpayer owned a house with substantial grounds. In 2007, she sold part of the land for the development of four houses to a company of which she was a director. She claimed only or main residence relief under TCGA 1992, s 222 on the disposal. HMRC refused the claim on the basis that the land was already under development when the contracts were exchanged and, to qualify for relief, the land had to be available to the owner as "garden or grounds" on the date it was sold.

Decision:

The First-tier Tribunal found that the company had been allowed on to the land to begin foundation work "on an informal basis". The land had retained its character as garden or grounds until contracts were exchanged. The company starting work did not constitute a disposal of the land, therefore only or main residence relief was due. The taxpayer's appeal was allowed.

Comments – The principal private residence relief is a well known relief which has a number of conditions which must be met. There are conditions that apply to the land attached to the residence and it is essential that these are met if the PPRR is to apply to the sale of the land. The taxpayer was lucky with the decision of the tribunal as the land was not really available as gardens or grounds before the sale. When advising clients practitioners need to alert clients to the conditions.

A Dickinson TC3037

Principal residence relief: had dwelling become settled property?

The issue was whether a dwelling had become 'settled property' under a trust. If it had, then under a combination of TCGA 1992 s 223 and s 225, as the dwelling was the occupier's principal residence, the gain triggered on sale of the dwelling was not taxable. Veronica had sold her flat for £45,000 to her son Stephen in February 1996. The sale was subject to a brief agreement, under which Veronica was entitled to continue living at the flat at no cost for the remainder of her life or until her remarriage, subject to payment of £5,000.

Decision:

The tribunal found that Stephen had only subsequently re-sold the flat with the agreement of his mother and that he had therefore not become absolutely entitled to the flat in February 1996 but had held it on trust for his mother until the second sale.

Comments - Although identifying trust property in the absence of trust language can be challenging, this decision reminds us that only the relationship between the parties matters.

Veronica and Stephen Wagstaff v HMRC TC3183

CGT: negligible value claim for deposit account

Mr Weston appealed against HMRC's decision to deny a negligible value claim (TCGA 1992 s 24) in relation to a claim he had against Stanford International Bank Ltd (SIB). Mr Weston had invested in a non-negotiable certificate of deposit issued to him by SIB ('the CD'). SIB had been placed in liquidation and its liquidator had informed Mr Weston that he would not recover his investment.

Decision:

The tribunal considered that the asset was a sterling deposit with SIB (regardless of the fact that SIB had converted the monies in dollars and invested them in dollars) and that the fraudulent activities of SIB did not affect the debtor/creditor relationship between Mr Weston and SIB. Consequently, the CD was not a chargeable asset for CGT purposes. Furthermore, applying Zim Properties [1985] STC 90, Mr Weston's right of action against SIB was not a separate 'asset' for CGT purposes, because it was merely one of the rights which he held by virtue of holding the CD itself. The tribunal held that Mr Weston did not hold a chargeable asset in relation to which a negligible value claim could be made.

Comments - In confirming that a certificate of deposit and a right of action against the bank holding the deposit are not chargeable assets for CGT purposes, the case could have implications beyond the application of negligible value claims.

Gordon L Weston v HMRC TC3152

Negligible value claims

Many practitioners will be familiar with negligible value claims. S24(2) TCGA 1992 allows that, where an asset becomes of negligible value, a claim can be made as if the asset had been sold and immediately reacquired. The deemed disposal can be treated as if taking place at the time of the claim or an earlier time as specified, although no more than two years prior to the date of the claim.

The use of negligible value claims is common in terms of planning as it allows a capital loss to be crystallised at the point when it can be best used by the taxpayer. It is often used in collaboration with a claim under s131 ITA 2007 which enables the loss arising on shares in a qualifying company to be set off against the income of the individual rather than being restricted to being set off against only other capital gains which is the normal treatment of capital losses. The crystallisation of the loss using a negligible value claim means an individual can determine the year in which the loss arises so that it matches up with a period when he has the most income. Additionally the shareholder does not have to wait until the company is struck off to be able to claim relief for the loss he has suffered.

The author has recently been involved in a case which raises some interesting issues around this process. The shareholder, Mr X, owned 154,000 £1 ordinary shares in a company W Ltd. This company went into liquidation in October 2008 and was dissolved on 1 July 2010. Mr X submitted his 2009/10 tax return electronically on 24th November 2010 showing capital losses of £154,000. Of this amount, some were set off against income in 2009/10 with the balance being carried back into 2008/09 as is allowed by s131 ITA 2007. The bulk of the income relieved was in the earlier year.

HMRC opened an enquiry into the return and quickly issued a closure notice on the basis that the negligible value claim was not valid because Mr X did not own the shares at the date of the claim. Their reasoning for making this decision was the wording of s24(1A)TCGA 1992 which states that a negligible value claim can be made by the owner of an asset where certain conditions are met. Their view was that if you no longer own the asset, you cannot make a negligible value claim. Although the legislation effectively allows the claim to be backdated for up to two years, the claim has to be valid and would only be valid if the asset is owned at the time that it is made.

Although this view is expressed in the HMRC manuals, it does not appear to have been tested before any Court or Tribunal.

The taxpayer was willing to take this matter to the First Tier Tribunal but as a preliminary stage, an application was made to have the company reinstated on to the register at Companies House. HMRC were told that this was being done. The argument was that if a company is restored then the company is deemed to have continued in existence as if it had not been dissolved or struck off the register (s1032 Companies Act 2006).

The response of HMRC is interesting. They argued that a company cannot be reinstated once it has been dissolved. In their view "all that can happen is that the dissolution can be declared void ie ruled not to have taken place". Although this may seem like the same thing, this meant (in HMRC's eyes) that shares in dissolved company cannot not be treated as continuing to exist after dissolution which is what was needed for the claim to become valid by virtue of the reinstatement. We were told that this analysis of the impact of corporate law had been provided by the Solicitor's Office.

Their argument, however, seems illogical and so the opinion of a barrister specialising in corporate law was sought. He pointed out that it was clear from HMRC's letter that they were referring to the statutory framework for the restoration of dissolved companies prior to changes affected by the 2006 Companies Act. He also pointed out that even that analysis was wrong as it failed to acknowledge different options which would have been available to the High Court under the old rules. He did confirm that the rules within s1032 Companies Act 2006 now make it clear in all cases that a dissolved company which is reinstated is deemed to have continued in existence and that in his view this meant that the shares in W Ltd would also be deemed to have continued in existence. If those shares continued in existence they must have been held by someone and that someone would be the previous shareholder.

This opinion was provided to HMRC who eventually conceded the case before it went to the First Tier Tribunal.

This case raises two interesting issues. The first is in relation to a possible way of getting around a problem where shares no longer exist at the point at which you want to make a negligible value claim. It is not a cheap option but one which appears to work and might be worth considering where there is sufficient tax at stake. The second is that HMRC appear to have been significantly out of date in their understanding of the way in which corporate law operates.

Contributed by Ros Martin

Disputed share ownership and resulting CGT Liability on disposal

A 2005/06 tax return in the married name of the taxpayer (now divorced) was received by HMRC in May 2007. It declared employment income and a large capital gain in respect of a disposal of shares in Capstar Media Group. A cheque in settlement of the gain was included with the return.

In May 2010, the taxpayer wrote to HMRC saying the return had been submitted fraudulently by her ex-husband. She said she had no knowledge of the shares that were allegedly sold and asked for a full refund of the capital gains tax paid.

HMRC replied that no amendments could be made to the return more than 12 months after the filing date, but suggested that she claim overpayment relief under TMA 1970, Sch 1AB.

This claim was subsequently refused on the basis that the relevant documents for the disposal of Capstar shares had been filed at Companies House. The taxpayer appealed.

Decision:

The First-tier Tribunal said the main question was whether the taxpayer had overpaid capital gains tax.

The judge concluded that there was evidence to show that the shares had been disposed of, even though the taxpayer had been "deprived of the benefit of that consideration almost instantaneously". She had been company secretary of the company but, according to the correspondence between the taxpayer and HMRC, it seemed that her ex-husband dealt with the financial affairs of the company and she signed documents as required. The tribunal inferred from this that the taxpayer “broadly consented to this pattern of the conduct of financial affairs” and that she was content with her husband's decisions during their marriage.

The taxpayer had been unable to prove that she did not have beneficial ownership of the shares and, therefore, the tribunal could not find that she had overpaid capital gains tax.

The taxpayer's appeal was dismissed.

Comments – This represents a very unusual set of circumstances where the taxpayer was alleging that some time after the tax return had been submitted that she had not been the person who submitted the return. The avenue was one that the taxpayer thought might gain some financial recompense in a presumably messy divorce. Prima facie the facts supported the tax return and therefore the Tribunal had to follow that course.

S Sehgal TC3055

Business property relief – Not available

The issue was whether shares forming part of the deceased's estate benefited from business property relief (BPR) for IHT purposes. BPR was not available if the business of the company consisted wholly or mainly of the holding of investment (IHTA 1984 s 104).

The company owned and managed a 'business centre', which comprised land and buildings occupied for office and light industrial use. Businesses occupying the business centre under licences benefited from the services of a receptionist and could also (for an additional fee) hire the services of a forklift truck.

Decision:

Referring to IRC v George (exors of Stedman decd) [2003] EWCA Civ 1763, the tribunal thought that it must consider 'the nature and extent of the additional services and their contribution to the business', both qualitatively and quantitatively. The tribunal concluded that the non-investment services provided by the company did not 'predominate' when considering the activities of the company as a whole. Most of the income from additional services related to recharges for electricity, telephone and postage and the income from the other additional services was very modest compared to the licence fee income.

Comments - This case is yet another example of the difficulties of establishing that a property rental business is not an investment business.

John Best v HMRC TC3217

Administration

Appeal out of time: taxpayer unaware of assessment

The taxpayer sought permission to be allowed to appeal out of time against HMRC's assessments for the years 1997/98 and 1998/99 (under TMA 1970 s 49). The taxpayer had been unaware of the assessments. Mrs Davison had moved to Spain. Her accountant had informed HMRC of the move but HMRC had continued to attempt to contact her in the UK. HMRC eventually was able not only to locate her in Spain but also to withdraw monies from her bank account corresponding to two assessments for the years 2000/01 and 2001/02. Mrs Davison telephoned HMRC on 8 July 2008 and received confirmation that the tax withdrawn from her account had been incorrectly raised. However, HMRC also explained that the tax levied by mistake could not be repaid until Mrs Davison paid the tax still due on the 1997/98 and 1998/99 tax years.

