Tolley®CPD

March 2014

Disclaimer

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

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

Contents

Personal Tax **4**

Loan to employee 4
UK residence: full-time abroad? 4
Compensation payment under compromise agreement – Employment Income 5
Marketed loss scheme 6
Stock lending arrangements and manufactured dividends – Scheme fails 6
Loans and recommended medical treatment (Lecture P821 – 11.06 minutes) 7
Fixed Protection 2014 and Individual Protection 2014 8
Official rate of interest 9

Capital Taxes **10**

CGT: allowable expenditure 10
Entrepreneurs' relief on business premises 10
PPR relief – how important is the taxpayer's intention? (Lecture P822 – 19.29 minutes) 11
IHT Developments (Lecture P823 – 16.39 minutes) 14
Business property relief and partnership interests (Lecture P824 – 16.06 minutes) 16
New Inheritance Tax forms IHT205 (2011), IHT217 and IHT206 (2011) Notes 18

Administration **19**

Existence of a compromise agreement 19
Taxpayer's negligence in completing a tax return 19
Confusing due dates for tax payment 20
Read the guide 21
Confusion over deferral with TTP agreement 21
Partnership purchase 22
Effect of illness 23
Disclosure of documents 23
Information notice 24
Application for postponement of tax 24
Application for costs 25
Reasonable excuse: genuine belief 26
Insufficient information about the tax system 26
HMRC Enquiries: Closure Notices (Lecture P825 – 9.39 minutes) 27
Withdrawal of Extra-statutory Concessions 29

Business Taxation **30**
Samadian case: home travel claims (Lecture B821 – 16.32 minutes) 30
Partnerships – LLP employed partners 34
Cross Border Group Relief 47
Marginal relief: associated companies 47
Loans to participators 48
Transfer of real property into unapproved benefit scheme 48
Fatal closure notice 49
Group relief for underwriting losses 50
Capital versus revenue expenditure (Lecture B822 – 13.16 minutes) 51
FA 2012 capital allowances changes for fixtures (Lecture B823 – 27.17 minutes) 53
Corporation tax penalties (Lecture B824 – 10.08 minutes) 57
The new Employment allowance 60

VAT **62**
Vouchers: is a commission charged on redemption taxable? 62
Are vouchers, given away to customers, subject to VAT? 62
Retail vouchers 63
Supplies are closely related 64
Date of claim 65
House! 65
Freemasonry and VAT exemption 66
Import duties erroneously paid 67
Vans adapted for use by handicapped passengers 67
Duty fraud: confiscation orders 68
Recreational purpose 68
Leaving the flat rate scheme? (Lecture B825 – 13.21 minutes) 69

Personal Tax

Loan to employee

The tribunal had to decide whether Mr Curtis was liable to income tax on the benefit of a mortgage loan provided by a subsidiary of his employer under the beneficial loans provisions (ITEPA 2003 s 175).

Mr Curtis worked for RBS; he was also a longstanding customer of NatWest, which was taken over by RBS before 2008 when he first took a loan from NatWest. The interest rate was variable and was 0.44% above the bank's base rate. During the tax year at issue (2009/10), NatWest's base rate was 0.5% so Mr Curtis paid interest at 0.94%. The loans were 'employment-related loans'. The issue was whether they were 'taxable cheap loans', ie the interest paid on the loans was less than the official rate (as fixed by the Treasury). As Mr Curtis paid interest at the rate of 0.94% and the official rate was 4.75%, the loans were 'taxable cheap loans'. Furthermore, evidence suggested that all loans by NatWest had higher interest rates than Mr Curtis' loan for the first two years.

Decision:

Finally, the tribunal noted Mr Curtis' argument that the official rate was too high and that therefore 'almost all variable commercially available loans would have been treated as cheap'. However, relying on Flanagan (2012) TC 02161, the tribunal felt that it had no jurisdiction to ignore the rate fixed by the Treasury.

Comments - The tax payable by Mr Curtis was partly calculated by reference to an official rate which was totally disconnected from any economic reality — it was 3.5% higher than the Bank of England base rate at the end of the relevant period. Unfortunately, the tribunal had no jurisdiction to correct this injustice.

PD Curtis v HMRC TC3303

UK residence: full-time abroad?

The first issue was whether Mr Daniel had left the UK and worked full time abroad so as to have become non-UK resident for the relevant tax year.

Decision:

Having extensively reviewed Mr Daniel's whereabouts and activities during the relevant tax year, the tribunal found against the taxpayer. During the first part of the year, Mr Daniel had not worked at all for many weeks. In relation to the second part of the year, during which he had resided mainly at his holiday home in France, the tribunal rejected Mr Daniel's contention that he had worked full time on a specific project (the 'project'). Finally, Mr Daniel's most 'crucial contributions' to the project were made at meetings in London with substantial preparatory work in London.

The tribunal also had to decide whether the taxpayer had been negligent in completing his tax return, thus justifying a discovery assessment by HMRC (TMA 1970 s 29). The tribunal noted that the test was whether a reasonable man would have claimed non-UK residence in the circumstances of the taxpayer. The tribunal held that Mr Daniel had been negligent, as the 'plain reality' was that he had not been working full time abroad and he must have been aware that his role in the project had been intermittent. The tribunal also 'failed to understand' how the taxpayer had thought that working in the UK for a Belgian company constituted work done full time abroad.

Comments - The case turned on the interpretation of IR20 and so may be seen as less relevant under the statutory residence regime. However, the tribunal's analysis of the facts can provide a useful reference to any taxpayer wishing to establish full-time work abroad.

Paul Daniel v HMRC TC3312

Compensation payment under compromise agreement – Employment Income

The issue was whether a payment made to an employee was taxable as a capital gain or as employment income. Ignition (Mr Essack's employer) was acquired by another company in 2007, and the shareholder agreement referred to an employee share option plan. In 2008, a senior manager of Ignition referred again to the company's promise to issue shares to key employees. In 2009, Mr Essack decided to leave Ignition and a compromise agreement provided for the payment by Ignition to Mr Essack of £200,000 as 'compensation for loss of employment'. A concomitant letter referred to the payment being partly compensation for Mr Essack's share entitlement, which had never materialised.

Decision:

The tribunal found that Mr Essack had not acquired any right to shares in Ignition, adding that an unenforceable promise could not be an asset for CGT purposes (even in the aftermath of Zim Properties [1985] STC 90). The fact that the sum of £200,000 was well above compensation for loss of earnings did not mean that the amount related to a loss of rights over shares. The payment stemmed from Ignition's desire to stop Mr Essack making claims in legal proceedings in respect of the share pool. Finally, the tribunal added that even if Mr Essack's right to the shares amounted to an asset for CGT purposes, the ambit of ITEPA 2003 s 401 was so wide that the payment would still be taxable as employment income.

Comments - Following Zim Properties, identifying those rights which can constitute assets for CGT purposes can be challenging. The case is therefore a useful reference in this respect. It is also a stark reminder of the very wide scope of ITEPA 2003 s 401.

Ismail G Essack v HMRC TC3297

Marketed loss scheme

The tribunal reviewed the 'Working Wheels' marketed loss scheme. The success of the scheme depended on the taxpayers having carried out a trade, paid a manufactured overseas dividend and incurred a fee representing the 'incidental cost of obtaining finance' under ITTOIA 2005 s 58.

Decision:

The tribunal found that none of the appellants had carried on a trade. Under the joint venture agreement they had signed, a bare trustee was buying and selling cars and allocating the transactions to the participants. The participants only obtained the information necessary for the completion of their tax returns and displayed no interest in any of the transactions. Judge Bishopp found that 'this was not a trade but a means of securing tax relief'.

Although the tribunal accepted that the legislation contemplates the possibility that a manufactured dividend payment will exceed the 'dividend of which it is representative', in the present case, the difference in scale was too great. It was not 'possible to say that £5m is representative of £61.64' and so the manufactured payment did not represent the dividend. Furthermore, the tribunal noted that it would be absurd to pay a £5m fee to borrow £7,500 and that the fee was not paid 'wholly and exclusively for the purpose of obtaining loan finance', but to gain a tax advantage.

Finally, referring to the Ramsay doctrine, the tribunal concluded that the appellants wished to 'appear to have incurred vast fees as a condition of borrowing modest amounts of money they did not need in order to invest it in a “trade” they had no desire to pursue'. So, had the scheme worked, it would have been necessary to disregard its intended fiscal consequences.

Comments - This was an aggressive scheme. It failed on many counts but it seems that its main weaknesses were the large disparities in value between the manufactured payment and the dividend and between the fee and the amount borrowed, making it glaringly artificial.

Flanagan and two others v HMRC TC3314

Stock lending arrangements and manufactured dividends – Scheme fails

Mr Barnes had participated in a tax avoidance scheme exploiting both accrued interest relief and manufactured interest relief in relation to the same income. The scheme failed unless both reliefs were available. Both reliefs apply to the payment of interest to the transferee of securities, in respect of a period during which the transferor held the securities and the transferee passed part of that interest back to the transferor.

Decision:

Vos LJ considered that the arrangement, viewed 'realistically', constituted a 'stock lending arrangement', as Mr Barnes was required to return the very same securities that he had borrowed.

Consequently, accrued interest relief was not available (ICTA 1988 s 727(2) and TCGA 1992 s 263(B)) and the scheme failed. In case the court was wrong and accrued interest relief did apply, Vos LJ also considered whether manufactured interest relief was available. Again, he found against Mr Barnes, on the basis that he would not have been 'chargeable to income tax' in relation to the interest, as the accrued interest allowance would have reduced his income to nil under ICTA 1988 s 714(4). Sir Timothy Lloyd agreed with Vos LJ, insisting that Mr Barnes had been under a legally binding obligation to re-transfer the very same securities that had been transferred to him, so that the stock lending provisions applied to disallow accrued interest relied. McFarlane LJ agreed.

Comments - Interestingly, the court adopted a purposive approach when deciding whether the arrangement was a stock lending arrangement.

Nicholas Barnes v HMRC (A3/2013/0395

Loans and recommended medical treatment **(Lecture P821 – 11.06 minutes)**

Beneficial loans

Hitherto, where an employer provides an employee with a loan which is either interest-free or subject to a low rate of interest, there is no taxable benefit if the aggregate of all such loans does not exceed £5,000 in the tax year – see S180 ITEPA 2003. Nor is there a Class 1A NIC charge. This limit, which has been unchanged since its introduction in FA 1994, was originally intended to ensure that most employer-provided season ticket loans for commuting were not caught.

The Chancellor has decided to increase the exemption to £10,000 with effect from 6 April 2014. This doubling of the threshold applies to all loans, no matter when they were taken out. When considering whether the limit of £10,000 has been exceeded, any employer-provided loans which attract income tax relief (ie. because they were made for a qualifying purpose) are ignored.

For 2014/15 onwards, employers will therefore be required to report fewer loans on Forms P11D.

It will be intriguing to see whether companies now start to make more beneficial loans available to members of their staff.

Recommended medical treatment

Under current legislation, an employer who arranges and pays for medical treatment for a member of staff is generally providing a benefit which is deemed to be earnings and so is liable to income tax. Where an employer pays for medical treatment arranged by the employee or reimburses the employee for the cost of such treatment, this will be dealt with in the same way.

By virtue of new S320C ITEPA 2003, an exemption from a charge to income tax is being introduced for any payment made by an employer to meet the cost of medical treatment which has been recommended by occupational health services up to a limit of £500 per employee per tax year.

This exemption will only apply as long as the provision, payment or reimbursement is not subject to any salary sacrifice or flexible remuneration arrangements. S320C(3) ITEPA 2003 spells out the detail of what is required in order for the medical treatment to be 'recommended'.

This provision will take effect from a date to be set out by Treasury Order and is intended to support the Government's aim 'to widen access to occupational health treatment and to encourage employers to engage with the well-being of their employees'.

Note that the new relief will operate alongside the existing exemptions for:

(i) eye tests in S320A ITEPA 2003; and
(ii) health screening and medical check-ups in S320B ITEPA 2003.

Contributed by Robert Jamieson

Fixed Protection 2014 and Individual Protection 2014

Reminder to submit Fixed Protection 2014 applications by 5 April 2014
The window for applying for Fixed Protection (FP2014) closes on 5 April 2014. An online tool to help individuals decide whether they should apply for FP2014 can be found here.

If an individual decides they want to apply for FP2014 they should notify HMRC by completing this online form

Submitting the form online is secure, quick and easy to do and, unlike with postal applications, immediate confirmation of receipt is provided for online applications, along with a reference to assist with any future enquiries. This email will provide individuals with details of when they can expect to hear from us regarding their application and should be stored safely as proof of submission.
If the application for FP2014 is accepted, we will send a certificate to the individual which should be shown to their pension scheme administrator every time they take any benefits from their pension scheme. Where an individual has successfully applied for FP2014, to keep this protection there are restrictions on any tax relieved pension savings that they can make from 6 April 2014. More information about these restrictions and FP2014 can be found here

FP2014 is only open to individuals who don't on 6 April 2014 have any of the existing Lifetime Allowance protections, that is, primary, enhanced or fixed protection 2012.