Decision:

The tribunal accepted evidence that it was agreed during the telephone conversation that if Mrs Davison did not ask for the repayment of the monies incorrectly withdrawn from her Spanish bank account, HMRC would not pursue the tax liability arising from the 1997/98 and 1989/99 tax returns. The tribunal also noted that HMRC had not repaid the withdrawn monies. The tribunal therefore concluded that Mrs Davison was entitled to believe that the earlier assessments had been vacated and so it had not been unreasonable for her not to appeal.

Comments - The case is not only an interesting (and somewhat entertaining) example of a series of blunders by HMRC, it may also be useful to any taxpayer wishing to appeal out of time against an assessment he has not been aware of.

Catherine Leslie Davison v HMRC TC3121

Systems failure provides reasonable excuse

The taxpayer submitted his 2010/11 employer annual return late. He claimed that the form was completed in May and that he tried to submit it on 16 May using HMRC's PAYE tools program. The transmission failed and it subsequently proved impossible for the taxpayer to connect with HMRC's server. He tried to obtain information from HMRC about how to solve the problem, but said that it was not until October 2011 that someone provided him with the solution.

HMRC imposed a penalty for the late submission of the return, against which the taxpayer appealed.

Decision:

The First-tier Tribunal found that the taxpayer had tried to submit the return but “encountered unexpected transmission difficulties”. HMRC's helpline was unable to assist. The taxpayer knew the return was due and tried, in the intervening period, to submit the form but with no success.

The tribunal decided the taxpayer had done what he could to submit the form and noted that there was no "financial benefit" for him to delay sending the return. He had a reasonable excuse for the late submission and no penalty should be imposed.

The taxpayer's appeal was allowed.

Comments – This case represents another case where HMRC's systems were not up to scratch and because the taxpayer was able to provide evidence of the efforts made the tribunal exercised their judgement and gave a fair decision. While the HMRC computer systems are not perfect it reminds of the importance of record keeping particularly by reference to the attempted submissions.

Michael Birch trading as The Woodman Inn TC2951

Late P35 – Penalty stands

The taxpayer was an unincorporated rugby union club with one employee. It submitted the form P14 for 2010/11 on time, but did not file the employer return P35 until it received a notice of penalties of £300 for non-submission.

The club said it was "onerous" to expect an organisation of its nature to submit returns online and that had HMRC acted more quickly, it would have submitted the P35 sooner and avoided the large penalty.

Decision:

The First-tier Tribunal sympathised with the taxpayer but said that the Upper Tribunal's decision in Hok Ltd v CRC [2012] UKUT 363 stated that HMRC's delay in issuing penalties was not ground for allowing an appeal. However, the tribunal did question why HMRC's computers could not have been programmed so that, when acknowledging receipt of the P14, a warning was issued to the taxpayer that a P35 was also required.

"Regrettably" the tribunal said it had to dismiss the appeal. The judge, however, added:

"It is presumably of no comfort for the appellant and certainly not for the general body of taxpayers that the respondents have probably incurred costs in excess of £300 in pursuing this penalty."

Comments - The Upper Tribunal's decision in Hok Ltd v CRC [2012] UKUT 363 stated that HMRC's delay in issuing penalties was not grounds for allowing an appeal demonstrates the need for the taxpayer to have another rationale for the failure. The comments by the Tribunal judge were made with regret but of course highlighted the obvious solution in that HMRC could have arranged for reminders to be programmed.

Seghill Rugby Football Club TC3078

Refiling required for end of year returns

The taxpayer, a small company run by its managing director, L, and his 84-year old mother had two other employees. HMRC imposed penalties of £900 on the company because it was late filing its 2011/12 employer return.

L said the return was filed on 18 May, but HMRC said there was a discrepancy in the figures contained in the P14s and the P35, and the latter was not resubmitted until February 2013. L said he refiled the P14s at the request of HMRC, which said there was a computer problem with his submission, on 21 May. Even though the figures on the P14s matched those on the original P35, unbeknown to L, it was also necessary for him to resubmit the P35.

The taxpayer appealed against the penalties.

Decision:

The First-tier Tribunal decided the taxpayer had a reasonable excuse from May 2012 to August 2012. The computer error was an unforeseeable event which prevented the employer from fulfilling his obligation to submit his return. Computer printouts issued to the taxpayer from HMRC showing the returns as “unsatisfactorily validated” were, said the tribunal, “far from clear”. However, subsequent correspondence from HMRC was clear and should have alerted the taxpayer to the fact that he needed to resubmit the P35. He therefore had no reasonable excuse from September 2012 to February 2013.

The tribunal reduced the penalty to £500.

The taxpayer's appeal was allowed in part.

Comments – The integrity of the computer system is dependent upon correct filing and where this is impeded either by system failures or the difficulty for the end user problems occur. As evidenced in this case there were both technical problems and a lack of understanding hence the failures. The Tribunal took a fair view and therefore the penalty was reduced to £500 – probably an equitable result.

Littlewood Hire Ltd TC2975

Too late – CGT liability

The taxpayer applied to the First-tier Tribunal to allow a late appeal against a penalty of £45,604 imposed by HMRC for the failure to report a capital gains tax liability in his tax return. HMRC notified the penalty in May 2011. The taxpayer's accountant requested a review, but the fine was confirmed in August 2011. The letter from HMRC said that an appeal would have to be lodged within 30 days of the letter.

In November, the accountant wrote to HMRC saying that he hoped to lodge an appeal within seven days. The delay was attributed to the taxpayer's poor health. In a conversation with HMRC in January 2012, the accountant said he would submit the appeal shortly but was having problems contacting the taxpayer because of his health problems. HMRC said they would not object to a late appeal but said, ultimately, the decision lay with the tribunal.

Eventually, after several other telephone calls and letters to HMRC, the appeal was submitted in June 2012.

Decision:

The First-tier Tribunal declined to accept the late appeal. The judge said the purpose of the time limit was to create certainty. The delay in this instance had been “inordinate”. The taxpayer and his accountant did not appear to understand that submitting an appeal notice was all that was necessary to comply with the time limit. No supporting evidence was necessary at that stage.

The tribunal concluded that the accountant, despite repeated advice from HMRC, seemed to have a “total disregard to the statutory time limits”.

The application was unsuccessful.

Comments – Many of the comments are self explanatory. All professionals are aware of the importance of time limits and procedures. It is difficult to understand how the accountant could have had a “total disregard to the statutory time limits”.

A McMullan TC3025

Taxpayer was not negligent

The taxpayer included income from property in her 2010/11 tax return, but made an error in her calculations. This resulted in her claiming losses to which she was not entitled. HMRC claimed that she had made a careless or negligent error and imposed a penalty of £435.

The taxpayer appealed. She denied that she was careless, but said if there was a negligent error in the return she had a reasonable excuse because she had relied on her adviser to deal with her tax affairs.

HMRC said this was not an excuse because the adviser had been in contact with the taxpayer about her property income in respect of the previous year.

Decision:

The First-tier Tribunal said that this was a “powerful argument” but it was the “state of mind or state of knowledge of the appellant” that mattered. She relied on her agent to act as a professional adviser, not as a “mere functionary”. He claimed to have tax expertise and the taxpayer had no reason to doubt his competence.

If the advice of a professional proved to be negligent, “that negligence was not to be imputed to the taxpayer”. The judge said:

"It is contrary to the very notion of negligence (that is, a failure to take reasonable care) that the person who perceives there to be a need to take the advice of a professional person upon whom she believes she can properly rely, can be said to be negligent if she then relies upon that properly provided advice (even if it turns out to be wrong)."

Referring to the Special Commissioners' decision in AB (a firm) (SC572), in which the tribunal said it accepted "that a taxpayer who takes proper and appropriate professional advice with a view to ensuring that his tax return is correct, and acts in accordance with that advice (if it is not obviously wrong), would not have engaged in negligent conduct", the First-tier Tribunal said there was a difference between using an adviser to file a document by a certain deadline and appointing an agent to give professional advice on specific issues. The latter would be acting as a "true professional", while the former was a "functionary". It was not careless to rely on a professional adviser who "holds himself out as having appropriate expertise in and about a person's tax affairs and dealings with the respondent".

The tribunal rejected HMRC's argument that a "person is careless even if the negligence or carelessness is that, and only that, of the professional adviser even when that adviser is not acting as a mere functionary, but in a truly professional capacity".

The taxpayer's appeal was allowed.

Comments – This case goes to the root of where a person is to be considered to be negligent. The tax system is complicated and accordingly taxpayers take on the services of adviser. It was not careless to rely on a professional adviser who "holds himself out as having appropriate expertise in and about a person's tax affairs and dealings with the respondent". Consequently the Tribunal quite correctly rejected HMRC's argument that a "person is careless even if the negligence or carelessness is that, and only that, of the professional adviser even when that adviser is not acting as a mere functionary, but in a truly professional capacity".

E Mariner TC3039

'Reasonable excuse' and the Courts: An Update (Lecture P820 – 13.20 minutes)

HMRC Guidance

There is no statutory definition for the term 'reasonable excuse' and we therefore need to look to HMRC guidance and case law. HMRC interpret reasonable excuse as an 'unforeseeable or unusual event' that is 'beyond the person's control' which may prevent them from complying with an obligation. Examples may include:

- bereavement
- serious illness
- IT systems failure

When deciding if the defence of reasonable excuse applies, it is important to look at the individual circumstances, as HMRC will decide each case on its own merits. Furthermore, it is important to show that the taxpayer corrected the failing as soon as the excuse ended. The onus is on taxpayer to satisfy HMRC that they have a reasonable excuse and have acted in the 'same way as someone who seriously intends to honour their tax liabilities would act' (*B&J Shopfitting Services v Commissioners for HMRC UKFTT 78 [2010]*). HMRC will not accept the same 'reasonable excuse' more than once and the guidance specifically states that the following are not reasonable excuses:

- pressure of work
- ignorance of basic law
- absence of reminders from HMRC
- reliance on an accountant or other professional

Furthermore, personal circumstances are not considered a reasonable excuse unless they directly affect the taxpayer's ability to pay.

Recent Cases

David Wake-Walker Limited v Commissioners for HMRC [2013] UKFTT 717

The taxpayer filed a tax return but HMRC did not receive it and therefore issued a penalty notice. The company contested the penalty advising that the return had been filed, printed off and filed. The HMRC log substantiated that the online system had been accessed. The Tribunal did not rule on whether or not the return had been filed, but whether the taxpayer had an honest belief that it had done so. It was decided that an honest belief was held and this constituted a reasonable excuse. The Tribunal also found that HMRC had failed to discharge the onus of proving that the return had not been filed. The appeal was upheld.

Access Solutions Scaffolding Ltd v Commissioners for HMRC [2013] UKFTT 748

A penalty notice was issued for late payment of PAYE. The taxpayer contended reasonable excuse on the grounds that the companyhad moved premises during the relevant year and that the long-term illness of the director's mother, together with the director himself undergoing surgery, had caused significant disruption to the business. The personal circumstances of the director and his family led to delays with chasing debtors, thus causing a cash flow problem and the subsequent late payment of tax. The tribunal decided that while the circumstances were unfortunate, they were not exceptional and that cash flow problems are a regular business occurrence. The appeal was dismissed.

Hirst Kidd &Rennie Ltd v Commissioners for HMRC [2013] UKFTT 703

The taxpayer made late payments of PAYE in every month for the 2011/12 year. A 4% penalty was imposed in line with the 'new' penalty regime introduced by Schedule 56 FA 2009. The taxpayer argued that no warnings had been issued by HMRC regarding the penalties, despite regular contact. The Tribunal decided that the penalties had been calculated correctly and there was no obligation on the part HMRC to provide warnings, on the basis that the new penalty regime had been widely publicised. The appeal was dismissed.

Ian Bond v Commissioners for HMRC [2013] UKFTT 761

The taxpayer failed to pay his full Self Assessment liability on time and received a late payment penalty. He contended reasonable excuse on the grounds that he was not able to meet the liability as he was awaiting outstanding payments which contributed around 97% of his income. The taxpayer had also been ill for a prolonged period and this had impacted significantly on his business, for which he was solely responsible. The Tribunal decided that Insufficiency of funds is not a reasonable excuse unless it is attributable to events outside the taxpayer’s control. However, it was decided that the taxpayer’s illness constituted a reasonable excuse as it could be shown to have had an effect on the hisability to make payments (e.g. affecting his mental state).

Advice to clients

As with all tax matters, it is key to maintain as much of an audit trail as possible, in the event that evidence is required to show that a taxpayer is fulfilling their self-assessment obligations. Below are some practical tips that may assist in making a claim for reasonable excuse:

- retain copies of submission confirmations received via HMRC’s on-line filing
- retain copies of any error messages and the time/date (e.g. by using print screen)
- retain file copies of cover letters if submitting paper returns
- correct the failure as soon as the excuse ends, even if after the due filing date
- ensure that all relevant occurrences are documented as soon as possible after the date if not at the time they occur
- obtain professional certificates where relevant e.g. doctor’s certificates etc.

Finally, it is important to remember that the Tribunal does not have the jurisdiction to change penalties on the basis of *unfairness*, following the Hok case. The Tribunal can change penalties on the basis of the reasonableness of the excuse, but they cannot override statute or impose penalties that HMRC cannot.

Contributed by Paul Howard of Gabelle LLP

Reasonable excuse

The taxpayer appealed against a penalty for the late filing of his self-assessment return. His accountant had written to HMRC on 5 April 2013. The letter included the following: 'The late filing penalty was applied as a result of the SA100, which was filed electronically on 25th January, in some way not reaching the HMRC computer. As we explained in our letter of 11 March we have no explanation for it but it happened to five of our clients which were all filed on the same day but at different times.'

HMRC did not accept the accountant's explanation, even when it informed HMRC that the late filing penalty imposed on the other four clients had been quashed. HMRC would not explain what distinguished the appellant from the other four taxpayers whilst, in the view of the tribunal, it would have been possible to do so 'without offending the principles of confidentiality'.

Decision:

The tribunal concluded that, 'in the interests of fairness and of being even handed' the appeal should be allowed and the penalty quashed.

Comments - This is a fine example of an HMRC officer refusing to accept the obvious. Although the amount at stake was small, the taxpayer was clearly right to appeal. He was, of course, very fortunate to be able to show that the computer failure had affected other taxpayers in the same way.

Suchant J Varma v HMRC TC3147

Penalties stand because of lack of reasonable excuse

The taxpayer was late paying its PAYE and National Insurance over the period June 2011 to February 2012. The finance director of the company said it had a reasonable excuse for the delays. HMRC had often allowed it extensions of time for making payments in the past, and had more recently made similar allowances.

The director admitted that if he had realised penalties would be imposed for late payment, he would have arranged for the sums to be paid on time. The First-tier Tribunal said this in effect precluded any excuse based on an unexpected event causing an inability to pay.

Other excuses put forward by the company were cashflow problems, overlooking the fact that payment was due, and an employee's holiday.

Decision:

None of these amounted to a reasonable excuse according to the tribunal.

The taxpayer's appeal was dismissed.

Comments – This is a case where clearly the taxpayer could have avoided the penalties by making the payments on time but other matters appeared to take priority and the taxpayer was basing his rationale on the previous methodology of HMRC which would not be applicable since the regime had changed. The others reasons that were put forward were clearly never going to amount to a reasonable excuse.

Crownfold Ltd TC3079

No reasonable excuse

The taxpayer was issued a notice to file a self-assessment tax return for 2010/11 on 6 April 2011. She submitted the return online on 11 October 2011, but did not pay the tax due until 6 March 2012. As a result, HMRC imposed a surcharge at 5% of the outstanding tax.

The taxpayer appealed saying she had not been told, either by HMRC or her adviser, how much tax to pay. She claimed that previously she had always paid on time, having received advance notice from HMRC of the amount due. On this occasion, neither she nor her agent had received a notification of what to pay from HMRC.

HMRC said that the agent would have been automatically sent a calculation of the tax due for 2010/11 on receipt of the tax return. Furthermore, the agent would have been able to check the taxpayer's self-assessment record to check the amount to be paid. There was no need to rely on HMRC to issue a statement to the taxpayer herself.

Decision:

The First-tier Tribunal said that, given the taxpayer had been in self assessment since 1996, she would be aware of when she had to pay the tax. She should have asked her agent or HMRC to ascertain what was due.

The taxpayer's appeal was dismissed.

Comments – It seems almost unbelievable that a taxpayer could advance the argument that they needed to be informed by HMRC of the tax due since her adviser should have done so and the taxpayer had been in the self assessment regime since 1996. Accordingly the tribunal gave the taxpayer short shrift and the appeal was dismissed.

E N Jones TC3085

Reasonable excuse and special circumstances explaining late payment of tax

The taxpayer had been imposed a penalty for late payment of tax. His contention was that HMRC had not provided him with a statement of the tax due in time for him to pay the tax within the deadline.

Mr Seaborn had submitted his tax return without information relating to the disposal of shares in a company, as this information had not been finalised by his accountant (despite his repeated chasing). As soon as the information had been ready, Mr Seaborn had forwarded it to HMRC, indicating that it should be added to his return. Having received an assessment for 50p of tax, Mr Seaborn waited for a second assessment reflecting the additional information he had supplied. He never received it and so did not pay the tax.

Mr Seaborn claimed that he had a reasonable excuse as HMRC had been under the obligation to recalculate the tax due.

Decision:

Judge Charles Hellier disagreed, noting that TMA 1970 s 9(3) only requires HMRC to compute tax due when a return is made before 31 October, but that it imposes no such obligation in relation to amendments. He added that the reason for the taxpayer's failure was his ignorance of his obligation to pay the tax, which did not constitute a reasonable excuse.

The tribunal, however, added that in failing to consider the possibility of a reduction of the penalty for special circumstances (TMA 1970 Sch 56 para 9), HMRC's discretion had been flawed, so the tribunal was at liberty to reduce the penalty. Although Mr Seaborn was not 'above criticism', HMRC had erred in accepting the first and incomplete tax return and should have requested the re-submission of a return which would have led to the expected calculation of the tax. These circumstances were 'out of the ordinary' and had led to an unfair result. The tribunal therefore reduced the penalty by 20%.

Comments - Taxpayers in default frequently invoke 'reasonable excuse' but not 'special circumstances'. This case shows that the scope of the two concepts — although it may overlap — is not the same.

George Seaborn v HMRC TC3226

Closure notice

The tribunal had to decide whether HMRC should be directed to issue a closure notice, thereby ending an enquiry into a taxpayer's return which had been ongoing for two and a half years.

Decision:

The tribunal noted that Mr Khan's business was substantial; he managed a portfolio of 22 properties producing an annual rental income of £335,000. Mr Khan must therefore have had the skills and available resources to produce records of his business, yet his disclosures had not been adequate or timely. However, the tribunal also accepted that the length of the enquiry was also due to poor administration by HMRC and the probable mishandling of the taxpayer's documents. The tribunal concluded that HMRC must not be forced to close an enquiry when significant information still needed to be provided but that imposing a long stop date (of nine months from the decision) would not cause any ultimate prejudice, as the taxpayer could appeal HMRC's closure notice.

Comments - This was an unusual case in which both parties were partly responsible for the delays in the enquiry. The imposition of a long stop date in such circumstances comes across as fair and may become a precedent.

Assan Khan v HMRC TC3159

Sentencing for conspiracy to cheat the public revenue

The trial judge had sentenced each of the defendants (found guilty of MTIC fraud) for the offence of conspiring to cheat the public revenue. Dosanjh received a sentence of 15 years' imprisonment; the other two defendants received sentences of 11 and nine years.

The appellants had been convicted of conspiracy to commit the common law offence of cheating the public revenue. Had they been convicted of statutory fraud or VAT offences, they would have been liable to maximum penalties of ten and seven years respectively. They therefore argued that it was wrong in principle to pass a sentence on a common law conspiracy that was longer than the maximum penalty available for the equivalent statutory offence. The tribunal disagreed, noting that Parliament had created statutory offences of fraud and conspiracy to defraud to which maximum penalties apply, but that it had also expressly retained the common law offence of cheating the revenue. This was because major frauds on the revenue are offences of 'particular seriousness'. They represent a high cost to the public and not therefore 'victimless' offences.

The defendants also contended that the sentences imposed were too high compared with statutory offences, previous decisions of the court and the draft guidelines of the Sentencing Council. Here, the court agreed that the sentencing judge had chosen too high a starting point for Dosanjh, as a result of placing too much reliance on Randhawa [2012] EWCA Crim. The main organisers in Randhawa had a much higher level of criminality, which included money laundering and deception — offences which were not in point in the present case.

The court concluded that the sentence of 15 years imposed upon Dosanjh was too high and reduced it to 13 years. The other two sentences were therefore reduced to ten and eight years.

Comments - The defendants were all of 'previous good character' and were all in their thirties, yet the court showed no leniency, only marginally reducing the sentences.

Dosanjh & Others v HMRC 2012/4167

Want of proof to validate reasonable excuse

The taxpayer received a penalty because its 2010/11 P35 was not submitted on time.

The director of the company said he had asked a friend to file the form and that he only became aware that the return had not been received when the penalty was imposed in September. He said the tax had been paid on time and the filing of the P35 did not affect that. He admitted that he did not look for an acknowledgement that the return had been filed, but both he and his friend believed it had been filed successfully.

HMRC said there was no evidence to show the return had been submitted by the due date.