Individuals with these protections should check that the particular protection they have remains valid. If the existing protection is lost before 6 April 2014, then the individual will be able to apply for FP2014, giving them a protected lifetime allowance of £1.5 million from 2014-2015 onwards.

Official rate of interest

The Official Rate of interest, used to calculate the income tax charge on beneficial loans, has been announced for tax year 2014-15. The new Official Rate of interest of 3.25% will take effect from 6 April 2014.

Capital Taxes

CGT: allowable expenditure

HMRC considered that expenditure of £25m claimed by Mr Blackwell as a deduction from the consideration received on the disposal of shares was not allowable under TCGA 1992 s 38(1)(b). Mr Blackwell had entered into a confidential agreement with a company called Taylor and Francis for the sale of his shares in BP Holdings (as well as other obligations). When another company called Wiley had made a much higher bid for BP Holdings, Mr Blackwell had accepted the offer of Taylor and Francis to release him from his obligations under the agreement, in consideration of the payment of £25m.

Decision:

The tribunal considered that the £25m had been incurred on the shares for the purpose of enhancing their value. Mr Blackwell believed that the payment would enhance the value of his shares because it would enable the higher bid to be accepted. The tribunal also found that, although the expenditure had not changed the 'nature' of the shares (as the rights attaching to them remained the same), it had changed their 'state' and so all the conditions of s 38 were satisfied. The tribunal drew an analogy with a car unfit to be driven: it would still be a car, and so any expenditure incurred to make it fit for the road would not change its nature but would change its state. The appeal was however only allowed in part, as a fraction of the £25m had been advanced by another shareholder.

Comments - Enhancement expenditure incurred on a bundle of rights such as shares are often challenged by HMRC. The case is therefore helpful in clarifying the approach by drawing an analogy with a physical object; namely a car. Interestingly, the case also confirms that the belief that the expenditure will enhance the value, even if the belief turns out to have been ill-founded, is sufficient.

Blackwell v HMRC TC3243

Entrepreneurs' relief on business premises

The issue was whether entrepreneurs' relief (TCGA 1992 s 169I) was available on the disposal of business premises situated on Fletton Avenue, a busy main road in Peterborough.

Mr Rice sold used sports cars. From 2005, as a result of problems with vandalism, he had ceased trading at Fletton Avenue and had started selling used cars at premises near his home in a country village. He eventually sold the premises at Fletton Avenue in April 2008. Because of space and planning restrictions at the new premises, Mr Rice had to change the way he operated his business. He no longer relied on passersby (and no longer exhibited cars on his forecourt) but advertised extensively on the internet. He also only sold family cars.

Decision:

The tribunal therefore had to decide whether the business which had operated at Fletton Avenue had ceased and, if so, at what date. The tribunal considered that the alterations to Mr Rice's business following his move from Fletton Avenue had constituted a 'significant change', which in turn constituted a cessation of the trade carried out at Fletton Avenue. However, relying on Mr Rice's recollection of the date when he had moved out of Fletton Avenue, the tribunal accepted that this date was within three years of the disposal. Consequently, entrepreneurs' relief was available.

Comments - Identifying what constitutes a sufficiently 'significant change' to amount to the cessation of a business can be challenging. The case is useful in that it covers the key cases (Ingram v Callaghan [1968] 45 TC 151 and Rolls Royce v Bamford [1976] STC 162) which have established the distinction between organic growth and sudden change.

Jeremy Rice v HMRC TC3273

PPR – how important is the taxpayer’s intention? (Lecture P822 – 19.29 minutes)

In recent months, there has been a spate of cases involving principal private residence relief under S223 TCGA 1992. Two contrasting decisions of the First-Tier Tribunal have been in respect of:

1. Bradley v HMRC (2013); and
2. Morgan v HMRC (2013).

Bradley

In the Bradley case, the taxpayer (B) lived in a house owned jointly with her husband. She also owned a flat and another house in her own name, both of which were normally rented out. Intending to separate from her husband pending a divorce, B moved out of the family home and into her flat (which was empty) in August 2007. When the tenancy of the other property came to an end in April 2008, B decided that it would be more convenient to have a house and she moved in there. Having been tenanted for a number of years, this property was in a poor state of repair and so B repainted the house, carried out some other improvements and generally made it more of a home.

B had originally placed this latter property with an estate agent in March 2008, but, bearing in mind the poor state of the market at the time, she was not hopeful of a sale and expected to live there for the time being. However, later in the same year, she was reconciled with her husband and moved back into the matrimonial home. The house was finally sold in January 2009.

Although the Tribunal judges were satisfied that B had every intention of separating permanently from her husband in 2007, they decided that she did not occupy the house as a residence.

Taking into account the evidence that, at the time when B moved into it, she had already placed it on the market and that she did not subsequently withdraw her instructions to the estate agent, their

conclusion was that she never intended to live permanently in the property – it was always going to be a temporary home and so was never her residence. Thus no part of B's gain was eligible for the exemption under S223 TCGA 1992.

In this case, the judges seem to have relied heavily on the decision in Goodwin v Curtis (1998), with consideration being primarily focused on the intention of the taxpayer at the time of moving into the property. However, it is only fair to point out that the taxpayer in the earlier case completed the purchase of another house, which he intended to be his private residence, just two days after moving into the property in question. This would seem to be quite a critical distinction which was not even discussed in Bradley v HMRC (2013).

Morgan

In preparation for the purchase of a house in Redhill where the taxpayer (M) intended to live when he was married, M sold his flat and moved in with his fiancée's family. Unfortunately, a fortnight before the purchase, the engagement was broken off and M went to live with his parents. Despite this, M carried on with the purchase of the property (which cost £132,000) in the hope that his fiancée would have a change of heart and would join him in what he planned to be their family home. M moved in on 15 June 2001 and stayed there until 30 August 2001.

Some 10 days after the move, M contacted his mortgage lender (Bradford & Bingley) and requested a tenancy pack, although he did not immediately seek to let the property. M found it difficult to manage financially in the house alone and so he again contacted Bradford & Bingley on 22 August 2001, seeking permission to let the property. His tenant moved in on 31 August 2001, by which time M had returned to live with his parents, and the house was rented out until 15 March 2006. On the termination of the tenancy, M moved back into the property with a view to selling it. The sale took place on 28 July 2006 at a price of £188,000.

M claimed principal private residence relief for the requisite period of his ownership of the property, but HMRC argued that his occupation of the property between June 2001 and August 2001 lacked the degree of permanence, continuity or expectation of continuity sufficient to justify its description as a residence for the purposes of Ss222 – 223 TCGA 1992. M, they said, was only staying in the house on a temporary basis.

In line with the Bradley case (discussed above), the First-Tier Tribunal took the view that it was not so much the quality of the occupation but rather the intention which mattered. By this the judges meant that, even if M had moved into a fully furnished property with all the utility bills addressed to him personally (in order to satisfy the criterion of 'quality'), the quality of his occupation would have been irrelevant where he had already formed the intention to sell or let the property.

It was their opinion that the taxpayer needed only to show that, at the time of moving into the property, it was his intention to make the house his permanent residence (even if he changed his mind a week or

so later). They accepted M's evidence that he continued to hold out hope that the relationship with his ex-fiancée could be healed and that the couple would in due course live together in the property.

Despite M's brief occupation, the First-Tier Tribunal, following the principles enunciated in Goodwin v Curtis (1998), held that principal private residence relief was available in this 'extremely finely balanced' case on the basis of M's intention at the time of buying and moving into the property.

They paid some attention to the quality of M's occupation by noting that he had received at the house:

- water and sewerage bills relating to the property which were addressed to him personally;
- two letters, one dated 22 August 2001 from Bradford & Bingley and the other dated 23 August 2001 from his solicitors.

In seeking to demonstrate that the taxpayer was not resident in the property for the purposes of principal private residence relief, HMRC adduced the following items of evidence:

- a gas bill made out to the 'occupier' where the amount charged was surprisingly low and so might be seen to be inconsistent with occupation of a main residence; and
- a lack of evidence of furniture being transported to the property when M moved in, ie. no removal firm had been used.

The Tribunal clearly thought that the weight of evidence was on M's side, pointing out that:

- there were several utility bills which were addressed to the taxpayer personally;
- it was not unreasonable that the gas bill was on the low side, given that M only occupied the house during the summer months of June, July and August 2001; and
- the property had plenty of fitted cupboards (thus obviating the need for free-standing furniture) and any furniture which M did possess was transported by him personally in his car from his parents' home where it had been stored.

The irony with this decision is that the taxpayer in the Bradley case spent rather more time in her house than M did, but she lost her dispute with HMRC while M won his!

Contributed by Robert Jamieson

IHT Developments (Lecture P823 – 16.39 minutes)

The Chancellor's autumn statement on 10 December 2013 and draft Finance Bill 2014 clauses contained various inheritance tax (IHT) measures. They included the following:

Further freezing of IHT nil rate band

The IHT nil rate band (£325,000 for 2013/14) can normally be expected to increase annually by reference to an indexation factor as at September in each year. Any such increase is generally applied to the rates of chargeable transfers made on or after 6 April in the following year.

However, Parliament may determine the nil rate band instead, otherwise than by reference to this indexation factor (IHTA 1984, s 8(1)), and in recent years has done so. The last increase in the nil rate band was for 2009/10 (i.e. to £325,000). It was subsequently frozen at £325,000 for 2010/11 to 2014/15 inclusive (FA 2010, s 8).

The nil rate band is to be further frozen at £325,000 for subsequent tax years up to and including 2017/18, following the draft Finance Bill 2014 clauses published in December 2013.

Trusts: Filing and payment dates

As part of the government's simplification measures for trusts, the IHT filing and payment dates in respect of relevant property trusts (e.g. discretionary trusts) are to be aligned, in relation to IHT periodic or exit charges arising from 6 April 2014.

Present position

The time limit for filing an IHT account is currently the later of the following (IHTA 1984, s 216(6)(c)):

- Twelve months from the end of the month in which the transfer is made; or
- Three months when the trustees first become liable for the tax.

The time limit for payments of IHT depends on when the chargeable event occurred (IHTA 1984, s 226(1)):

Chargeable event	IHT due
6 April to 30 September (inclusive)	30 April in the following tax year
1 October to 5 April (inclusive)	6 months after the end of the month in which the chargeable transfer is made

Proposed changes

The filing and payment dates for IHT trust charges is to be aligned, so that trustees of relevant property trusts must file the IHT account and pay the relevant IHT no later than six months after the end of the month in which the chargeable event occurs (Draft Finance Bill 2014 clause).

Ten year anniversary charge

Present position

The calculation of IHT ten year (and also exit) charges for relevant property trusts (e.g. discretionary trusts) can be complex. One of the potential difficulties is in distinguishing between trust income and capital; the latter is generally taken into account in calculating the IHT charge.

Trust income which is not distributed to beneficiaries is often accumulated by the trustees and treated as additional capital (e.g. if required by the trust deed to do so, or by the trustees exercising their discretion). However, in some cases the trust deed may not stipulate when income must be accumulated, and the trustees may not have made any formal decision to accumulate. This can result in uncertainty when calculating the IHT position, particularly when trust income remains undistributed for long periods.

Proposed change

For ten year IHT charges (under IHTA 1984, s 64) from 6 April 2014, trust income which remains undistributed for more than five years up to the ten year anniversary will generally be treated as part of the trust capital for the purposes of the IHT calculation. This general rule is subject to certain limited exceptions, such as in the case of trusts created by non-UK domiciled settlors where the income is situated outside the UK.

In calculating the IHT rate for the ten year charge, a reduction is generally made in respect of assets which were not relevant property (or were not owned by the trust) throughout the whole of the ten year period (IHTA 1984, s 66(2)). However, IHT will be charged at the full rate on any trust income treated as such under the above new rule (i.e. without reduction to reflect the period during which the trust income was retained) (Draft Finance Bill 2014 clause).

IHT simplification of trust charges

HMRC published a document 'Inheritance Tax: Simplification of the trust charges - the next stage' in December 2013, in response to a consultation document published in May 2013. The original document outlined a number of areas for simplification or possible reform.

One proposal put forward in the May 2013 consultation document was to split the IHT nil rate band between the number of settlements created by the same settlor, and apply an IHT rate of 6% for ten year (and exit) charges. The original intention was to introduce new legislation to this effect in Finance Bill 2014.

However, in its December 2013 document, HMRC stated that it will "consult further on alternative proposals to split the nil rate band that will meet trustees concerns whilst maintaining tax revenues; and as a result puts the simplification of the calculations on a slightly slower track so that any new legislation is introduced in Finance Bill 2015".

In addition, HMRC announced that its proposal to require trustees to self-assess IHT when delivering IHT returns would be deferred until Finance Bill 2015.

Contributed by Mark McLaughlin

Business property relief and partnership interests **(Lecture P824 – 16.06 minutes)**

The CIOT have recently collaborated with the Tax Faculty and STEP in producing a technical guidance note (TAXGUIDE 1/14), which has been agreed with HMRC, relating to the availability of business property relief in connection with interests in partnerships and LLPs.

The central issue which is discussed in the guidance note is how the business property relief rules apply in relation to partnerships or LLPs which own shares in an unquoted trading company. It is well established that an individual who satisfies the relevant conditions and who owns shares in an unquoted trading company is eligible for full business property relief. However, if that individual is a member of a partnership or LLP which holds shares in the same company, his partnership interest will only qualify for relief if the business of the partnership or LLP meets the 'wholly or mainly' trading constraint. Thus, if the sole or main activity of the partnership or LLP is holding shares in an unquoted trading company, no business property relief will be available given that the business is wholly or mainly one of holding investments – see S105(3) IHTA 1984.

It should be noted that, for a company whose activity is wholly or mainly that of being the holding company of a predominantly trading group, there is a specific let-out in S105(4)(b) IHTA 1984 which ensures that its shares will still attract business property relief. Unfortunately, there seems to be no equivalent assistance for partnerships or LLPs. The main raison d'être for this debate with HMRC can be summarised in the following words from the guidance note:

'No relief is available where a partnership or LLP acts as a holding vehicle for shares in the holding company of a trading group. The policy justification for this approach should be addressed as there appears to be no apparent justification for treating partnerships or LLPs differently from that of closely held companies and groups.'

HMRC, in their response, were not prepared to give ground. While accepting the increasing use of partnerships and LLPs in structuring commercial arrangements, their concluding words summarise the official position:

'Although we appreciate that at present there appears to be an anomaly between companies and partnerships or LLPs in this regard, that is what the legislation directs us to do and is a result of the drafting of the provisions.'

The paper then sets out eight examples involving partnerships or LLPs culled from details supplied by members of the three professional bodies. The HMRC view was requested for each of the situations. Two of them are discussed below.

The analysis sent to HMRC in Example 3 reads as follows:

'It is becoming increasingly popular for property to be held outside of the main trading company. There are various reasons for this, including protecting the property from trading risk and also allowing the owners to benefit from a single CGT charge on any onward sale.
If the property were held directly by the owners, then, as this was an asset used wholly or mainly for the purposes of a business carried on by a company which they control (or a partnership in which they are partners), they would have qualified for 50% business property relief under S105(1)(d) IHTA 1984.

However, in our scenario and in order to mitigate the difficulties of owning land jointly, the owners decide to hold the property via an LLP. On this basis, the asset which they hold is an interest in the partnership. We then assess the business of the partnership, which will either be determined to be dealing in land or buildings or the holding of investments, and therefore business property relief will be denied.'

Unsurprisingly, HMRC confirm that this analysis is correct. They say:

'When assessing the level of relief available on the partnership interest, we recognise that the underlying asset is indeed held for business purposes and is employed in this manner. However, the legislation does not enable us to assess the underlying assets and we must look at the business actually carried on by the partnership. On this basis, relief is denied by S105(3) IHTA 1984.'

Example 8 looks at the situation where a partnership or an LLP is conducting a qualifying trade for business property relief purposes. The partners are an individual and a company. The individual holds an interest in a trading partnership and is therefore eligible for business property relief. That much is reasonably clear. However, do the shares in the corporate partner also qualify for relief? The analysis here is that the shares (which are assumed to be unquoted) are in a company which holds an interest in a trading business. On this basis and assessing the underlying assets of the company, it is argued that business property relief should be available. HMRC agree that this is indeed the case.

Contributed by Robert Jamieson

New Inheritance Tax forms IHT205 (2011), IHT217 and IHT206 (2011) Notes

HM Revenue & Customs (HMRC) have today published:

- new form IHT205 (2011) - Return of estate information
- new IHT206 (2011) - Notes to help you fill in form IHT205 (2011)
- revised form IHT217 - Claim to transfer unused nil rate band for excepted estates

The new forms IHT205 (2011) and IHT206 (2011) Notes should be used when the person died on or after 6 April 2011. The main changes to the form are to the pension's questions which have been simplified. You will also see the form and notes look different as they have been rebranded.

The revised IHT217 replaces the current version of the form and should be used where the person died on or after 6 April 2010.

Administration

Existence of a compromise agreement

The tribunal had to decide whether a valid compromise agreement had been entered into between HMRC and the taxpayer and what its implications were. Southern Cross had made a Fleming claim under VATA 1994 s 80 for repayment of VAT paid in the years 1993 to 1997. Southern Cross contended that it had entered into a valid compromise agreement with HMRC in relation to its claim prior to the decision in Moher [2012] STC 1356 — as a result of which Southern Cross was not entitled to a repayment.

Decision:

The tribunal accepted that the exchange of correspondence between HMRC and the taxpayer had amounted to a 'meeting of minds' under contract law and that, therefore, a compromise agreement had been entered into. Furthermore, the agreement was intra vires, as HMRC had been entitled to enter into such an agreement. Applying IRC v Nuttall [1990] STC 194, the tribunal stressed that HMRC can enter into compromises if it considers that the 'public interest in collecting taxes' will be better served. Finally, HMRC was not entitled under VATA 1984 s 80(4A) and s 78(1) to make the assessments under appeal. The compromise agreement had created a liability for HMRC to repay the tax as a matter of law (in the same way as a judicial determination). The assessments were therefore invalid.

Comments - The power of HMRC to enter into compromise agreements has been challenged on a few occasions recently. The case contains a useful analysis of the basis of this power.

Southern Cross Employment Agency v HMRC TC3228

Taxpayer's negligence in completing a tax return

The taxpayers had participated in a capital redemption policy scheme in order to mitigate substantial capital gains realised on the disposal of a business. HMRC considered that the taxpayers had filed their returns negligently. This was on the basis that the scheme required a loan to have been advanced and it was very clear that no such advance had taken place. HMRC contended that the taxpayers should have established that the scheme was not a sham from a commercial perspective, in order to fulfil 'the reasonable taxpayer test'. The taxpayers argued that it had been reasonable for them to rely on their professional advisers for all aspects of the transactions, including the commercial aspects.

Decision:

The tribunal, agreeing with HMRC, found that it was not reasonable for a 'relatively sophisticated investor' to rely on this level of advice from his advisers and to complete his tax return relying on their assurances, knowing that a loan was required but had not been advanced. The tribunal therefore concluded that the taxpayers had been negligent in signing their tax returns. The DOTAS number included on the returns did not change the analysis, as it only related to the technical analysis of the scheme and not to its commercial reality. The tribunal, however, did mitigate the penalties imposed by HMRC on the basis that the taxpayers had fully cooperated with HMRC.

Comments - The negligent filing of the returns stemmed from the taxpayers' lack of understanding of the various steps of the scheme. The message is clear: taxpayers are under the obligation to ensure that the steps of a scheme set out in their return actually take place, and cannot simply rely on their advisers.

Litman & Newall v HMRC TC3229

Confusing due dates for tax payment

The taxpayer was an employee and did not normally have to complete a tax return. On 22 August 2012, having found that the taxpayer had outstanding tax of £8,595 for 2009/10, HMRC sent him a tax return. This was required to be filed by 29 November 2012. In February 2013, they sent him a self-assessment tax calculation showing the tax due of £8,595, saying it had been payable by 31 January 2011. They also imposed a surcharge on the late paid tax.

The taxpayer appealed against the penalty saying he was unused to completing tax returns, was not a tax expert and did not employ an adviser.

Decision:

The First-tier Tribunal said it was understandable that the taxpayer was unaware that an underpayment had arisen that could not be collected through his tax code because, in previous years, any shortfalls had been coded.

When he was sent a return, the due dates advised on it had passed and HMRC had sent conflicting information about when he should pay. He was in effect in a position that made it impossible to pay on time.

The taxpayer's appeal was allowed.

Comments – This case is a good demonstration of how illogical some of the tax provisions are. Practitioners know this and work to ensure that the various deadlines are met particularly when it comes to tax payments. Systems between taxes vary and it is not surprising that a taxpayer who would normally be an employee is not aware of other parts of the tax system. Fairness prevailed.

D Urwin v HMRC TC3145

Read the guide

The taxpayer's 2011/12 tax return, which he submitted in January 2013, showed tax due of £3,992.50. He ticked the box in the return indicating that the amount should be collected through his tax code, not reading the information on the return stating that for tax to be collected this way, the return had to be filed by 30 December and the sum due under £3,000. He said the software accepted his selection to have the tax included in his code and did not warn him or generate an error code that it would be too large to code out.

HMRC issued a penalty for late payment of the tax. The taxpayer appealed.

Decision:

The First-tier Tribunal said that the taxpayer would have received a notice explaining the deadlines for filing the return and the conditions for coding outstanding tax. He should have realised that by filing in January he would have to pay the debt in full by the end of that month. He did not have a reasonable excuse for late payment.

The taxpayer's appeal was dismissed.

Comments – A demonstration of how taxpayers are responsible for reading relevant information to do with their tax affairs. Accordingly failure to do these basics ended up with a hopeless result.

P Bristow v HMRC TC3146

Confusion over deferral with TTP agreement

The taxpayer, a family-run engineering business, was late paying its PAYE tax and National Insurance for June, July, August, September and December 2010 and January 2011. HMRC imposed penalties under FA 2009, Sch 56. The taxpayer appealed. It claimed that the months were covered in a time-to-pay agreement made with HMRC in November 2009 in relation to the business's VAT liabilities.

HMRC said no deferral agreement had been made to include PAYE liabilities and that lack of funds did not constitute a reasonable excuse.

Decision:

After reviewing the evidence, the First-tier Tribunal found that the taxpayer had discussed the PAYE due for June and July and reached an informal agreement that those months sums be deferred. The evidence for the remaining months was less clear, but it seemed that the taxpayer believed that HMRC had agreed that the August and September payments could be deferred. The penalties for those four months were therefore cancelled.

However, with regard to December 2010 and January 2011, the tribunal said it was reasonable that, after a telephone conversation with HMRC, the taxpayer should have been aware that a formal arrangement was necessary for a deferred payment agreement. There was therefore no reasonable excuse for the late payments in relation to those months and the penalty was upheld.

The taxpayer's appeal was allowed in part.

Comments – Over recent years deferral via TTP agreements has become necessary for many taxpayers. It means the taxpayer is agreeing a different schedule for payments from those laid down in the law. It may seem a statement of the obvious that the terms need to be clear to both parties. However the passage of discussions may have blurred those lines and consequently the Tribunal allowed the appeal in part.

R J Herbert Engineering Ltd v HMRC TC3132

Partnership purchase

In 2009, HMRC began an investigation into the taxpayer's affairs because they discovered that he had bought a flat, carried out some refurbishment and sold it in 2003. They sent him a 2003/04 tax return which the taxpayer completed. He declared rent but not a capital gain. HMRC opened an enquiry and, eventually, the taxpayer's accountant submitted a capital gains computation in respect of the sale of the flat. The taxpayer subsequently told HMRC that he had bought the flat in partnership with another person, Mr Al-Alawati. Therefore he was liable to tax on only a proportion of the gain. HMRC did not accept the taxpayer's contentions. The taxpayer appealed.

Decision:

The First-tier Tribunal noted that there were inconsistencies in the taxpayer's evidence. However, the judge said that “more probably than not” Mr Al-Alawati was involved in the purchase, at least in part because it seemed unlikely that the taxpayer could fund the purchase cost on his own.

The taxpayer's gain should be reduced. His appeal was allowed.

Comments – When appealing against HMRC decisions or returning information it is essential that clarity exists. This is amply demonstrated in a case where if there is more than one individual involved the gain will be substantially reduced by being divided by the more than one person. The words used by the judge show that clarity did not exist but the tribunal took a more lenient view than might otherwise have occurred.

Ali Al-Jibouri v HMRC TC3151)

Effect of illness

The taxpayer, a solicitor, was late paying the balancing payment of £91,651 for 2011/12. He paid £50,000 on 18 January 2013 and, on 7 March 2013, he requested a time-to-pay arrangement. HMRC issued a penalty on 19 March and the taxpayer paid a further £30,000 on 29 March followed by the remaining £11,651 on 10 April. He appealed against the penalty.

He said he had been unable to pay the tax due because of an outstanding payment from the Legal Services Commission — which made up 97% of his income. He had also been ill for a long period.

Decision:

The First-tier Tribunal decided the taxpayer's illness constituted reasonable excuse. He had provided medical and other evidence to show the illness had prevented him dealing with his personal and business affairs.

The taxpayer's appeal was allowed.

Comments – This is another case demonstrating the value of evidence to support one's contention. The evidence therefore allowed the Tribunal to accept the taxpayer's circumstances as a reasonable excuse. Be prepared is an excellent motto and if circumstances prevent the carrying out of obligations being prepared with a good argument pays off.