Decision:

The First-tier Tribunal concluded that there was no reasonable excuse in this instance. The director and his friend were "entirely credible and responsible witnesses" but they could not produce evidence that confirmed receipt of the P35 by the due date.

The taxpayer's appeal was dismissed.

Comments – The result is self explanatory as described by the FTT. Reliance on the friend was not sufficient. The Tribunal commented that the director and his friend were "entirely credible and responsible witnesses" but they could not produce evidence that confirmed receipt of the P35 by the due date. At the end of the day their appeal was bound to fail.

Michael Young Plumbing & Heating Engineers Ltd TC3090

Application to allow appeal out of time

The tribunal had to decide whether to allow HMRC's application to appeal out of time.

HMRC had lodged its appeal 56 days late. This was the result of an administrative error; the email informing HMRC that permission to appeal had been granted had been overlooked.

Decision:

The tribunal rejected HMRC's contention that because HMRC had been granted permission to appeal, and the delay was quite short, it would be unfair to deny HMRC's application. The tribunal also relied on Andrew Mitchell MP v News Group Newspapers Ltd [2013] EWCA Civ 1537 as authority for the proposition that the factors in the 'old' CPR 3.9 should not be considered as a 'checklist' of issues which must be considered, but rather as a 'useful aid' to ensure that all relevant issues are taken into account.

Interestingly, the tribunal noted that HMRC's application would have been granted on the basis of the 'old' CPR 3.9. The facts that HMRC had reacted promptly on discovering the oversight and did not persistently overlook time limits would have weighed in HMRC's favour.

Comments - The case clarifies the relevance of the 'old' CPR 3.9. It is also interesting that the tribunal found against HMRC. After all, the delay was reasonably short and had been caused by the sick leave of a member of staff.

HMRC v McCarthy & Stone PTA/345/2013

RTI Update (Lecture B816 – 11.03 minutes)

Penalties

The draft secondary legislation finalising the penalty regime was released for comment in December. It is expected that the final version will be agreed by the Budget with changes unlikely.

Late filing penalties

There will be a late filing penalty for each tax month in which the Full Payment Submission is submitted late. If there are multiple FPS's in a month then only one penalty can be levied. There will not be a penalty for the first default in the tax year. (FA 2009 Sch 55 as introduced by FA 2013, Sch 50).

The amount of the penalty is to be set by this new legislation at:

- £100 for schemes with 1 – 9 employees

- £200 for schemes with 10 – 49 employees
- £300 for schemes with 50 – 249 employees, and
- £400 for schemes with 250 or more employees.

The new regulations also disapply the single unpenalised default for annual schemes, which are defined as a scheme which for the relevant year:

- All employees are paid annually
- All the employees are paid on the same date, and
- The employer is only required to pay HMRC annually.

There is also a provision to set an “initial period”. This is the period allowed for new employers to file their first FPS after first making a payment to an employee. The period is to be set at 30 days. This will still therefore require new employers to act swiftly to set up a PAYE scheme and obtain the necessary online ID and activation code to avoid late filing penalties.

Note that the legislation treats as a new employer any employer who is first required to make a return for these purposes, so this will also apply to an employer who has had employees but none of whom required to be reported on a FPS.

Late payment penalties

Late payment penalties will be issued in a respect of a tax month or quarter where the amount due is not paid by the due date. Once again, the first late payment is not penalised. (FA 2009, Sch 56 as introduced by FA 2013, Sch 50).

There is a tolerance for late payment or underpayment, which is set by the Regulations as £100, so that small differences in rounding etc will not trigger a penalty. If an employer underpays by no more than £100 then that is not treated as a default for penalty purposes. The payment tolerance will also apply to contractor-only schemes.

There is also a technical amendment to ensure that the penalties apply to NIC as well as tax due, and that the £100 applies to the total due to HMRC in the month or quarter, not each item of tax or NIC etc.

Relaxation for small employers

After much negotiation and lobbying, HMRC announced a relaxation to the on or before rule for very small employers. The current easement for employers with fewer than 50 employees will end on 5 April 2014 as planned, but a new easement for employers with fewer than 10 staff will commence at that point. From April 2014 until April 2016, existing employers with nine or fewer employees may report payments ‘on or before’ the last pay day of the month.

This additional easement will not be available to new employers who will have to comply with the on or before rule from the outset (subject to the 30 day initial period).

Employer payment summaries

This type of submission is made in more than one situation, and the timing and detail on the submission determines when the data appears on the Business Tax Dashboard (otherwise known as the Liabilities and Payments Viewer).

There are three types of EPS:

1. A period of inactivity or "no payments" EPS
2. A "financial EPS", which adjusts the amount due to HMRC as shown by the FPS submitted; these fall into three types:
    - Recovery of statutory payments such as SSP or SMP;
    - Limited company subcontractors offsetting CIS suffered against PAYE / NIC due,
    - Claims for regional NIC holiday (coming to an end now)
3. "End of year" (EOY) or "final" EPS.

Period of inactivity or no payments FPS

These will be allocated to the correct month only if submitted in the correct period. Otherwise there is a risk that the EPS will show in the incorrect period.

A no payments in the month EPS must be submitted after the end of the tax month it relates to, but by the end of the period allowed for payment – i.e. between 6th and 19th following the tax month it relates to. From April 2014 it is hoped that this can be submitted within the tax month.

A period of inactivity EPS must be submitted before the tax month in which the employer is inactive commences. So to report inactivity for the two tax months ended 5 January 2014, the EPS must be filed before 6 November.

Financial EPS

In order for a financial EPS to be allocated against the correct month, reducing the payment due accordingly and avoiding the possibility of a late filing penalty, the following dates should be followed:

- Submit between 20th and 5th of the month to which it relates (both dates inclusive) for it to be allocated against the current month, or
- Submit between 6th and 19th (inclusive) to be allocated to the previous tax month.

This gives the following table of submission dates for financial EPS:

Period financial EPS sent	Adjustment allocated against the payment due on	Tax month
Up to 19 May	19/22 May	1
20 May to 19 Jun	19/22 June	2
20 Jun to 19 Jul	19/22 July	3
20 Jul to 19 Aug	19/22 August	4
20 Aug to 19 Sep	19/22 September	5
20 Sep to 19 Oct	19/22 October	6

20 Oct to 19 Nov	19/22 November	7
20 Nov to 19 Dec	19/22 December	8
20 Dec to 19 Jan	19/22 January	9
20 Jan to 19 Feb	19/22 February	10
20 Feb to 19 Mar	19/22 March	11
On or after 20 Mar	19/22 April	12

End of year EPS

This should be submitted after all of the FPS and any other RTI returns have been submitted, and ideally by 19 April, although there is technically no deadline for it, provided the payroll software is set to the correct tax year.

It is also possible to make the year end declarations on an FPS using some payroll software, and in this case, no EOY EPS will be necessary.

Updates to the Business Tax Dashboard

In addition to the above information, the employer should be aware that the BTD (otherwise known as the Liabilities and Payments viewer(LPV)) is updated as follows:

- EPS submitted between 20th and 5th inclusive of the tax month appears on BTD by 12th of the following tax month
- EPS submitted between 6th and 12th inclusive of the tax month appears on BTD by 14th of the current tax month, and
- EPS submitted between 13th and 19th inclusive of the tax month appears on BTD within two days of receipt.

Note that the months shown on BTD are the month in which payment is due, not the month in respect of which payment is due, so month 1 liability is actually the liability for the previous year month 12.

Mis-matched liabilities and payments

There have been a number of scenarios in which HMRC's systems show amounts due in excess of the amount regarded as due by the employer. These are frequently due to duplicate employees on HMRC's system for various reasons.

There is currently a joint team of payroll specialists from the profession and HMRC staff working to resolve the worst of these problems. HMRC's website includes an announcement regarding incorrect BTD entries for months 9 and 10, again due to duplicate employees. Work in this area continues.

End of year process

At the end of the tax year, employers should submit the final FPS and/or EPS for the pay period as normal - on or before the date of payment. Most employers will therefore send the final FPS on or before the last payday in the tax year, which ends on 5 April.

The employer must also indicate on the last FPS or EPS for the year that:

- it is the 'Final submission for the tax year'
- answer the end-of-year questions and declaration, which previously appeared on form P35.

Employers must do this even if they have not made any deductions of PAYE tax or NICs from employees in that pay period.

More than one payroll for the PAYE scheme

The final submission must cover the whole PAYE scheme. Where a PAYE scheme covers more than one payroll, for example for weekly and monthly payrolls, the last submission indicator must only be used for the very last submission of the year – so all of the other pay interval must be complete. If the timing of submission of multiple FPS is unclear the employer can use an EPS to report the 'Final submission for the tax year', and answer the questions, after all FPS have been successfully submitted.

Final submission sent early

Where final payments to employees are made in, say, tax month 10 and so the employer indicates on that FPS that it is the 'Final submission for the tax year' and answer the end-of-year questions and declaration, the employer must still submit an EPS by completing the 'No payment dates' or 'Period of inactivity' fields to show that they won't be sending an FPS for tax months 11 and 12.
Final submission: final submission indicator omitted

Where the final FPS or EPS for the year has been submitted, but the employer has not indicated that this is the 'Final submission for the tax year', they must submit an EPS indicating that it is the 'Final submission for the tax year', and must complete the end-of-year questions and declaration.

No payments in final pay period

If there are no payments to employees in the final pay period for the tax year then the employer is not required to submit an FPS. Instead they must submit an EPS, by 19 April following the end of the tax year, indicating the following:

'No Payment For Period' or 'Period of inactivity'
'Final Submission for the tax year' - answer the end-of-year questions and declaration

Corrections after the end of year submission has been made

Where the employer needs to correct submissions made in the previous tax year and after the final EOY submission has been made, they will have to do so by submitting an “earlier year update” (EYU). This is filed where the final submission for the year has already been made or the error is discovered after 19 April. The amounts reported should be the difference between the previous cumulative figures and the correct amounts.

Contributed by Rebecca Benneyworth

Business Taxation

Travel and subsistence expenses for self-employed (Lecture B818 – 12.06 minutes)

Unlike employees there are no specific legislative provisions for the self-employed and their travel, subsistence and accommodation costs.

Therefore, to be deductible, the expenditure must be wholly and exclusively incurred in the course of the trade. It may be possible to apportion a part business/part private journey but HMRC commonly resists this (despite it being specifically permitted by s34(2) ITTOIA).

While all business travel is allowed for tax, HMRC has long been prepared to allow tax relief on the travel, subsistence and accommodation expenses of anyone in an 'itinerant' trade or profession.

Unfortunately there is uncertainty over what trades or professions HMRC considers to be itinerant so each case has to be determined according to its merits. Past cases seem to indicate that only those engaged in construction trades are treated as truly itinerant and even then not in all cases.