I Bond v HMRC TC3140

Disclosure of documents

HMRC appealed against the decision of the FTT to dismiss its application for the disclosure of documents. HMRC's inquiry had been extremely wide ranging and, in the interest of saving time and cost, HMRC and the taxpayers had agreed that the inquiry would focus on a sample of transactions. However, HMRC's disclosure application was not limited to the agreed sample of transactions.

Decision:

The UT ruled that it would be unfair and unjust for the taxpayers to 'be able to suppress or keep from view of HMRC and the FTT relevant documents which may be harmful to their case, as a consequence of the limitation on the extent of HMRC's inspection of the documents during the investigatory stage'. The UT also held that the FTT had been wrong when stating that the procedure rules 'are not intended to enable one party to make generalised requests for information from another party'. In the present case, which concerned a wide range of transactions, a generalised request was justified. It was also acceptable for HMRC to make the requests 'in general terms' because it did not know which documents would be relevant. The appeal was therefore allowed, although only in part (as one taxpayer had been treated differently).

Comments - The tribunal's finding, that any agreement between the parties as to the extent of an inquiry by HMRC has no bearing on the documents to be disclosed at the trial stage, is likely to disappoint many tax practitioners.

HMRC v Ingenious Games (FTC/004/2014)

Information notice

The issue was whether documents which were the object of an information notice (TMA 1970 Sch 36) were within the 'possession or power' of the taxpayers.

The documents were in the possession of trustees of a remuneration trust of which the taxpayers were the settlors. The taxpayers had sent a letter to the trustees requesting the documents in October 2012; however, having had no reply, they had not chased the trustees until a year later in October 2013. The trustees had then refused the request on the ground that the information requested was 'highly sensitive and confidential'.

Decision:

However, the tribunal noted that the taxpayers had been able to obtain substantial loans from the trustees and the evidence suggested that the trustees responded promptly to communications by the taxpayers. Furthermore, the trust deed did not suggest that it would be unlawful for the trustees to provide the documents. Finally, the tribunal noted that the taxpayers had made no effort to persuade the trustees to hand over the documents. The taxpayers' appeal against the information notice was dismissed.

Comments - This case is a useful reminder that documents will be in the taxpayer's 'power' if he is able to obtain them, using persuasion if necessary.

H A Patel and K Patel v HMRC TC3305

Application for postponement of tax

The NCA (then called SOCA) had raised tax assessments and the taxpayers had applied for a postponement of the tax assessed under TMA 1970 s 55.

Decision:

The tribunal noted that, in order to be successful, a postponement application must establish that the appeal had reasonable grounds, based not only on the law but also on the facts. Consequently, the inability of the taxpayer to evidence the existence of a bank loan was unhelpful to its application. Furthermore, the reasonable grounds must lead to a 'belief' that the appellant had been overcharged.

Relying on George v Rockett [1990] 170 CLR 104, the tribunal considered that 'belief is less than proof but more than suspicion'. This meant that the appellant must demonstrate that their income figure was lower than that assessed by the NCA, not that the NCA must prove that their assessment was right. Looking at the facts, the tribunal rejected the main taxpayer's case that, having been entrusted with over half a billion pounds by his clients over a period of five years, he had only earned £25,000 per year. However, the tribunal found that his wife had not owned any of the monies held on her bank accounts. Consequently, the application for postponement was rejected for the main taxpayer but allowed for his wife.

Comments - The case demonstrates that the burden of proof of the taxpayer in a postponement application is only marginally lighter than his burden in the substantial case.

Gui Hui Dong and Hong Fang v National Crime Agency TC3268

Application for costs

The tribunal had to decide on the taxpayer's liability to costs in a complex case.

Stomgrove contended that HMRC should be liable to costs in full, as it had been unreasonable in making a determination that Stomgrove should pay class 1 NIC in the first place.

Decision:

Referring to Catana [2012] STC 2138, the tribunal held that costs incurred before the proceedings had commenced could not be regarded as incidental to the proceedings. Consequently, the tribunal did not have jurisdiction to make an award in relation to these costs (TCEA 2007 s 29(1) and the Tribunal Rules, SI 2009/273, rule 10). As far as the claim for costs 'on an indemnity basis' was concerned, the tribunal accepted that costs incurred before the proceedings could be recovered. However, the tribunal was not convinced that HMRC's behaviour had been 'out of the norm'. The tribunal found that HMRC's offer to pay 90% of the amount claimed was an offer that 'no reasonable adviser … would have advised against'. Stomgrove and his adviser had repeatedly ignored the FTT's recommendation to settle. Finally, the tribunal was not prepared to reduce the amount awarded to HMRC on ground of proportionality. This was despite the fact that the cost award far exceeded the amount awarded to Stomgrove, who was the winner in the substantive proceedings.

Comments - The case clarifies the distinction between claims for costs 'on an indemnity basis', which can relate to costs incurred prior to the proceedings, and claims made under TCEA 2007 s 29(1) which cannot. Perhaps more importantly, it reminds litigants to pay heed to the tribunal's recommendations to settle.

Stomgrove Ltd v HMRC TC3307

Reasonable excuse: genuine belief

A penalty had been imposed upon the taxpayer for the late filing of the end of year P35 return. Mrs Gray had believed that it was not necessary to file a P35, as the firm had no employees in the relevant tax year. She had contacted HMRC to obtain confirmation that no return was required but had not obtained a reply. HMRC and the tribunal accepted that Mrs Gray had held a 'genuine belief' that no return was required. However, HMRC argued that her belief was unreasonable.

Decision:

The tribunal noted that an honest belief can be a reasonable excuse. However, the more 'unreasonable' a belief is, the more unlikely it is that the tribunal will accept that it was genuinely held. Disagreeing with Coales v HMRC [2012] UKFTT 477, the tribunal added that once it was established that a belief was genuinely held, whether or not the belief was reasonable was no longer relevant. 'The sole enquiry is into the subjective state of mind' of the taxpayer claiming that he held an honest belief. It is that belief that constitutes a reasonable excuse.

Comments - This decision is very similar to David Wake-Walker v HMRC (TC03097 — 28 November 2013). Both decisions should therefore be referred to in circumstances where HMRC staff argue that a belief is too unreasonable to constitute a reasonable excuse.

Gray Publishing v HMRC TC3253

Insufficient information about the tax system

The taxpayer had been a teacher for 35 years and had always paid tax through PAYE. In 2011/12, she began receiving property rental income, but did not inform HMRC about the new income source until February 2013. They sent her a return which she submitted online in May 2013. The return showed tax due of £2,404 which she paid on 24 May. HMRC imposed a penalty for late payment of tax.

The taxpayer appealed saying that she had done all that HMRC had told her to do. HMRC said they would not charge the late notification penalty and told her to complete the tax return by a specific date, which she did. She said no one had told her that a penalty would be charged for late paid tax.

Decision:

The First-tier Tribunal found that the taxpayer had acted “properly and in good faith”. The information given to her by HMRC had been helpful but not complete. Had she been advised about the payment position, the tribunal accepted that she would have paid sooner. The tribunal thought that “one would have expected the [HMRC] adviser to give some sort of warning”, given that the taxpayer had contacted the Revenue to tell them she believed she owed tax.

The taxpayer had tried to fulfil her tax obligations “in an unfamiliar and complex area”. She had reasonable excuse for the late payment and no penalty was due.

The taxpayer's appeal was allowed.

Comments – More cases appear before the tribunals which involve taxpayers who have previously been involved in part of the tax system but have become involved with another such as in this case a taxpayer who had previously only had PAYE income started to have property income which caused other obligations. For many years we have heard a lot about the simplification of tax but it is questionable whether it gets any easier for the end user – the taxpayer.

M C Armitage v HMRC TC3195

HMRC Enquiries: Closure Notices (Lecture P825 – 9.39 minutes)

Taxpayer protection

HMRC enquiries into self-assessment returns are often extensive, and can be time consuming. Taxpayers and advisers may sometimes consider that HMRC's enquiries are being unduly protracted.

However, an important protection is available to the taxpayer in such circumstances. Individuals (or trustees) may apply to the First-tier Tribunal for HMRC to issue a closure notice. The legislation provides (at *TMA 1970, s 28A(4)*):

> *"The taxpayer may apply to the tribunal for a direction requiring an officer of the Board to issue a closure notice within a specified period."*

Furthermore, *s 28A(6)* states:

> *"The tribunal shall give the direction applied for unless satisfied that there are reasonable grounds for not issuing a closure notice within a specified period."*

Similar protection is provided in respect of HMRC enquiries into the tax returns of partnerships (*TMA 1970, s 28B(4)*) and companies (*FA 1998, Sch 18, para 33*).

As indicated above, if an individual's or trustee's application for a closure notice is successful, the tribunal is required to direct that HMRC issues a closure notice within a specified period, unless there are reasonable grounds for not doing so. The onus is therefore on HMRC to convince the tribunal that the enquiry should be allowed to continue.

HMRC's persistence in an enquiry may test the taxpayer's (or adviser's) patience. Whist it may be tempting to apply to the tribunal for a closure notice early in the enquiry, this temptation should be resisted. Applications for closure notices have been dismissed in a number of First-tier Tribunal cases (e.g. *BJH Building & Plumbing v HMRC* [2010] UKFTT 60 (TC); *S Price v HMRC* [2011] UKFTT 624 (TC).

Recent cases

The period specified by the tribunal for HMRC to issue a closure notice following the taxpayer's application may vary. No time limit is specified in the legislation.

In *Khazenifar v Revenue & Customs* [2013] UKFTT 752 (TC), HMRC opened an enquiry into the taxpayer's 2009/10 self-assessment return on 12 January 2012. The tribunal decided that HMRC had reasonable grounds for not issuing a closure notice at that point, but directed that they must do so within six months of the tribunal's decision.

In *Bloomfield v Revenue & Customs* [2013] UKFTT 593 (TC), HMRC's enquiry had lasted for over three years. The tribunal directed in the circumstances of the case that HMRC should issue a closure notice in respect of its enquiry within 30 days. The tribunal considered that this allowed time for HMRC's enquiries to be completed without undue delay.

In *Khan v Revenue & Customs* [2014] UKFTT 18 (TC), HMRC opened an enquiry into Mr Khan's 2009/10 self-assessment return on 15 June 2011. The enquiry progressed very slowly for various reasons, which included HMRC apparently having mislaid the taxpayer's records. The taxpayer eventually applied to the First-tier Tribunal for HMRC to issue a closure notice. Despite "poor administration by the Revenue", the tribunal considered that the taxpayer still needed to provide HMRC with genuinely significant information. It held that nine months was an adequate period for the enquiry to be concluded properly.

Points to note

- As indicated from the above cases, whilst the tribunal may refuse an application for an enquiry to be closed immediately, it can specify a time period within which HMRC must conclude its enquiries.
- A closure notice application can be made at any time following HMRC's issue of an enquiry notice.
- Even if the tribunal refuses an initial application by the taxpayer for HMRC to close the enquiry, this does not prevent the taxpayer from further closure applications later on in respect of the same enquiry (e.g. if it is felt that HMRC are prolonging the enquiry unnecessarily).
- If the tribunal directs HMRC to close the enquiry immediately, HMRC will assess any additional income or gains based on its conclusions at the point where the enquiry is closed. If those assessments are excessive, the taxpayer may need to appeal, possibly resulting in a further tribunal hearing.
- HMRC can appeal on a point of law against the First-tier Tribunal's decision to give a direction for HMRC to issue a closure notice. Conversely, the taxpayer can appeal against the tribunal's decision not to give a direction (EM1990).
- HMRC encourages its officers to consider alternative dispute resolution (ADR) as a possible means of resolving disputes or impasses without the taxpayer having to go to the tribunal (EM1976).

Contributed by Mark McLaughlin

Withdrawal of Extra-statutory Concessions

HMRC has published details of 13 extra-statutory concessions that will be withdrawn with effect from April 2015. The concessions relate to:

VAT

- Construction of new student residential accommodation: vacation use ignored when determining whether new student accommodation is intended to be used for a relevant residential purpose.
- New student dining halls: zero-rating allowed if dining halls are used predominately (50%) by living in students. From April 2015, they will have to be used solely (95%) by living in students.
- Reduced value rule for long-stay accommodation: breaks in stay (see VAT section of these notes).
- Tour Operators Margin Scheme: use of a fixed rate margin (10%) for shore excursions sold by cruise operators will end; instead cruise operators will have to account for bought-in shore excursions using TOMS.
- Tour Operators Margin Scheme: The Airline Charter Option which allows tour operators to treat certain supplies of a bought-in charter flight as an in-house supply of zero-rated passenger transport will be withdrawn.