Generally, the cost of food, drink and accommodation paid for by a trader is not generally incurred wholly and exclusively for the purposes of the trade, since everyone must eat in order to live.

Such costs are (either wholly or partly) normal costs of living incurred by all and not for the purposes of trading. Where these costs are disallowable they cannot be apportioned to allow extra costs incurred from the necessity of lunching away from home or the place of business because there is no identifiable part or proportion of the expense which is incurred wholly and exclusively for trade purposes.

Deduction is allowed for reasonable expenses on food and drink for consumption by the trader either at a place to which he travels in the course of the trade or while travelling in the course of the trade, if certain conditions are satisfied.

The cost of travelling to the place must be deductible (or would be if the trader incurred any such costs) and either:

1. the trade is an itinerant trade at the time the expenses are incurred; or
2. the trader does not travel to the place more than occasionally in the course of the trade and either:
   - the travel concerned is not part of the trader's normal pattern of travel in the course of the trade; or
   - the trader does not have such a normal pattern of travel

Where a business trip by a trader necessitates one or more nights away from home, the hotel accommodation and reasonable costs of overnight subsistence are deductible.

This does not extend to overnight accommodation and subsistence at the base of trade operations, even if there is a contractual requirement for the trader to reside in a particular place.

The reasonable costs of meals taken in conjunction with overnight accommodation are allowable, whether or not paid on the same bill.

This principle is extended to traders who do not use hotels, for example, self-employed long distance lorry drivers who spend the night in their cabs rather than take overnight accommodation.

Contributed by Malcolm Greenbaum

Dr Samadian - Deductibility of travel expenses

The issue was the deductibility of travel expenses incurred by a consultant geriatrician.

Dr Samadian worked in full-time employment at two NHS hospitals. He also maintained a private practice as a self-employed medical practitioner, for which he maintained an office at home and rented consulting rooms at private hospitals. The appeal concerned the deductibility of expenses on travels between: the NHS hospitals and the private hospitals; his home and the private hospitals; and the NHS hospitals and patients' homes for home visits. Under ITTOIA2005 s 34, those expenses could only be deductible if they were incurred 'wholly and exclusively' for the purpose of Dr Samadian's profession.

Decision:

The tribunal accepted that the taxpayer's home office was a place of business and so travels between his home and other places of business could be deductible if the s 34 test was satisfied. However, such travels had a mixed purpose; part of their object was to maintain a private residence away from his place of work. Consequently, applying Mallalieu v Drummond ([1983] STC 665), the expenses were not deductible. In relation to travels between the NHS hospitals and the rented consulting rooms, the tribunal held that these were not travels in the course of business, but rather travels to the place where the business is carried on. Consequently, expenses incurred in those travels were not deductible. Expenses incurred on home visits to patients were however deductible.

Comments - The case law on the deductibility of travel expenses is not always easy to apply to situations where the taxpayer has several places of business. This case will therefore be a useful reference in such circumstances. This case highlights the difficulties faced by self-employed taxpayers in deciding which travel costs are deductible in computing their profits and which are not. Given the increasing numbers of people working both at home and at other places of work the decision is bad news for many taxpayers.

We know from the OTS's Review of employee benefits and expenses interim report which was published in August 2013 that it is looking at changes to the travel and subsistence expense rules for employees because of significant changes to working patterns over the last 15 years. It would also appear to be a good opportunity to look at the rules applying to self-employed workers because they have seen similar changes to working patterns.

Dr Samadian v HMRC (FTC/53/2013

To support the decision and provide advice going forward, the Upper Tribunal provided a summary of categories for treating travel expenses as deductible or non-deductible, which in its view, would 'attract broad public acceptance':

- Travel expenses are treated as deductible in relation to itinerant work (such as Dr Samadian's home visits to patients).
- Travel expenses for journeys between places of business for purely business purposes are treated as deductible.
- Travel expenses for journeys between home (even where the home is used as a place of business) and places of business are treated as non-deductible (other than in very exceptional circumstances, such as if Dr Samadian is at one of the private hospitals preparing to see a patient, he realises he needs his notes on the patient which are located in his office at home so he makes a special trip to go home to collect the notes, and immediately returns to the hospital to see the patient).
- Travel expenses for journeys between a location which is not a place of business and a location which is a place of business are not deductible.

Partnerships with Company Members – Loan Relationships

The draft Finance Bill legislation issued on 10 December included aspects of partnership anti-avoidance legislation. A further announcement has been made in respect of other new legislation relating to partnerships.

Legislation will be introduced in Finance Bill 2014 to amend the rules that apply to partnerships with company members. The changes will consolidate the loan relationships rules in Part 5 CTA 2009 that apply to such partnerships, and establish a general principle that all the rules that apply in relation to companies that are party to loan relationships also apply to corporate partners in firms that are party to loan relationships.

The current rules for calculating the profits of the partners treat each one as having done everything done by the partnership, with the partner taxed on a share of the resulting profit or loss. This is determined by the profit sharing ratio for the period. HMRC's concern was that this allowed considerable scope for the partners to agree between themselves how the profits should be apportioned.

The new rules determine that a corporate partner in a firm is party to a loan relationship held by the firm, to the extent of its share of the firm's debts. The loan relationships rules will then have effect as if each partner is party to the debt held by the firm, and stands in the firm's shoes as respects any money debt or other property, rights, liabilities or powers of the firm, to the extent of that partner's 'appropriate share'. Anything done by or in relation to the firm is treated as if it were done by or in relation to the company partner, or where that matter can be apportioned, by the company partner to the extent of its 'appropriate share'. The effect is that all the loan relationship rules in Part 5 apply to a company partner in the same way as they do to any other company.

The normal rules for calculating the corporation tax profits and losses of a company partner in s.1259 CTA 2009 (firm's profits calculated on corporation tax principles if there is a corporate partner) will be disapplied. Where a company partner is treated as having a loan relationship, the company partner's credits and debits will be based on its share of the firm's profits and losses, and the operation of other rules will similarly be based on the firm's accounts. An example: foreign exchange gains and losses arising to a company partner will be determined in accordance with the firm's functional currency.

These provisions apply even where their consequence is that the company partner is counterparty to itself. This will be the case, for example, where a company lends money to a firm in which it is a partner, and is treated as party to a share of that debt by virtue of the principle that each partner stands in the firm's shoes to the extent of its appropriate share. Where there is lending between a partnership and one of its partners the new rules mean that, in most cases, Part 5 will apply as if there were lending between that partner and each of the partners individually, and as if the amount of the lending in each case were the appropriate share of the actual lending. Where the rules result in a company partner being a creditor and debtor to the same loan relationship (which will be the position where the company partner is the one lending to or borrowing from the firm), that relationship is treated as a connected companies relationship. The rules in Part 5 that apply to such loan relationships, including the requirement to use the amortised cost basis of accounting and the exclusion of debits and credits relating to impairment and releases, therefore apply to company partner's share of the firm's debt.

The changes will operate from the date of Royal Assent of the Finance Bill.

Also, legislation will be introduced in the Finance Bill to enhance existing the anti-avoidance provisions at s.492 CTA 09 to prevent abuse of the 'bond fund' rules. These rules apply to corporate investors with holdings in open ended investment companies, unit trusts, or offshore funds that are treated as creditor relationship rights.

Calculation of business profits by HMRC

HMRC had enquired into a partnership return and issued a closure notice dramatically increasing profits. Relying on the presumption of continuity, HMRC had also increased the profits for the following four years by the same percentage.

Decision:

The tribunal reviewed the calculation of the profits made by the partnership, a small takeaway business, and concluded that the profit increase suggested by HMRC was not substantiated. It assumed an increased volume of sales which would not have been sustainable given the size of the premises and the number of staff. It also assumed a gross profit ratio far superior to the average achieved by similar businesses in the area — which would have made the cash injections by the partners unnecessary.

HMRC had criticised the taxpayer for failing to keep the till rolls. The duty to preserve records 'may be discharged by the preservation of the information contained in them' (TMA 1970 s 12B). As the daily sales had been recorded at the end of each day, the taxpayers had complied with their duties.

HMRC's key argument had been the unexplained deposits on the bank account of one of the partners. However, the partner was a gambler who was able to provide ample evidence of his gambling activities.

The tribunal concluded that the return had been correct. Consequently, under the principle of continuity, the later returns did not require amendment.

Comments - It is regrettable that the taxpayers were unable to convince HMRC of the accuracy of their profit calculations given the compelling evidence that was subsequently provided to the tribunal. It may be that the proceedings could have been avoided, had the information been provided and articulated to HMRC at the time of the enquiry.

Mr Hugh Newell and Mrs Icilda Newell t/a Tanya's Takeaway v HMRC TC3120

Substitution permitted

HMRC opened an enquiry into the taxpayer's 2006/07 partnership return. W was a partner in the taxpayer and HMRC also opened an enquiry into his tax return in respect of a claim he made for relief losses. In June 2011, HMRC issued a closure notice in relation to the partnership return, denying a claim to first-year allowances. The taxpayer appealed but no progress was made with the appeal for some time.

In May 2013, W applied to continue the appeal in his name as a member of the taxpayer partnership. HMRC opposed the application, saying W had no authority to pursue the appeal on behalf of the taxpayer.

Decision:

The First-tier Tribunal noted that although other members of the partnership were happy for W to undertake the appeal, he had not been authorised to do so by the taxpayer. The tribunal said it did not have the power to grant the right of appeal to a person who did not have that statutory right. Furthermore, the tribunal disagreed that ITTOIA 2005, s 863(1)(b) gave W the authority to pursue the appeal, referring to Mr Justice Henderson's comment that limited liability partnerships and their members should not be treated as interchangeable.

However, previous case law, such as Sutherland & Partners v Barnes [1994] STC 387, found that “fairness and justice required that a taxpayer named in a joint assessment should himself have a right of appeal…”. This led the tribunal to conclude that a partner should also be able to ensure he pays the right amount of tax, regardless of whether the other partners wished to challenge an assessment. Therefore, W had a right of appeal against an amendment to the taxpayer's partnership return.

The tribunal decided it was “appropriate” to allow W to be substituted as the appellant, but said the taxpayer should be given another opportunity to pursue the appeal first.

Comments – It is important as part of the appeal process that the correct party is a party to the appeal and this is particularly true with a partnership. The substantive appeal in this case was dealt with albeit unsuccessfully as far as the partnership was concerned. However as the Tribunal highlighted the need for fairness for a party in a joint assessment and therefore allowed another opportunity.

MCashback Software 6 LLP TC3061

Bad debt relief

Mr White appealed against HMRC's refusal to give relief for bad debts owed by his father's company, M White Ltd, to Mr White and his skip businesses.

Decision:

Distinguishing Reid's Brewery Co v Male (3 TC 279 [1891] QB 1), the tribunal noted that in Reid, the brewery advanced monies to its customers to encourage them to continue to buy their alcohol from the brewery. The payments made by Mr White were different in that they were not necessary for the purposes of his skip businesses. Consequently, agreeing with HMRC, the tribunal found that the loans should be treated as capital, as Mr White was not carrying on the business of a moneylender or a bank and therefore the loans were not used wholly and exclusively for the purposes of Mr White's businesses.

Comments - Although the trader considered that the loans were in the best interest of his businesses viewed as a whole, the tribunal confirmed that each business has to be viewed individually when it comes to deductibility.

Jamie White v HMRC TC3186

New Tax Incentives For Employee Ownership Trusts (Lecture B819 – 11.28 minutes)

The proposal is that a number of tax reliefs/exemptions will apply on a disposal of a controlling interest in a trading company to a qualifying trust used as an indirect employee ownership structure. If the employer already has an EBT consideration is being given to how best to ensure that it can be used for this new relief without having to amend the trust deed or to resettle into a new trust.

Specifically the tax breaks will involve the following:

1. CGT relief on gains on disposal from 6 April 2014.

2. Exemption from income tax from 1 October 2014 for certain payments made to employees of the qualifying employee-owned company.

3. IHT exemption on the transfer of shares and other assets into the trust.

4. Corporation tax relief on payment of a relevant bonus.

Before considering the exact requirements, let us identify the likely non-tax issues:

- The controlling shareholders will in practice probably sell for less than market value.
- Funding by the trust of the purchase price, if not a gift.
- Are the shareholders happy to sell to their staff?
- Are the employees in fact likely to be able to run the business properly?
- Do the employees think they are capable of running the business?
- Will the shareholders need and/or want to remain actively involved with the company?
- What are the initial and continuing costs?

The Main Requirements

1. The company must be a trading company or the parent company of a trading group.

2. The trust acquiring the shares must operate for the benefit of all employees.

3. The trust must have a controlling interest in the company at the end of the tax year but not at the start.

4. Some participators are excluded from being beneficiaries of the trust.

5. The claimant must not have previously qualified for relief on the same company's shares.

The Income Tax Exemption

1. This involves exemption of a cash award, other than regular salary or wages, paid to all employees on equal terms.

2. Bonuses can be set by an employer by reference to a % of salary; length of service; or hours worked.

3. Annual cap of £3,600 per employee for each qualifying company.

Details From The Consultation On Draft Finance Bill Clauses

Schedule 1 proposes a new Section 236H TCGA 1992, with several definitions. There are essentially 5 relief requirements to be met:

1. The disposal must be by a person other than a company, of ordinary shares to an ***all-employee benefit settlement.***

2. The company must meetthe ***trading requirement*** at the time of the disposal and for the rest of the tax year.

3. The settlement must not meet the ***controlling interest*** requirement at the end of the tax year before the disposal to it, but must do so by the end of the tax year of disposal.

4. The ***limited participation*** requirement must be met.

5. In an earlier tax year there must have been no ***related disposal*** by the transferor or a person connected with him.

All-Employee Benefit Settlement

This applies if the terms of the settlement do not permit any of the following:

- The application of any of the settled property at any time otherwise than for the benefit of all the eligible employees on the same terms.
- The application by the trustees of any of the settled property at any time by creating a trust, or by transferring property to another trust.
- The making by the trustees of loans to beneficiaries of the trust at any time.

The trustees may, however, permit the following in respect of the trust's income and assets without the equality requirements being jeopardised:

- Apply it for the benefit of a surviving spouse, civil partner or dependant of an eligible employee who has died, for up to 12 months after death or such shorter period as the trust deed may provide. Then the recipient is treated as an eligible employee.
- Not apply it to individuals who have not been continuously employed by the company or group member for a minimum period (of no more than 12 months) preceding the payment.
- Not apply it to employees who have freely asked not to receive benefits.
- Apply it for charitable purposes.

Trading Requirement

The company must be a trading company or the principal company of a trading group.

This basically follows the Entrepreneurs' Relief tests which also apply for the purposes of the Substantial Shareholder Exemption for limited companies:

1. The activity test in para 22A SchA1 TCGA1992 applies, with the result that a trading company is a company *carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities.*

2. Trading activities are then defined as activities carried on by the company in the course of, or for the purposes of, a trade being carried on by it.

3. Trading group activities are defined as activities carried on by a member of the group in the course of, or for the purposes of, a trade being carried on by any member of the group.

4. In practice (but not in law) the EIS test will presumably apply, as it does for entrepreneurs' relief in looking at whether or not outlawed activities are carried on to a substantial extent although of course there is no relevance to the type of trade as is the case with EIS. The test involves 20% of

the activities of the company as the maximum to be ignored, but the measure of this 20% test is problematical.

Controlling Interest Requirement

This applies if all of the following requirements are met:

- The trustees own over 50% of the ordinary share capital, and have voting powers on all questions affecting the company as a whole which, if exercised, would yield a majority of the voting rights.
- The trustees are entitled to over 50% of the profits available to distribute to the equity holders.
- On a winding up the trustees would be entitled to over 50% of the company's assets available for distribution to the equity holders.
- There are no provisions in existence affecting the company's constitution or management, or its shares or securities, whereby the above conditions can cease to be satisfied without the consent of the trustees.

Limited Participation Requirement

This applies if either the vendor has not been a participator in the company at any time in the 12 months after the disposal date, or the fraction NP/NE does not exceed 2/5 (= 40%).

NP is the sum of (a) the number of persons who immediately after the disposal are both participators and/or employees/office holders, plus (b) the number of other persons who are both employees of the company, or of a group member where appropriate, and are connected with persons within (a) above.

NE is the number of persons who at that time are employees of the company (or of a group member where appropriate).

For this purpose any participators not owning, or being entitled to acquire, 5% or more of the share capital are excluded.

Contributed by Gerry Hart

FRS 101 - Summary of the changes to the accounting standards

There currently exists a suite of accounting standards in the UK. Subject to certain restrictions detailed in the respective standards themselves, entities may choose or may be required to prepare their accounts under one of the following:

- EU endorsed IFRS/IAS: those accounts prepared in accordance with International Accounting Standards within the meaning of s395 of the Companies Act. Hereafter 'IAS' for the purposes of this paper.

- New UK GAAP: FRS 100, FRS 101 and FRS 102. Entities applying New UK GAAP will, within the framework of FRS 100, apply one of FRS 101 or FRS 102. FRS 101 is effectively the recognition and measurement requirements of IAS subject to some adjustments to ensure alignment with UK Companies Act and also reduced disclosure requirements. FRS 102 is a new suite of accounting requirements which are closely aligned to, but are not the same as, IFRS. Hereafter 'New UK GAAP' for purposes of this paper.

- Current UK GAAP: substantively the FRS's, SSAP's, UITF's and relevant accepted practice in existence and applied prior to the introduction of New UK GAAP. For purposes of this paper this is described as 'Current UK GAAP'. For the avoidance of doubt this paper includes FRS 26 (and related standards) within its meaning of Current UK GAAP unless otherwise stated. ▯ FRSSE: the Financial Reporting Standard for Smaller Entities. Entities that meet the eligibility criteria may prepare and file abbreviated accounts. ▯ Micro entities: Companies that meet the eligibility criteria may prepare and file abridged accounts.

For periods commencing on or after 1 January 2015 UK companies will not be permitted to prepare their accounts in accordance with Current UK GAAP. Instead entities which applied Current UK GAAP will need to transition from Current UK GAAP to one of the alternatives. It is expected that for many entities currently applying Current UK GAAP they will transition to one of FRS 101 or FRS 102.

For example: a large UK company may continue to prepare its 31 December 2014 accounts in accordance with Current UK GAAP. However, for its 31 December 2015 accounts it is no longer allowed to use Current UK GAAP. Instead it must choose to apply one of IAS, FRS 101 or FRS 102.

Transition to one of IAS, FRS 101 or FRS 102 will impact on the accounts in two key ways:

- Assets and liabilities at the accounting transition date will be identified, recognised and measured in line with the requirements of the new standards; and

- Thereafter profits and losses will be recognised in accordance with the new standards. These may differ from those profits and losses that would have been reported had Current UK GAAP been retained.

FRS 101 and FRS 102 - Interaction of these changes with tax

Tax legislation for companies requires that the profits of a trade are calculated in accordance with generally accepted accountancy practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes (section 46 Corporation Tax Act 2009). Similar rules exist in other parts of the tax legislation.

Generally accepted accountancy practice for corporation tax purposes is defined at section 1127 Corporation tax Act 2010 and is:

- UK Generally accepted accountancy practice – generally accepted accountancy practice in relation to accounts of UK companies (other than IAS accounts) that are intended to give a true and fair view or,
- In relation to a company that prepares IAS accounts means generally accepted accountancy practice in relation to IAS accounts

As noted above, the corporation tax treatment for companies relies heavily on the accounting treatment adopted in the company's accounts. With the introduction of IAS in 2004 / 2005, a number of changes were made to the tax legislation to deal with certain issues that arose for companies that transitioned to IAS in their entity accounts. In many cases, the effect of these rules is to provide tax treatment which is broadly equivalent to companies that continued to use the previous UK GAAP.

The changes made to the tax statute are not generally restricted to companies that have IAS accounts. So the rules will also apply to companies that have, for example, adopted FRS 26 with the result that derivative contracts have been fair valued. The rules are also likely to be relevant for companies which adopt FRS 101 and FRS 102 where they face similar issues to those encountered by companies adopting IAS.

Non-UK incorporated companies

It is possible for companies incorporated outside of the UK to be resident in the UK. In addition, the tax statute can require consideration of the application of generally accepted accounting practice to companies that are not resident in the UK (e.g. Controlled Foreign Companies).

In most cases the same statutory definition of generally accepted accounting practice applies. As such, where the company prepares IAS accounts, these will be used to calculate profits; and in other cases the profits will be calculated on the basis of UK GAAP (as it would be applicable for such a company).

Construction Industry Training Board (CITB) Levy deductions – change in practice

The CITB is an industrial training board responsible for promoting vocational training in the construction industry. It is empowered, by statute, to impose a levy on employers or contractors in the industry to fund its operations.

Many contractors seek to recoup this from their subcontractors in the form of a deduction made from the 'Gross amount of payment' shown on a contractors monthly return. Historically HMRC have accepted this practice and included it in their guidance.

HMRC have now reviewed the practice and concluded that it can no longer be supported as it is not a part of the current or past CIS legislation.