IHT

- Accumulation and maintenance trusts (F8). This concession addressed the situation where there was no statutory right to income at the age of majority which could mean that the relief under s.71 IHTA is not available. Subsequent legislation deemed the age of entitlement to settled property to be 18 so the concession is only relevant in limited circumstances which will be covered in revised guidance.
- Property chargeable on ceasing of an annuity (F11). This concession deals with the computation of the capital value of an annuity when an annuitant under a settlement dies or gives away an interest in an annuity secured under settled property. HMRC states that no cases have been seen in recent years so the concession will be covered in guidance.
- Disposition for maintenance of unmarried mother (F12). The concession treats a disposition by a child in favour of their unmarried mother (so far as it represents a reasonable provision for her care or maintenance) as exempt under s.11(3) IHTA 1984 if the mother is financially dependent on the child. Strictly, the legislation only applies where the mother is incapacitated by old age or infirmity. The concession is obsolete following changes to the definition of 'dependent relative' to include mother or father or the mother or father of a spouse or civil partner.
- Treatment of income tax in Canada on capital gains deemed to arise on a person's death (F18). The concession is an interpretation of law and will be replaced by guidance.

In addition, four concessions relating to Capital Transfer Tax will be withdrawn.

Business Taxation

Samadian case: home travel claims (Lecture B821 – 16.32 minutes)

The Upper Tribunal (UT) has now given its decision in the case of Samadian, upholding the First-tier Tribunal (FTT) decision in favour of HMRC. The case concerns claims for business mileage by a self-employed doctor who claimed to be operating his business from home. Here is a reminder of the key facts.

Facts

Dr Samadian specialises in the health care of elderly people. He is employed full time for the Epsom and St Helier NHS Trust at two hospitals in South London, the St Helier and the Nelson. He has a permanent NHS office with full administrative support, including a secretary.

He holds weekly out-patient sessions at two private hospitals, St Anthony's in Cheam and Parkside in Wimbledon, on a private, self-employed basis, with his secretary working part-time for him in this capacity.

After receiving a referral, Dr Samadian carries out a 'fact finding' consultation at one of the two private hospitals. He also occasionally visits patients at their homes and other places such as care homes. At the private hospitals S rents a room, typically for the three-hour duration of his visit. At other times the room is used by other doctors. A removable name plate is used for the duration of the session. No administrative support is provided.

After these initial consultations, he prepares a treatment plan in his home office and continues to monitor and care for the patient, liaising with the patient's GP and family as necessary. If patients are admitted to hospital, those patients remain under his care and he reviews their condition during his ward rounds six evenings a week at St Anthony's.

He keeps some basic medical equipment (e.g. stethoscope) at home, but does not see patients there (although all business correspondence with his patients and GPs shows his home address).

Horton v Young

Perhaps the leading case in this area is Horton v Young [1971], dating back well before the days of mobile phones and the internet. It concerned a bricklayer who was found to be an itinerant worker operating his business from home, which was the base of his operations due to the fact that he could be contacted there, reviewed plans there, etc. A different outcome was arrived at in Jackman [2004], about a self-employed milkman who essentially did the same work in the same location every day, delivering milk to the same streets. His work was held to begin when he arrived at the depot and picked up his milk float; the depot was therefore his place of business, so travel from home to the depot was not allowable.

FTT decision

The FTT in Samadian emphasised that It was implicit in the Horton decision that Mr Horton's trade was 'itinerant'. Crucially, the sites where he worked were spread across a large area. Also, he had no place of business except his home. According to the Tribunal, the reason why the Court of Appeal did not find that the building sites were additional places of business was the lack of any fixed or regular place at which Mr Horton actually plied his trade.

The FTT found that, unlike Mr Horton, S had a pattern of regular and predictable attendance at specific locations other than his home in order to perform significant professional functions. It was this pattern of regular and predictable attendance to carry out significant professional functions that meant both private hospitals were 'places of business' from which he was carrying on his profession. Thus his circumstances could be distinguished from those of Horton.

The FTT then considered whether Dr Samadian's mileage expenses were allowable under general principles. To do this, they took the unusual step of looking at business mileage in the context of Mallalieu, the well-known 1983 case about whether or not a barrister's clothing was an allowable expense.

The Tribunal found the Mallalieu ruling "important and helpful …in making clear that a court may look behind the conscious motive of a taxpayer where the facts are such that an unconscious object should also be inferred." Whilst it accepted that Dr Samadian had a place of business at home, there must have been a "mixed object" in the travel between home and the private hospitals because part of the object of the journeys must "inescapably" be to maintain a home in a location which was separate from the private hospitals!!

The FTT concluded as follows:

- S had places of business at the two private hospitals and his home, thus his travel between home and those other places of business fell outside the principles in Horton v Young.
- Although S's travel between his home and the hospitals was between places of business, on general principles in the light of Mallalieu v Drummond no deduction could be allowed in relation to that travel.
- S's travel between his places of employment with the NHS and the two private hospitals was undertaken in order to get to and from his place of business and not in the course of carrying on his business.

Appeal to the Upper Tribunal

S appealed to the Upper Tribunal on three grounds.

The FTT had erred in law in characterising the private hospitals as places of business and in distinguishing Horton on that basis. The FTT should have held that S had a single base of operations for his private practice, namely his home.

The FTT had erred in holding that S must have had a mixed object in his general pattern of travelling between his home and his places of business at the private hospitals, as the Tribunal had applied the 'wholly and exclusively' test derived from Mallalieu too strictly.

The FTT had erred in concluding that the travel between the NHS hospitals and the private hospitals was not deductible.

Decision

The Upper Tribunal found that the FTT had rightly focused on S having a number of places of business, rather than there being one single location which could be described as the base of his business. The statutory 'wholly and exclusively' test did not depend on identifying a single base of business.

If followed that the FTT had not made an error in law in analysing whether there was a mixed private and business purpose in travelling between S's home and the private hospitals.

The same reasoning applied to S's travel between the NHS employment and the private hospitals, so journeys between the private hospitals and the NHS hospitals could not satisfy the 'wholly and exclusively' test.

The overall conclusion was that the FTT's decision was correct in all key respects. The FTT had correctly applied the tests for treating travel expenses as deductible or non-deductible, namely:

- Travel expenses are deductible in relation to itinerant work (such as S's home visits to patients).
- Travel expenses for journeys between places of business for purely business purposes are also deductible.
- Travel expenses for journeys between home (even where the home is used as a place of business) and places of business are non-deductible.
- 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.

The appeal was dismissed.

What it means for your clients

Although a judgement that discusses 'subconscious motives' of having a home away from a place of business may seem harsh to some, it is understandable that HMRC pursued the case, as the judgement will enable them to clamp down on business travel claims of those who 'artificially' claim to operate a business from home by setting up an office there while, in effect, carrying out the vast majority of their professional work elsewhere at locations attended regularly.

For a client to be affected, it will have to be established that he or she is not an itinerant worker in the context of Horton. Thus the vast majority of tradesmen who continually move around to different sites should still be able to claim travel to and from home if their business is based there. Similarly, a freelance lecturer who writes material at home, perhaps broadcasts webinars from there and lectures at many different locations on an ad hoc basis should not be affected by the Samadian judgement in terms of claiming business travel to and from his lecturing venues.

It is not just doctors who will potentially be affected though. A freelance lecturer based at home who does the vast majority of his work for two or three colleges at their premises, which he attends on a regular basis, would appear to be caught by this judgement. Similarly, someone whose trade (based from an office at home) consists of attending a number of supermarket car parks on a regular, fortnightly basis to sell policies on behalf of motoring organisations is likely to come within the terms of the judgement, as these car parks would appear to be just as much a place of business for him as the private hospitals are for Dr. Samadian.

Those preparing tax returns will need to take account of this judgement. At the time of writing, it is not known if there will be a further appeal, but as a minimum I would suggest

- warning clients whose business travel claims may be affected by the outcome of this case, and
- including disclosure notes on the white space of the Return in order to limit the potential for discovery.

Also, in the event of a further appeal by Dr Samadian, if HMRC opens an enquiry into the business travel of one of your self-employed clients on the basis that although the business is carried on from home, the person is not an itinerant worker, it may be a good idea to request that the enquiry be put on hold until the outcome of Samadian, to prevent both parties perhaps incurring unnecessary costs.

Contributed by Kevin Read

Partnerships – LLP employed partners

On 21 February 2014 HMRC released updated guidance on LLP employed partners. The new guidance affects an article that appeared in the January 2014 release of Tolley Seminars Online. The updated article is reproduced below for completeness.

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

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

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

Further guidance has been issued on the application of these rules on 21 February 2014.

Partnerships – LLP partners with fixed profit share

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

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

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

The test

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

Condition A : there are arrangements in place as a result of which M is to perform services for the LLP in his capacity as a member of the partnership, and it is reasonable to expect that the amounts payable by

the LLP in respect of M's services will be wholly or substantially wholly "disguised salary" (i.e. it is a forward looking test).

As noted above, the test is a prospective one. Provided that the test is applied reasonably, the test is not revisited with the benefit of hindsight if it is found that any of the assumptions were incorrect.

It should be noted that general partnerships, such as small husband-and-wife partnerships, are unaffected by the Salaried Member rules, which only apply to LLPs.

Disguised salary is defined as an amount which is

(a) fixed,

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

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

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

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

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

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

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

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

In some cases, LLPs pay their fixed share partners though a "fixed profit share". For example, a number of junior LLP members each have a fixed profit share of £75,000 per annum. This fixed share is the first

charge against profits. Based on historical and projected performance, this aggregate entitlement is a small percentage of the firm's overall profits.

The amount is not a fixed amount because, if the LLP makes insufficient profits, the junior members would receive less than £75,000. However, on the facts, absent a catastrophic event, the junior members will receive £75,000. It is therefore reasonable to expect that they will obtain a reward which will not in practice be affected by the overall level of profits.

It should be noted that HMRC does not regard payments made on account of an expected profit share as disguised salary. These sums are only contingently paid and will later be tallied with actual profits (so as to give rise either to a right to further profit or a debt owed to the firm). In such a case, the reward for services is a profit share (with the drawings being the means by which the profit is accessed).

Illustrative examples from HMRC guidance

The examples form part of the guidance notes supporting the legislation, and a selection is reproduced here to aid understanding. It is worth noting that these have changed since the original guidance was issued.

Condition A

Example 1

John is a member in an LLP which has entered into an agreement to develop a property over a three year period. The agreement provides that John will receive a fixed profit share of £100,000 per year for the first two years and then 50% of the profit from the development, expected to be £500,000 in total. This arrangement is not changed.

John is not a salaried member because, viewed at the outset and taking into consideration the whole three year period, the fixed amount payable to John is expected to be less than 80% of his total profit so Condition A will not be met.

If we look again at the example above and consider the position in year 3: assume that the property market slumps and the expected profit does not materialise. John leaves the LLP with nothing other than the fixed profit amounts from years 1 and 2.

Although, as events have turned out, John has received only a salary, this is only the result

of an extraneous event. As the parties expected and intended for John primarily to be rewarded through a share in the overall profits of the LLP, John is not at any time a Salaried Member.

Example 2

X used to be an active member of JKL LLP but reduced his active work a number of years ago and has not provided any services to the LLP for a year. In recognition of his contribution to the partnership over his career, X remains a member of the LLP, continuing to receive a profit share.

X is not receiving a reward for working for the JKL LLP. X reports this profit allocation on the partnership pages of his tax return and pays income tax accordingly. This reward is not disguised salary.

Example 3

M is a member of the BYBY LLP. He has been approached by, and accepted, a more senior role with the Hello LLP.

Under the terms of the LLP Agreement, M will leave the BYBY LLP in three months' time. The Management Board agrees to commute M's expected profit share into a fixed sum, based on profit projections, and M is placed on "gardening leave" for three months.

The arrangement under which M is receiving the fixed sum does not involve the provision of services, and accordingly, Condition A is not met.

Example 4

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

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

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

Example 9

This example highlights that it is important to focus on whether, on **a realistic view**, the amount represents a share of the overall profits, so that the profit share that member gets will vary on the basis of the overall profits of the LLP.

In the ABC LLP, the profits are divided on the basis of units. Each year's profits are allocated by dividing total profits by the number of units in issue to determine the value of a "unit". There are no salaries, or guaranteed profits. Each member's profit share is calculated by reference to the profits and the number of units that they hold.

A is the senior member; he has been allocated units that reflect the time that he has been a member and the fact that he has the main client portfolio for the business.

R is semi-retired but has a large number of units, reflecting her equity investment in the business.

P is a junior member, but has been allocated additional units because she has had an exceptionally successful year.

Q has only just joined the LLP. He has been allocated units that are expected to give him a profit of about 10% more than the salary he had been on as an employee. It is agreed that Q can draw a higher proportion of his expected profits share, in line with his "take home" as an employee, but he has no priority over the other members, and he is aware that in the event of a shortfall, he will have to repay the excess drawings.

All four are receiving profit shares, because the sum they receive is dependent upon the profits of the business. In other words, it is not *varied without reference to the overall amount of the profits or losses of the limited liability partnership.*

To illustrate this, consider how the share P receives may be affected by the profits of the LLP as a whole:
Due to a professional negligence claim, the value of a unit is much lower than last year. As a result, although P has had an exceptional year and has been allocated more points than last year, her share of the profit is £20,000 less than the previous year.

Although P may have more units than last year, what she receives is dependent upon the profits of the business as a whole. The LLP has not had a good year, so even though she has had an exceptionally good year, P actually gets less money than the previous year.

<u>Example 11</u>
BBB LLP is a new fund management venture. The investors agree to provide seed funding of £1m while new investors are being sought.

B is a partner of BBB and is responsible for raising the funds. The partnership documentation says that he is entitled to a first preferential profit share of £100,000 each year including the first year, which will be paid irrespective of the profit and will not be refundable. He will also be entitled to a third of the total profits from year 3 onwards, which are expected to be substantial.

In year 3, the funds have not been raised and the partnership is dissolved.

B fails Condition A as the arrangements are not ones where it is reasonable to expect that B will be primarily rewarded by disguised salary. This was the outcome, but was not the intention and was not the outcome that was expected when the arrangement was entered into.

Reasonable likelihood?

<u>Example 13</u>

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

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

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

Example 14
J works for the ABC LLP. He will receive a salary of £100,000 plus a bonus determined by a remuneration committee, at their discretion.

For the purposes of this legislation, the question is about the terms governing the remuneration committee's exercise of its discretion in determining the bonus payable. If the bonus paid is genuinely a share of the profit of the business, it will not be considered as disguised salary.

In this case, more information is needed to determine whether her award is determined as an additional share of the overall profits of the firm or not. What are the terms of reference for the committee?

If the bonus is an additional share of the overall profit of the business, the next question is how realistic is it that any profit share will be 25% or more of the fixed salary of £100,000 (such that less than 80% of the total rewards will be disguised salary). As stated above, those rewards that are unrealistic and are unlikely ever to be triggered are ignored.

Guaranteed payments

Example 15
The MNS LLP makes a loss of £500,000. However, under the profit sharing arrangements, members A, B, C, D & E will all receive a profit share of £100,000 whilst F has a loss of £250,000 and K Ltd has a loss of £750,000.

The shares payable to members A to E are not affected by the fact that the LLP has made a loss and are disguised salaries. Members A to E satisfy Condition A.
The key point is not how the payment is described; rather that it is a sum that the member expects to receive and will not in practice vary with the profit even if it is expressed to be linked to profit.

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

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

Example 16
D joins the ABC LLP. In his first year, he is guaranteed a total profit share of no less than £30,000. If his allocated share of the profits is less than this, then his share will be £30,000 and the shares of the other members reduced accordingly.

D's guaranteed profit share of £30,000 is disguised salary as it is fixed. Accordingly, unless it is reasonable to expect that ultimately D's share for the period will exceed £37,500 (i.e. the variable element will exceed 25% of the fixed amount), he will meet Condition A.

Example 17
S joins the K LLP. The arrangement under which she joins the LLP provides that, in her first year, she is to be awarded 20 profit sharing units at the beginning of the year, with a guaranteed minimum profit of £80,000. This is intended to reassure her that in her first year, she will be remunerated at least the amount she was paid at her previous firm. When the units are awarded, each unit is expected to give a profit share of £4,500. In the event, the profits are higher than anticipated so that each unit is worth £5,500, giving her an actual profit allocation of £110,000.
At the start of the period, S has a disguised salary of £80,000 and is expected to have a total profit share of £90,000, meaning that Condition A is satisfied. This is not reviewed with hindsight. Obviously, if the profits are expected to be in line with those for the current period then this is taken into account when the test is applied again.

Example 23
This example looks at the "eat what you kill" model.

GGG LLP is a large professional partnership and operates a remuneration system under which each partner is paid a profit share according to the amount of fees he or she has brought in.

If this is an arrangement for the partner to be paid a share of profit, it will not be disguised salary. If it is an arrangement under which the partner receives a cash amount (for example, a proportion of billings), the partner will be a Salaried Member.

Example 24
W LLP operates sites offering "hand car washes". The individuals who wash the cars are members of the LLP rather than being given contracts of employment. Member D washes cars at one of these sites. Member D is paid on a piece work basis; the more cars washed, the more he receives.

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

Example 25
This example looks at guaranteed payments and rewards that are not parts of the overall profits.
The XYZ LLP decides to expand into a new business area. A new member, P, is recruited to run the new business area.
As it is expected that the new business area will initially make a loss, P will receive a guaranteed profit share of £100,000 plus a percentage of the turnover of the new business area.

Neither the guaranteed payments (which may be called "guaranteed profit share") nor the payment based on a percentage of the turnover of that business area is based on the profits of the LLP as a whole. Condition A is satisfied.

Divisions of a business
If a member is be rewarded by i) a fixed amount plus ii) a bonus calculated exclusively on the basis of the success of a particular branch or unit, then Condition A is satisfied.

On the other hand, if the member is to be rewarded on a basis that takes into account the overall profitability of the firm, then Condition A will not be met even if the reward also reflects personal performance or the performance of the division in which he or she works.

Example 26
ABC LLP carries on a financial services business with two divisions; tax and audit. Hank and Mitch run the audit division and Toni and Jo run the tax division. All four are members in the firm. The two divisions keep separate accounts. It is reasonable to expect both divisions to be profitable.

Whether condition A is met depends on all the arrangements and a relevant factor will be what would happen in the event of a loss being made by either business.

If, for example, the LLP agreement provides that each division is insulated from the results of the other (profits or losses), then all the members meet Condition A.

Alternatively the remuneration package may provide that the profits and losses of each division are to be aggregated (after deduction of common overheads) so as to give to a single figure of net profit for the overall business, which is then shared between the divisions, with those shares then being further allocated to the individuals in each.

Such shares may take into account personal and divisional performance as well as other factors, but with none of the members having a fixed entitlement to any of the divisional shares. In this latter case, none of the members meets Condition A.

Each division receives a share of profits allocated by reference to performance and each individual then receives a share of that share. Thus the amount that each individual receives varies with reference to the overall profits of the business (and is in practice affected by the amount of those profits).

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

Example 29

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

Although the written agreement was not amended when X was admitted, the implied terms of the agreement under which X was admitted was that he would have a significant say in the business. As a result, Condition B is not satisfied and X is not a Salaried Member.

It is unlikely that this Condition will exclude many members of very large partnerships, since, in such cases, it is likely that only a minority of individuals have significant influence over the affairs of the whole partnership.

Example 33
Legal Eagles LLP is a professional legal firm with 20 members. They meet each month for meetings at which the major business decisions are discussed and made. All partners attend these meetings and all are entitled to speak. Junior partners are entitled to attend these meetings (though not to vote).
On the facts, the junior partners satisfy Condition B.

Suppose that the way that the firm conducts its business differs from that in the written agreement:
It has become the practice of the firm that votes are never taken and all decisions are made by consensus.

The test is applied on a realistic view of the facts. In this example, the written agreement does not reflect the entire agreement, the implied agreement is now that all members have an equal say. All members fail to satisfy Condition B.

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

Example 34

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

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

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

Although it seems that Conditions A and C of the test could be met in light of her move from a variable to a fixed profit share and the withdrawal of her capital, the circumstances are that she will clearly have significant influence over the affairs of the partnership for the whole of this period. Therefore, Condition

B will not be met, meaning that Conditions A and B will not need to be considered; E will not be treated as a salaried member.

Indirect influence?
The test is whether that member has influence. Indirect influence, such as by being a director of another member, is not taken into account. Such indirect influence does not derive from the rights or duties of the individual as a member of the LLP.

Example 36
T is a member of the STU LLP and also a director of STU Ltd, the corporate member. Under the LLP agreement, control of the STU LLP is vested in the corporate member.

In her own right, T does not have significant influence. STU Ltd, of which she is a director, does have significant influence but this "indirect" influence is not taken into account. T therefore satisfies Condition B.

When to apply Conditions A and B
For individuals who are members at 6 April 2014, the test needs to be applied at that point.

For individuals who become members after 6 April 2014, the test needs to be applied at the date on which they become members.

Once the tests have been applied, then they do not need to be applied again until the arrangements change.

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

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

Applying Condition C at 6 April 2014
The test first has to be applied at 6 April 2014.

To avoid the position where individuals are treated as employees for a short period whilst they obtain finance in order to invest capital, the legislation is being amended.

Condition C will not be satisfied if:

- at 6 April 2014, there is an unconditional requirement for that member to provide the capital; and
- the capital is contributed within 3 months from 6 April 2014.

If the member does not contribute the capital within 3 months, then their position has to be reviewed.

Applying Condition C to new members
Individuals becoming members may also experience delays in obtaining loan finance to invest as capital so the basis on which Condition C is applied to new members is being amended.

Condition C will not be satisfied if:
- at the point at which the individual becomes a member there is an unconditional requirement for that member to provide the capital; and
- the capital is contributed within 2 months of becoming a member.

If the new member does not contribute the capital within 2 months, then their position has to be reviewed.

Contributions
The amount of capital contribution is based on the amount that the individual has invested as capital at that time in accordance with the LLP Agreement and which cannot be withdrawn unilaterally by the member (only on retirement, dissolution or with the agreement of all members).

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

Example 41

P has:

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

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

Example 42
M is appointed a member three months into the tax year. His reward package means that he will be due a fixed amount of £40,000 for the rest of the tax year (his "disguised salary"). The terms of his membership mean that he had to make a capital contribution of £12,000.

At first sight, M's contribution may appear to be at least 25% of his disguised salary (12,000/40,000 x 100 = 30%).

However, he will only be a member for nine months of the current tax year. His capital contribution is, therefore, reduced to reflect the period of the year that he will be a member: 12,000 x (9/12) = £9,000.

When the test is applied using this reduced figure (9,000/40,000 x 100 = 22.5%), Condition C is satisfied.

General examples in Annex to HMRC Guidance

Example 1

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

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

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

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

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

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

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

Example 2

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

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

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

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

This is not a factor in the Salaried Member test.

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

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

Example 3

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

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

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

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

Contributed by Rebecca Benneyworth and Malcolm Greenbaum

Cross Border Group Relief

The case concerned the entitlement of M&S to obtain group relief in relation to losses incurred by subsidiaries operating in other EU jurisdictions.

In May 2013, the Supreme Court held that the 'no possibilities test' should be applied at the date of the claim. This gives the right to cross-border group relief in relation to losses that cannot be relieved in the member state in which the loss-making company is established. The instant case dealt with the remaining issues.

Decision:

First, the court found that domestic legislation (FA 1998 Sch 18) allowed sequential/cumulative claims for the same losses and in respect of the same accounting period. This meant that M&S could withdraw its earlier claims, which had failed the 'no possibilities test', and submit new claims when the test was satisfied.

However, the court rejected M&S's contention that it should be allowed to make pay and file claims that were now time barred. Its contention was based on the fact that, when the claims could still have been made, the ECJ had not yet identified the circumstances in which losses may be transferred cross-border. The court considered that 'the principle of effectiveness could not be invoked since there was no right under Community law in respect of which a claim could be made within the time limit'.

Finally, the court held that the correct method of calculating the losses consists in applying the local rules to identify the loss and the amount that can be used. The remainder of the losses should then be converted to UK principles.

Comments - This decision provides clarity over an issue which arose over a decade ago. Although it confirms that some claims are now time barred, the judgment is generally favourable to international groups with loss-making companies in the EU.

HMRC v Marks and Spencer [2014] UKSC 11

Marginal relief: associated companies

The question to be determined by the tribunal was whether Ghelanis was associated with a company (EEE). If it was not, marginal relief from corporation tax was available under ICTA 1988 s 13. The issued share capital of Ghelanis and EEE was owned by the same seven shareholders (named A to G for convenience). The two companies were associated if they were controlled by the same person or persons (ICTA 1988 s 416). Ghelanis contended that the greater part of the share capital of EEE was owned by B and C together; therefore, the two companies were not associated, as Ghelanis was not controlled by these same persons.

Decision:

However, the tribunal pointed out that the test for control includes any persons, or combinations of persons, who could, in varying circumstances, exercise control. The tribunal concluded that there were two combinations that could control both companies: A, B and D; and A, C and D; and therefore the companies were associated.

Comments - ICTA 1988 s 416 is notoriously difficult to apply to situations where several shareholders can exercise control of a company together, whether as a result of shareholding rights or otherwise. The case is therefore a useful reference guide in such circumstances.

Ghelanis Superstore v HMRC TC3251

Loans to participators

The UT had to decide whether Aspect Capital (which was a close company) had made loans to employees (who were participators); and, if so, whether these were chargeable to tax under ICTA 1988 s 419.

Each employee had entered into a share acquisition agreement and a facility agreement with the company. Under the share acquisition agreement, each employee incurred the obligation to pay for shares that they had applied to acquire in the company; they obtained funds to finance the acquisition under the facility agreement. The funds were repayable on a 'conversion event', such as the employee leaving the company. The date of payment and the amount payable were therefore uncertain. The tribunal found that these uncertainties did not prevent the amount lent under the facility agreement from being a loan.