This change also has implications for VAT. Contractors will need to be aware that the value of the subcontractor's supply for VAT purposes will not be reduced by CITB levy deductions in the future.

This change will be effective from 6 April 2014. Contractors who use payroll software for CIS will need to ensure this is reflected in any new updates.

VAT

Lower green fees in sight

The taxpayer, Bridport and West Dorset Golf Club, was a private, non-profit-making golf club. For several years, the club accounted for VAT on its green fee income, i.e. fees paid by visiting non-members, but in 2009 it claimed a repayment of the VAT on the basis that these fees were exempt under article 132(1)(m) of the EC VAT directive.

Article 132(1)(m) requires member states to exempt “certain services closely linked to sport”. Articles 133 and 134 provide certain restrictions on the scope of this exemption. In the UK, VATA 1994, Sch 9 group 10 item 3 provides that, where the supplier operates a membership scheme, supplies to nonmembers are not exempt.

On the basis that the taxpayer fell into this category, HMRC rejected the claim.

The First-tier Tribunal allowed the taxpayer's appeal. HMRC appealed to the Upper Tribunal which *referred the matter to the Court of Justice of the EU for a preliminary ruling.*

Decision:

The court ruled that the exemption in article 132(1)(m) should apply to fees charged to visiting non-members, although the club was not obliged to pass on the saving to players. Thus the UK legislation was not compatible with the EU legislation.

Comments - The judgment confirms the view of KPMG, whose legal services team handled the litigation, that Sch 9 group 10 item 3, under which green fees paid by non-members were taxed at the standard rate of VAT was incorrect.

Gary Harley, head of indirect tax at KPMG in the UK, said: “Many non-profit-making golf clubs throughout the UK had lodged claims with HMRC for overpaid VAT on visitor green fees for periods in excess of nine years. I hope that the eventual repayments arising from this decision will enable additional investment to be made in their infrastructure and facilities to encourage participation in golf.” He added that “this is the first occasion that a big four firm has presented at a hearing at the CJEU”.

Billy Cairns, tax partner at BDO LLP, said: “The court's decision is potentially very good news for non-club golfers who may see the price of their round of golf fall, depending on how generous clubs are feeling. Golf clubs have always disagreed with HMRC over the distinction between members and non-members and have felt this contravened European law. The court's judgment upholds this view. Unless HMRC come up with a totally different argument, it looks like Bridport's appeal will be allowed and HMRC will have no choice but to repay VAT claims from clubs stretching back many years.”

Bridport and West Dorset Golf Club Ltd v CRC (C-495/12)

Penalties stand

In November 2012, HMRC imposed penalties on the taxpayer for the late filing of its quarterly EC sales lists for March and June 2012.

The taxpayer appealed claiming that the notices were issued without prior warning and, had HMRC issued a reminder in respect of the March return more promptly, it would have ensured the return for June would have been filed on time. The late filing was not intentional, rather "a mere oversight".

Decision:

The First-tier Tribunal said the obligation to file EC sales lists on time existed regardless of reminders from HMRC. The department's failure to charge the penalty for the late March return promptly could not constitute a reasonable excuse for the company's failure to submit the June return. Oversights were also not regarded as a reasonable excuse. HMRC had applied the legislation correctly and the penalties were confirmed.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: "Since 1 January 2010, EC sales lists must also be completed by a UK business that sells services to EU customers who are VAT registered. Many businesses and advisers have not appreciated this point and submitted late returns. Note that a penalty is not issued by HMRC until a penalty liability notice has been sent to encourage future compliance — in effect a lifeline that prevents a penalty for the first offence."

Xtreme Graphics Ltd TC3048

TOGC treatment where transferee trades only inside VAT group

The issue was whether the transfer of a business to a member of a VAT group could be a TOGC (transfer as a going concern outside the scope of VAT), where the transferee was to make supplies only to another member of the group.

Decision:

The tribunal accepted that the transferee intended to operate the business it acquired and that, therefore, but for the effect of the VAT group provisions, there would have been a TOGC. However, it insisted that VATA 1994 s 43 and (inter alia) the decision of the House of Lords in C&E Commrs v Thorn Materials Supply Ltd and another [1998] STC 725 made it clear that the purpose of VATA 1994 s 43 is to 'enable a group to be treated as if it were a single taxable entity, with only the representative member being treated as carrying on the businesses of the other members'. Consequently, the transferee did not make any supplies, its business had ceased and its acquisition of the business could not constitute a TOGC.

Comments - This seems to be the first case to decide whether a transfer of a business to a member of a VAT group which is only to make intra-group supplies can qualify as a TOGC. On the basis of the decision, such a transfer should probably be structured so that it is made to a company which is not a member of a VAT group. It can then join the group at a later stage.

Intelligent Managed Services Ltd v HMRC TC3119

Application of zero-rating to leaflets

The first issue was whether items printed by Hollinger were leaflets within VATA 1994 Sch 8 Group 3 and therefore zero-rated. The second issue was whether HMRC's decision to assess Hollinger could be set aside.

A HMRC officer had conducted a sample test over six months. He had identified several items which he thought should have been standard rated and which had been treated as zero-rated. Hollinger agreed with HMRC, except in relation to five items which were the object of the appeal.

Decision:

Referring to case law, the tribunal suggested that a leaflet is a small single sheet (or a few sheets attached together), containing information, advertising or propaganda designed to have a short useful life. The tribunal then applied the test to the five items — and found only one of the items to be a leaflet. In relation to a folder designed to hold leaflets, the tribunal found that it could not be part of a single supply of which the leaflet would have been the main part in the absence of evidence that it was part of a package.

Hollinger also claimed generally that HMRC should not have raised the assessment, arguing (inter alia) that it struggled financially, that many of the items were borderline so that its competitors may be treated differently and it was too late to recover most of the VAT from its customers.

The tribunal insisted that it could only decide whether HMRC's decision to assess was reasonable (not whether it was fair) and found that it was so.

The tribunal also rejected arguments relying on the Technip decision (VATD 19298). The unfairness in Technip had arisen because the intention of the legislation was that the taxpayer should have paid no VAT, whereas in the present case, the intention of the legislation was clearly for Hollinger to pay VAT.

Comments - Judge Charles Hellier's analysis of what constitutes a leaflet is sufficiently clear and generic to be relied upon by any practitioner wishing to rely on the zero-rating provisions. The decision also contains an exhaustive analysis of the powers of the tribunal to review HMRC's exercise of its discretion.

Hollinger Print Ltd v HMRC TC3117

Too much work

The taxpayer submitted its VAT return for the period 12/12 one day late. Because this was the business's third default, HMRC imposed a surcharge at 5% of the tax due. The director of the company explained that her daughter had fallen ill during a Christmas visit to her parents in Austria, and this meant she had to delay her return to London. On her return, she had to carry out a major project in relation to the Olympic site. This placed a lot of pressure on her because tight deadlines were involved and she had to work through January with little time off.

Decision:

The First-tier Tribunal decided the taxpayer had a reasonable excuse for the late filed return. The daughter's illness and subsequent delayed return from Austria, causing intense pressure to complete a work assignment, could not have been foreseen.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: “It is difficult to predict the outcome of 'reasonable excuse' cases in relation to default surcharges. A different chairman could easily have reached a different conclusion here, on the basis that the daughter was ill more than one month before the VAT return was due, and too much work has never really been an acceptable excuse. But good luck to the taxpayer in winning the case — it shows that it is worth having a go with an appeal if there are unusual circumstances in a particular period.”

Erect Architecture Ltd (TC3076)

VAT: time limit for repayment claim

The issue was whether a claim for repayment of VAT wrongly paid was time barred. The claim related to the payment of bonuses to purchasers of commercial vehicles, which amounted to reductions of the price paid.

The Sixth VAT Directive article 11C(1) provides for a retrospective adjustment to the taxable amount where there has been a price adjustment after the time of supply. The UK did not give effect to article 11(C) until 1 January 1990 in the 1989 regulations (SI 1989/2248, reg 7), superseded by the 1995 VAT regulations (SI 1995/2514, reg 38). Finally, FA 1989 s 24 (the precursor of VATA 1994 s 80) provided for a time limit for repayment claims, HMRC therefore argued that Iveco's claim was time-barred.

Decision:

The tribunal pointed out that the time limit in s 80 could only apply to Iveco if s 80 applied, and s 80 could only apply if Iveco had paid tax that was not due. This was not the case until Iveco had availed itself of the direct effect of article 11(C) in November 2011. Therefore, until then, there had been no basis 'for saying that the VAT accounted for by the taxable person was not “due”.'

The tribunal added that, 'applying normal domestic canons of construction', neither s 80 nor reg 38 would provide an appropriate remedy. However, the tribunal must interpret domestic legislation in conformity with Community law. The tribunal did so by applying reg 38, disregarding reg 38(5) (which imposes a time limit for claims). Iveco could therefore adjust its VAT account at any time.

Finally, the tribunal held that it had jurisdiction under VATA 1994 s 83(1)(b) to hear appeals on all questions relating to the chargeability of supplies of goods and services. This encompassed questions arising from the direct application of a VAT directive.

Comments - Although there have been many decisions on the application of VATA 1994 s 80, this case is unusual in that it turned on the interaction of the Sixth VAT Directive and the UK provisions. Interestingly, in this case, the taxpayer was able to benefit from the best of both.

Iveco v HMRC TC3141

VAT: reasonable excuse for late payment

The tribunal had to decide whether a taxpayer had a reasonable excuse for the late payment of VAT, in circumstances where it had been unaware that its direct debit to HMRC had been cancelled.

HMRC argued that, on submission of the electronic return, the company would not have received the usual message that the tax would be debited from its bank account by direct debit but, instead, a reminder to pay electronically. Furthermore, HMRC had sent a letter to the taxpayer informing it that its direct debit had been cancelled and, as this letter had not been received back, HMRC had assumed that the letter had been received.

Decision:

Relying on Total Technology Engineering Ltd [2011] UKFTT 473, the tribunal noted that it had no power of mitigation; however, if it considered the amount of the penalty wholly disproportionate to the gravity of the offence, it could discharge it. In this case, the tribunal did not think that the penalty was disproportionate.

The taxpayer insisted that it had changed address and was unaware of the cancellation of its direct debit. On the basis of various emails provided by HMRC and the taxpayer's bank, the tribunal concluded that it was likely that the direct debit had been cancelled by mistake by the taxpayer's bank.

Furthermore, the tribunal found that the computer acknowledgement of the VAT return would not have been sufficient to alert the taxpayer to the fact that its direct debit had been cancelled. The tribunal therefore concluded that the taxpayer had a reasonable excuse for the late payment.

Comments - This was clearly the right decision. One is left to wonder why, on review, HMRC did not accept the taxpayer's explanation for the delay.