Decision:

The tribunal also found that a debt (equal to the facility amount) had been created, on the basis that the agreement had created a contingent obligation to repay.

Comments - Close companies wishing to establish an employee share scheme should bear this case in mind and avoid financing the acquisition of shares by their employees.

Aspect Capital v HMRC (FTC/71/2012)

Transfer of real property into unapproved benefit scheme

Mr Dhanak had set up an unapproved retirement benefit scheme for his sole benefit. In April 2009, following the decision of the Court of Appeal in Irving v HMRC [2008] EWCA Civ 6, HMRC had concluded its inquiry into Mr Dhanak's returns by amending them in relation to transfers of real property which were now considered as 'sums paid' into the scheme. In January 2010, Mr Dhanak's brother became the sole beneficiary of the scheme. Mr Dhanak therefore applied for relief under ITEPA 2003 s 392.

Decision:

The Upper Tribunal (UT) noted that there is no provision for an appeal against a refusal of relief under s 392 and concluded that there was no legislative intention that a refusal of relief under s 392 should be appealed. The UT therefore allowed HMRC's appeal against the refusal of its application to strike out Mr Dhanak's statutory appeal. Applying Tower MCashback [2011] UKSC 19, the application for relief under s 392 was clearly not within the scope of HMRC's inquiry and so could not be within the scope of an appeal against HMRC's closure notice in any event. Finally, Mr Dhanak also challenged HMRC's decision not to apply the relief by way of judicial relief. The UT did not consider it 'inevitable' that, if required to retake the decision, HMRC would refuse the application for relief. However, rather than quashing HMRC's decision, the UT circulated its ruling in draft form and left it to the parties to agree the way forward. HMRC agreed to grant relief.

Comments - The case confirms that, in the absence of a statutory right of appeal, taxpayers can avail themselves of their right to a judicial review. The decision of the UT to circulate its decision in draft, leaving it up to the parties to agree the final outcome on the basis of the UT's analysis, is also interesting.

HMRC v Mitesh Dhanak (FTC/52/2012)

Fatal closure notice

In August 2003, Bristol & West plc (B&W) transferred a swap contract to its sister company, Bank of Ireland Business Finance (BIBF), for £91m, intending to take advantage of a loophole in the derivatives transitional provisions in FA 2002, which changed the tax rules for the swap from an accruals to a mark-to-market basis.

The new regime applied to a company's first accounting period beginning on or after 1 October 2002. B&W's accounting period began on 1 April 2003, so was in the new regime, but BIBF's accounting year began on 1 September 2002, so was not when the transfer took place. The aim was to rely on the rollover rule in FA 2002, Sch 26 para 28, so that the £91m paid to the taxpayer would disappear from B&W's accounts but not reappear in BIBF's accounts.

The First-tier Tribunal agreed with HMRC that the rollover rule did not apply and the whole £91m was subject to tax. The taxpayer appealed.

Decision:

The Upper Tribunal agreed with the First-tier Tribunal's decision. Mr Justice Smith said he could “not see how para 28 can operate unless both companies fall within the regime”. However, the Upper Tribunal allowed the taxpayer's appeal on a point involving a closure notice mistakenly sent to the company by HMRC. In November 2005 HMRC issued a notice of enquiry into the return submitted by B&W for the period ending 31 March 2004. On 31 October 2007 HMRC mistakenly issued two closure notices, which did not include a substantial adjustment that should have been made to the company's profits.

On the same day HMRC emailed the taxpayer, informing it about the mistake. In November HMRC wrote to B&W, stating that the notices had statutory effect under FA 1998, Sch 18 para 32 but that they proposed to amend B&W's returns under Sch 18 para 34. In April 2008 HMRC again wrote to the taxpayer purporting to withdraw the closure notices, and in February 2010 tried to issue revised new closure notices. B&W appealed, contending that the closure notices issued in October 2007 were final and that HMRC had no power to amend its returns under Sch 18 para 34.

The Upper Tribunal accepted this argument, noting that, in their letter of November 2007, HMRC "plainly accepted that the closure notices were valid".

The taxpayer's appeal was allowed in part. In summary, the judge ruled that the swap transfer was not to be disregarded for the purposes of FA 2002, but because the closure notice for the period ending 31 March 2004 was valid, HMRC were unable to collect the tax arising out of the transfer between the two companies in that tax year. HMRC issued a press release noting that, as a result of the decision, "a further £215m was protected when other followers of the [swaps] plan settled before being taken to tribunal".

Comments - The taxpayer had sought to take advantage of a perceived loophole (created in all likelihood by a drafting mistake) and failed. The case may be a warning to other taxpayers tempted to take advantage of legislative loopholes in ways that are obviously at odds with the legislative intent.

Bristol & West plc, Upper Tribunal

Group relief for underwriting losses

The tribunal considered the eligibility for group relief of underwriting losses of a corporate underwriter at Lloyd's. The tribunal explained that the special scheme of taxation which applies to underwriters — and which takes into account the fact that the profit and losses of a particular period may not be known for a few years after the end of the period — gave rise to potential abuse. A loss-making company could be shut down and transferred into a profitable group before the losses were recognised for tax purposes, so that the losses would be available for group relief. FA 1994 s 227A is aimed at such tax avoidance.

Decision:
The tribunal found that s 227A could apply to losses incurred in the underwriting year 2000 which had been postponed by an election (under FA 1994 s 107(4)) so as not to crystallise until 2007/08.

However, the tribunal found that the wording of the provision did not catch the present situation, as the 'group-relief continuity provision' was satisfied — regardless of the fact that the relationship had changed from a consortium to a group relationship. A 'previous economic relationship' between the transferor and the transferee of the losses was sufficient and so the appeal was allowed.

Comments - The tribunal refused to interpret an anti-avoidance provision beyond its intended purpose.

Standfast Corporate Underwriters v HMRC TC3322

Capital versus revenue expenditure (Lecture B822 – 13.16 minutes)

Repair versus replacement
A repair to an asset restores it to what it originally had been and is normally an allowable revenue expense (e.g. replacing roof tiles blown off by a storm). Replacing part of an asset is also a repair, as opposed to replacing substantially all of it which would be capital.

Case law has backed up this principle many times (for example replacing a chimney on a building is a repair, but where the chimney IS the building, such as with a power station, replacing it is capital).

The cost of alterations are normally capital for tax purposes as they involve improving or changing an asset and so providing an enduring benefit to the business, rather than simply restoring it to its previous state. For example extending the area of the roof or taking off the roof and building another storey.

Replacing the whole roof should be an allowable expense as this is the replacement of part of an asset (i.e. the building).

A repair or replacement of a part of an asset using modern materials if the new materials are broadly equivalent to the old materials is normally an allowable expense (e.g. replacing single-glazed windows with double-glazed windows).

Change of use of an asset
The possibility of expenditure on improvement or alteration should particularly be considered where a newly acquired asset is being subjected to a change of use, and therefore needs to be altered to adapt it for its new purpose.

Integral features
There are also special capital allowances rules relating to expenditure on specified 'integral features' of buildings, such as electrical systems, water systems and lifts. Under these rules if the expenditure represents more than 50 per cent of the cost of replacing an integral feature, the expenditure is to be treated as capital expenditure for tax purposes but capital allowances will be available.

Repairs to newly acquired assets
There are circumstances in which the cost of repairs may constitute capital expenditure even though the work does not improve a newly acquired asset but merely restores it to an acceptable condition. Factors that may be relevant are:

- whether the asset could be used in the business without being repaired
- whether the asset could only be used in the short term as its long term use was dependent upon the repairs being carried out
- whether the purchase price of the asset was substantially reduced because the asset needed repairing.

As an example, if a car was purchased which had failed its MOT, the cost of gaining an MOT certificate does not improve the car but the car could not be used without the work so it should properly be treated as capital.

Incidental costs
Expenses incurred in the course of capital transactions are not allowable as revenue expenditure. Costs such as SDLT or legal and professional fees (e.g. architects', engineers' or surveyors' costs), incurred when acquiring or disposing of an asset should be treated as capital expenditure. This is even true for abortive purchases where the transaction ultimately does not go ahead.

Costs incurred in bringing a new asset into use, such as transporting it to its intended site or erecting and installing it should also be capitalised as part of the cost of the asset.

Changes in capital structure
Fees incurred in connection with the acquisition, alteration or enhancement of how the ownership of a business is structured should generally be disallowed. This will include costs incurred on items such as the following:

- forming, varying or dissolving a partnership
- the incorporation of a sole trader's or a partnership's business
- a partnership becoming a limited liability partnership
- defending a petition by shareholders to wind up a company

Training resulting in new skill
Where a completely new specialisation or qualification is acquired as a result of training, it is possible that the expenditure will not be wholly and exclusively for the purposes of the existing trade.

Software
Most off-the-shelf computer software is now acquired under licence. If the licence is paid for by regular periodical payments then these should be treated as revenue expenditure and normally spread over the useful life of the software.

If a lump sum payment is made for the software licence, and it is evident that the useful economic life of the software is greater than two years, consideration should be given to treating the payment as capital expenditure.

For proprietors and partnerships any amortisation of capital expenditure in these circumstances should be disallowed, and a claim should be made for capital allowances. The same treatment will apply to companies if the software acquired is in the nature of an operating system, or similar system designed to bring a computer system into its intended use within the business, which will generally be regarded as a tangible asset.

However if the expenditure relates to application software then it may be regarded as an intangible asset and for companies such expenditure may fall within the corporate intangible assets regime. In these circumstances any amortisation of the capitalised expenditure may be allowed for tax purposes, or alternatively the company may elect to exclude the expenditure from the intangible assets regime and claim capital allowances instead.

Website development

Application and infrastructure costs, including domain name, hardware and operating software that relates to the functionality of the website should normally be treated as capital expenditure. Design and content development costs should normally be treated as capital expenditure to the extent that an enduring asset is created.

One such indication may be an expectation that future revenues less attributable costs to be generated by the website will be no less than the amounts capitalised.

A website that will directly generate sales, subscriptions, advertising or other income will normally be regarded as creating an enduring asset and consideration should be given to treating the costs of developing, designing and publishing the website as capital expenditure.

Whilst a revenue deduction would not therefore be allowable, this capital expenditure will generally qualify as expenditure on plant and machinery for capital allowances purposes.

Expenditure on initial research and planning, prior to deciding to proceed with development, is normally allowable as revenue expenditure.

The cost of maintaining or updating a website (in relation to price changes, for example) should be treated as revenue expenditure.

Contributed by Malcolm Greenbaum

FA 2012 capital allowances changes for fixtures **(Lecture B823 – 27.17 minutes)**

Introduction

Finance Act 2012 introduced new sections 187A and 187B of the Capital Allowances Act 2001 (CAA 2001). These created two obstacles that buyers of commercial property must navigate to claim plant and machinery capital allowances for fixtures.

The first is called the 'Fixed Value Requirement' (although there is a rarer alternative called the 'Disposal Value Statement Requirement'). The second is called the 'Pooling Requirement' - which will be covered in a future seminar.

The changes were introduced in two stages. The first has effect from April 2012 and the second from April 2014. They only apply to property sales and purchases taking place from April 2012 (or 2014 as appropriate).

If the property was purchased before April 2012 then the capital allowances claim is unaffected. Capital allowances may be claimed by the buyer in a later period's tax return (even after April 2012) providing that the fixtures in question are still owned in that later period (that is, they have not been stripped-out, or the property sold, by then).

Failure to comply with these new rules, where they apply, is catastrophic for the buyer of a commercial property. Its capital allowances claim for the fixtures in question will be nil. To make matters worse, if the property is later sold on, then all future owners' claims will also be nil. The outcome is a permanently blighted property with no capital allowances associating with those fixtures. This may damage the market price of affected properties.

Background to Changes

In March 2011 HMRC announced that it would consult on changes to the rules dealing with plant and machinery allowances for fixtures. Following consultation, about a year later these became law in Finance Act 2012.

HMRC suggested that the ability to make late capital allowances claims several years after a property acquisition (when there might be limited information about the seller's capital allowances treatment) had led to an increase in some capital allowances' advisers encouraging buyers to make substantial late capital allowances claims. In itself there was nothing wrong with that.

However, HMRC was concerned that capital allowances statute was not always being followed. First, HMRC believed that some sellers were not properly accounting for disposal proceeds. If that was the case it meant that the seller and buyer were double-claiming on the same qualifying expenditure. Second, where a seller has pooled expenditure on fixtures, CAA 2001 s 185 limits the buyer's qualifying expenditure to the seller's disposal value. But if the seller had failed to account for disposal proceeds (or to tell the buyer that it had claimed) then there was a risk that the buyer would inadvertently claim on an unrestricted apportionment of the purchase price. This could ramp-up, or inflate, the qualifying expenditure.