Capital Coin Machine v HMRC TC 3144

VAT: validity of default surcharge when HMRC holds monies paid by mistake

A default surcharge had been imposed upon Graffiti Busters (GB) for late payment of VAT. GB had also paid HMRC in error under the CIS and these monies had not been refunded.

Interestingly, GB did not make a claim for restitution, nor did it claim the equitable right of set-off. Instead, it simply argued that the fact that HMRC held an equivalent amount of money without any statutory basis constituted a reasonable excuse for the late payment of VAT. The tribunal agreed with the company, and found that it had a reasonable excuse in relation to the monies already held by HMRC.

GB also contended that it fell within the Steptoe exception ([1992] STC 757). The case is authority for the proposition that the cause of insufficiency of funds may be a reasonable excuse — even though 'insufficiency of funds' is not in itself a reasonable excuse (VATA 1994 s 71(1)(a)). GB was struggling with cashflows. It had not been able to obtain further funds from the banks and had asked for help from family and friends. It had also repeatedly sought a refund of the monies paid to HMRC in error.

Decision:

Again, the tribunal agreed that GB had exercised 'reasonable foresight and due diligence' and had 'a proper regard for the fact that the tax would become due on a particular date' and that, therefore, it had established a reasonable excuse under Steptoe.

The tribunal allowed the appeal in part, applying the default surcharge only to the balance of unpaid VAT.

Comments - The case law on insufficiency of funds as a reasonable excuse for non-payment of tax remains confusing as it is often contradictory. That said, the fact that the tribunal was willing to apply the Steptoe exception is very good news for taxpayers.

Graffiti Busters Ltd v HMRC TC3201

Face value vouchers

The taxpayer sold vouchers entitling their holders to hot air balloon rides (and other related goods).

The vouchers did not show their cash value on their face as they were often bought as presents. The issue was therefore whether they could be 'face value vouchers'. If they were, unless they conferred an entitlement only to one category of goods or services, the normal time of supply rules were overridden, and taxable supplies would be made only when the vouchers were redeemed (VATA 1994 Sch 10A).

Decision:

On a purposive interpretation, the tribunal held that the vouchers were 'face value vouchers' and were not 'single purpose vouchers'. They entitled the holder to whatever services or goods he wished to acquire from Skyview, up to the cash value of the vouchers. Finally, as the cash amount was not printed on the vouchers, the tribunal had to decide whether 'it was recorded in it'. The tribunal noted that it was generally accepted that vouchers in the form of plastic cards, whose value could be ascertained by inserting the card into the retailer's terminal, were 'face value vouchers'. The tribunal considered that there was no reason to distinguish Skyview vouchers from plastic card vouchers, as the code printed on each Skyview voucher enabled Skyview to ascertain its value. The tribunal therefore held that VAT supplies occurred only when the vouchers were redeemed.

Comments - There have been many cases on the correct VAT treatment of vouchers. Interestingly, the success of its appeal increased Skyview's immediate VAT liability (a consequence it was well aware of) but improved the company's cashflows going forward.

Skyview Ballooning v HMRC TC3173

MTIC fraud: should the trader have known that the transactions were connected with fraud?

The UT had to consider an appeal against a decision of the FTT, holding that the taxpayer should have known that transactions he had entered into were connected with MTIC fraud.

The tribunal referred to the decisions of the CJEU in Kittel v État Belge (C-440/04) and of the Court of Appeal in Mobilx Ltd v HMRC [2010] EWCA Civ 517. The ultimate question was 'whether the trader should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected to fraudulent evasion of VAT'.

The main ground of appeal was that the FTT's decision had not been open to it on the evidence. The FTT had essentially relied on two facts: the transactions were 'too good to be true'; and the trader had undertaken insufficient due diligence. The tribunal agreed with the FTT that the basis on which the taxpayer had concluded that the high profits on the deals in question were normal for the grey market, was questionable.

Decision:

The tribunal also noted (inter alia) that the mobile phones were equipped with two-pin chargers, which made them unsuitable for the UK market, bringing into question the reason for their purchase by the taxpayer. As to the lack of due diligence, although it was not determinative, it was a factor which the FTT had been entitled to take into account. The appeal was dismissed.

Comments - Although there have been many decisions on MTIC fraud (particularly by the FTT), this decision contains a useful analysis of the relevant case law and applies it to the facts with welcome clarity.

Else Refining & Recycling v HMRC FTC/86/2012

Repayment claims: does the cut-off date infringe the EU principles?

The Court of Appeal had to decide whether FA 2005 s 3 — which had given HMRC the unjust enrichment defence against claims for repayment of VAT — infringed the EU principles of equal treatment and fiscal neutrality.

The appeal was on the basis that claims relating to the same period were treated differently, depending on whether they had been filed before or after FA 2005 s 3 came into force (the 'cut-off date').

Decision:

Lady Justice Arden noted that the principle of equal treatment requires that comparable situations be treated in the same way, unless the difference is objectively justified; whilst the principle of fiscal neutrality precludes unequal treatment of similar claims, where the difference in treatment leads to distortions in competition. She considered that Weber's Wine World (C-147/01) is authority for the proposition that a member state can, without infringing the equal treatment principle, introduce the unjust enrichment defence so that it applies to some only of the claimants for a prior period, namely those who have not filed their claims before the cut-off date.

In relation to the question of the similarity of claims made before and after the cut-off date, again, Lady Justice Arden found that in light of Weber's Wine World, such claims were not similar for the purposes of the principle of equal treatment.

Lord Justice Aikens and Lord Justice Vos, agreeing with Lady Justice Arden, insisted that the date of the claim for the repayment of the overpaid VAT is one of the 'essential characteristics' of the claim, so that claims made before and after the cut-off date were not similar. The appeal was dismissed.

Comments - Reed Employment is a branch of the now well-known judicial saga affecting repayment claims. Although the decision was eagerly expected, its outcome is not surprising.

Reed Employment v HMRC A3/2013/1413

Selling fixed assets – how much output tax? (Lecture B820 – 13.29 minutes)

It is tempting to think that if we sell a fixed asset owned by our business then we charge 20% VAT on the sale, unless the sale relates to a motor car, in which case it is sold without any VAT being charged. These assumptions apply in most cases, but there are situations when we might need to charge VAT on selling a motor car (e.g. because we are a driving school and claimed input tax when we initially purchased the vehicle) and in other situations, we can avoid or partly avoid charging output tax on the selling proceeds, perhaps because of an input tax block or apportionment when we first acquired it.

This session considers three practical examples on this issue.

Situation1 – John trades as a financial services adviser, so is partly exempt as far as VAT is concerned (ie some of his income is exempt from VAT and other income is taxable). He purchased a computer three *years ago and only claimed 50% input tax under the partial exemption standard method (residual input tax) because the item was used for both taxable and exempt activities. He is now selling the computer for £2,000 – how much output tax must he declare on his VAT return? He bought another computer at the same time and claimed no input tax because it wholly related to exempt use – how much output tax is due if he sells this item for £2,000?*

I know that accountants and advisers often look at tax and VAT according to the spirit of the law – and the natural reaction in the above situation will probably be: we only claimed 50% of the VAT when we bought the first computer so we only need to account for output tax on 50% of the selling proceeds i.e. £1,000 x 1/6 = £166.67. Unfortunately this is not correct, and the legislation (VATA1994, Sch 9, Group 14 – Supplies of goods where input tax cannot be recovered) only allows output tax to be avoided on the sale of the second computer i.e. where no input tax was claimed on the purchase because it wholly related to exempt activities. In such cases, the sale is exempt under Group 14. Unfortunately, if the seller has claimed the whole or a part of the amount of VAT as input tax on the original purchase of the asset, then the onward sale is standard rated in the normal way.

Situation 2 – Mike is a builder and bought a van for £5,000 plus VAT last year and only claimed input tax on 80% of the expense, he blocked the other 20% as being relevant to private use. He is now selling the van to another builder for £3,000 plus VAT – how much VAT should he charge on the sale?

Mike will want to ensure he does not overcharge VAT on the sale because it is possible the buyer might be a small builder who is not VAT registered and therefore unable to claim input tax. The good news is that the initial input tax block of 20% took this part of the van out of Mike's business completely, only leaving the other 80% in the picture. So the correct output tax charge is £480 i.e. £3,000 x 80% x 20%.

Situation 3 – Jean is an accountant (sole trader) and uses the flat rate scheme. She bought a car in 2010 and did not claim input tax on the purchase (correctly because the car was available for private use). She has claimed 80% of the vehicle expenditure on her self-assessment tax returns (capital allowances etc) and disallowed 20% for private use. She is now selling the car for £3,000. What is the VAT position on the sale?

A downside of the flat rate scheme is that it captures the proceeds of a car sale if the car was a business asset. Does this mean that a business asset is only relevant if a balance sheet is completed by the business and is not relevant to e.g. a sole trader who only completes a profit and loss account for self-assessment tax purposes? The answer is 'no' – the relevant issue being whether capital allowances have been claimed for the asset in question, or other costs to maintain or improve the performance of the asset in question. See Box 1 below, an extract from HMRC VAT Notice 733. The key point is the bottom sentence, namely that the sale of an asset where input tax was not claimed on the purchase of the asset is included in the flat rate turnover of the business. There is no partial exclusion for private use.

Answer: Jean is an accountant which means she will have a flat rate percentage of 14.5% for her business i.e. within the category of 'Accountancy or bookkeeping'. The VAT payable on her car sale is therefore £435 ie £3,000 x 14.5% and there is no reduction allowed for the 20% private use of the vehicle.

Note – as a separate observation, the final sentence in Box 2 uses the phrase ‘capital item’ – this is perhaps not the best wording because VAT enthusiasts think of a ‘capital item’ as being an asset that is within the capital goods scheme eg land and buildings costing over £250,000 excluding VAT; ships, boats, aircraft, computers costing at least £50,000 excluding VAT. That is not correct – the section at 15.9 applies to the sale of all capital goods by scheme users.

Box 1 – output tax on sale of capital goods – flat rate scheme user

15.9 Output tax due on disposal of capital expenditure goods
Where you have reclaimed input tax on capital expenditure goods then, when they are eventually sold out of the business, you must account for output tax at the appropriate VAT rate for the sale (not at the flat rate).

Example:
A business on the scheme buys a delivery van for £6,000 including VAT of £1,000 and it is not used for anything else. As the van is capital expenditure goods, VAT can be reclaimed. When the business later sells or part exchanges the van, say for £2,000, it must account for the VAT on this amount at 20 per cent, not at the flat rate.

Note: if you have not claimed input tax on capital items, either by choice or because it was not allowed, you must include the sale of those items in your flat rate turnover.

Contributed by Neil Warren