Fixed Value Requirement

This applies to property sales and purchases from 1 April 2012 (corporation tax) or 6 April 2012 (income tax).

Where a seller (or other previous owner since April 2012) has claimed plant and machinery allowances for fixtures then, in the vast majority of normal transactions, in order for the buyer to satisfy the Fixed Value Requirement and claim capital allowances one of two things must happen within two years of the transaction Completion date, either:

<u>Option 1 - Section 198 election</u>

The seller and buyer may agree a CAA 2001 s 198 (or s 199 for leases) joint election to establish the seller's disposal value (and maximum buyer's claim, where this is lower than an apportionment).

Option 2 - First-tier Tribunal Determination

Where no election is agreed the seller should account for disposal proceeds calculated as an apportionment of the sale proceeds, capped at a maximum of the qualifying expenditure originally pooled (if this is lower than the apportionment). The buyer may pool expenditure calculated as an apportionment of the purchase price, capped at the seller's disposal value (if this is lower than the apportionment). Then either party (likely to be the buyer) must apply to the Tax Tribunal of the First-tier Tribunal to ratify the figures used.

The Fixed Value Requirement only applies to individual plant or machinery fixtures upon which capital allowances have been claimed previously. It does not apply to assets upon which a claim has not previously been made. A common example, is 'pre-commencement integral features' (that is cold water, general electrical power and lighting, and external solar shading). These often are not plant in a seller's hands because its expenditure was incurred before April 2008 (when CAA 2001 first designated these assets as plant in all circumstances). To claim upon such fixtures the buyer simply needs to prepare an apportionment of the purchase price and pool the qualifying expenditure in the usual way. It is not possible to enter into a s 198 election in respect of such expenditure. Nor is it necessary to apply to the Tribunal in respect of these assets.

Section 198 elections

A s 198 election can be sensible if the amount is fair (that is, it broadly approximates to the lower of the seller's qualifying expenditure or an apportionment) and it meets the necessary technical conditions. This provides certainly at the time of the deal and avoids a Tribunal application.

However, in practice section 198 elections generally favour sellers. This is because without an election most (or all) of the qualifying expenditure will automatically be clawed-back on sale and pass to the buyer. By agreeing as low an election amount as possible, an election opens the opportunity for a seller to keep some (or all) of the tax relief despite selling the qualifying assets or having suffered any economic loss.

Section 198 elections are generally inadvisable for buyers because even if there is an election, in many cases an apportionment will still be needed to value chattels (which cannot be covered by a fixtures election) and fixtures upon which a claim has not been previously made. The most common example of the latter is 'pre-commencement integral features' - these can only be valued by apportionment of the total purchase price.

Elections must meet various technical considerations. Taxpayers commonly get these wrong and there is a likelihood that HMRC will look for reasons to reject flawed elections. If a purported election is found to be invalid but by then the buyer is out of time to remedy this or make a Tribunal application instead, then its capital allowances claim is nil.

The main danger is that many buyers sleepwalk or are railroaded into bad elections at low amounts. Without an election a buyer is in the strongest possible position because it will automatically inherit all of the qualifying expenditure. That is how the capital allowances system is meant and designed to work. But when capital allowances become a commercial matter for negotiation, reasonable buyers get talked into 'compromising'. More often than not this means giving away valuable tax relief (without getting anything of equivalent value in return) that the buyer should, and would, otherwise receive without an election.

First-tier Tribunal application

There should be nothing to fear about applying to the Tribunal.

The First-tier Tribunal is relatively informal and used to hearing self-represented litigants and accountants, rather than barristers.

HMRC is not involved. One taxpayer (likely to be the buyer) simply puts forward a valuation that it proposes to use for capital allowances purposes and asks the Tribunal to rubberstamp this (or adjust it as appropriate). The other party has the right to put forward its own evidence. The underlying capital allowances mechanisms and valuation methodology used are well-established . As long as the facts, statute and valuation protocols are properly presented then the process should be straightforward, and the time and costs involved be modest. And the outcome arguably gives greater certainty than a potentially flawed election which is open to challenge by HMRC.

Given the amounts at stake in commercial property transactions, the interests of many buyers will best be protected by declining to enter into a sub-optimal s 198 election and instead seeking a Tribunal determination.

Because it is possible to agree an election before the Tribunal determines the application or the application is withdrawn, the Tribunal arbitration process can also be used to encourage an uncooperative seller to provide sensible information about its capital allowances position and to foster a realistic approach to a fair election amount.

Certain Written Statements

There is also a 'fallback' mechanism to satisfy the Fixed Value Requirement. This is called 'certain written statements' and applies where a property owner that is not within the charge to tax (such as a charity) bought the property after April 2012 from someone who had claimed allowances, but upon purchase the charity inadvertently failed to satisfy the Fixed Value Requirement.

If the charity later sells the property onto a taxpaying business, in order for that taxpaying buyer to claim allowances it needs:

- A written statement from the charity confirming that it failed to agree an election or make a Tribunal application and is now out of time to do so, and
- A written statement from the taxpaying business that sold the property to the charity, confirming the disposal value brought into account when that prior owner sold the property to the charity.

So, even if commercial property is being brought from a charity or the like, the buyer still needs to know whether the charity bought the property after April 2012, who the previous owner was, and what that previous owner's disposal value was if it had claimed capital allowances.

Disposal Value Statement Requirement

There is also a rarer alternative to the Fixed value Requirement. This is called the Disposal Value Statement Requirement. This is unlikely to often be seen in practice.

It applies in circumstances where a s 198 election is not permitted and CAA 2001 requires a market value disposal value. These are changes of ownership where the past owner's disposal value falls within items 2 or 3 of the table in CAA 2001 s 196, or item 7 of the table in CAA 2001 s 61.

Contributed by Steven Bone

Corporation tax penalties (Lecture B824 – 10.08 minutes)

If the company or organisation has Corporation Tax to pay but it did not receive a 'Notice to deliver a Company Tax Return' from HMRC, it still must notify HMRC it' is liable for Corporation Tax within 12 months of the end of the Corporation Tax accounting period.

If it does not there may be a 'failure to notify' penalty. The penalty is based on the amount of tax unpaid or that the company or organisation is liable for (the 'potential lost revenue' or 'PLR').The potential lost revenue from a failure to notify chargeability for corporation tax is the amount of tax that is unpaid 12 months following the end of the accounting period.

This includes s.455 liability for loans to participators in close companies.

A penalty (of any kind) will not be charged if the company had a 'reasonable excuse' for a failure or late payment.

A reasonable excuse is normally an unexpected or unusual event that is either unforeseeable or beyond the person’s control, and which prevents the person from complying with an obligation to notify when they would otherwise have done.

A combination of unexpected and foreseeable events may be a reasonable excuse when viewed together.

It is necessary to consider the actions of the person from the perspective of a prudent person, exercising reasonable foresight and due diligence, having proper regard for their responsibilities under the tax acts.

If the person could reasonably have foreseen the event, whether or not it is within their control, HMRC expects the person to take steps to meet their obligations.

Some examples that can constitute reasonable excuse are death or serious illness of key employees/directors or a close relative, and unforeseen events such as flood or fire, or extended strike action of the postal service.

If there is a reasonable excuse it must exist throughout the period of the default.

The law does specify two situations that are not reasonable excuses

1. shortage of funds (except where the shortage is due to unexpected events outside the control of the company or organisation)
2. reliance on another person (though if professional help is obtained and there is no reason to suspect the advice is incorrect, the company or organisation can have a reasonable excuse)

The penalty is calculated by applying a percentage to the PLR, which depends on whether the error or failure)was:

- **careless** - a lack of 'reasonable care'
- **deliberate** - such as intentionally sending incorrect information
- **deliberate and concealed** - such as intentionally sending incorrect information and taking steps to hide the error

These penalties are also applicable to inaccuracies in a corporation tax return resulting in potential lost revenue to HMRC.

Reason for penalty	Max Penalty	Min penalty (unprompted)	Min penalty (prompted)
Careless inaccuracy	30% of PLR	0% of PLR	15% of PLR
Deliberate, not concealed inaccuracy	70% of PLR	20% of PLR	35% of PLR
Deliberate and concealed inaccuracy	100% of PLR	30% of PLR	50% of PLR
Understated assessment not notified	30% of PLR		

The maximum penalty percentage is reduced by an amount that represents the quality of disclosure. To calculate the reduction for disclosure, HMRC considers the three elements of disclosure

1. telling (up to 30% reduction)
2. giving reasonable help (40%)
3. allowing access to records (30%)

Example:
A company has a PLR for a deliberate not concealed inaccuracy of £7,000. There is unprompted disclosure and the HMRC officer indicates that this disclosure has a quality of 55% overall.

The penalty payable will be 70% minus 55% x (70% - 20%) = 42.5% of £7,000.

Automatic flat-rate penalties for late Company Tax Returns
If it files a CT return late, the company or organisation will be charged a flat-rate penalty of £100. HMRC will charge a further £100 penalty if it files the return more than three months late.

If the Company Tax Return is late for three or more accounting periods in a row, the initial flat-rate penalty increases to £500 with a further £500 charged if it files the return more than three months late.

Additional penalties for very late Company Tax Returns

If the company fails to file the CT Return **by the later of**:

- 18 months from the end of the Corporation Tax accounting period
- the filing deadline

HMRC may charge the company or organisation further penalties from that date on top of the flat-rate penalty or penalties already been charged.

These additional penalties are:

- where a return is filed between 18 months and 24 months after the end of the company's accounting period: 10% of any unpaid Corporation Tax
- where a return is still not filed 24 months after the end of the accounting period: a further 10% of any unpaid Corporation Tax

Here, the amount of unpaid Corporation Tax is the amount due but unpaid by the date the company first became liable to a tax-related penalty.

Failure to keep sufficient records

Failure to keep sufficient records to enable filing of complete and accurate return – up to £3,000 penalty (but only charged in very serious cases).

Contributed by Malcolm Greenbaum

The new Employment allowance

Who can claim

- the Employment Allowance permits eligible employers to reduce their employer Class 1 NICs by up to £2,000 each tax year
- a business or charity can claim the Employment Allowance if it pays employer Class 1 NICs on its employees' or directors' earnings
- if a company belongs to a group of companies, or a charity is part of a charities structure, only one company or charity can claim the allowance
- a business can only claim the £2,000 Employment Allowance against one PAYE scheme, even if the business runs multiple schemes.
- not all businesses can claim the Employment Allowance: see excluded employers below

How to claim Employment Allowance

Employers can use their own payroll software or HMRC's Basic PAYE Tools to claim the Employment Allowance.

Employers making a claim must reduce their employer Class 1 NICs payment by an amount of Employment Allowance equal to their employer Class 1 NICs due, but not more than £2,000 per year. For example, if employer Class 1 NICs are £1,200 each month, in April the Employment Allowance used will be £1,200 and in May £800, as the maximum is capped at £2,000.

Once made, HMRC will automatically carry your claim forward each tax year.

Excluded employers

An employer cannot claim the Employment Allowance if they:

- employ someone for personal, household or domestic work, such as a nanny, au pair, chauffeur, gardener, care support worker
- already claim the allowance through a connected company or charity
- are a public authority, including local, district, town and parish councils
- carry out functions of a public nature (unless it has charitable status), eg:

  - NHS services
  - GP services
  - the managing of housing stock owned by or for a local council
  - providing a meals on wheels service for a local council
  - refuse collection for a local council
  - prison services

- collecting debt for a government department

Personal and Managed Service Companies who pay contract fees instead of a wage or salary may not be able to claim the Employment Allowance, as the allowance cannot be claimed for any deemed payments of employment income.

Service companies can only claim the allowance if they pay earnings and have an employer Class 1 NICs liability on these earnings.

VAT

Vouchers: is a commission charged on redemption taxable?

The issue was the correct treatment of transactions involving 'Secrets money'; vouchers issued by the Secrets companies, which enabled patrons to continue spending money in lap dancing clubs when they had run out of cash. The Secret companies charged 20% commission on issue of the vouchers to patrons and again on redemption of the vouchers by the dancers. It was accepted that the supply of the vouchers to the patrons was a taxable supply. The question was the VAT treatment of the commission charged to dancers. Secret companies had no right to any part of a dancer's earnings, and derived their income from entrance fees from both dancers and patrons, cloakroom charges, the sale of drinks and food, and commissions on Secrets money.

Decision:

Relying on the statutory words 'without gloss', the tribunal found that 'Secrets money' is a security for money within the exemption provided by VATA 1994 Sch 9 Group 5. The tribunal stressed that 'security' has a wide meaning and can be issued by a person which does not fall within Group 5 note 4, regardless of the fact that the transaction does not generate a credit risk. However, the tribunal, found that the composite supply by Secrets to the dancers was not one of 'dealings in ... security for money'. Rather, the 20% charge was consideration for Secrets' provision of a single, taxable supply of performance facilitation services to the dancer. Redemption of the Secrets money itself represented only an ancillary part of the overall, composite supply, which was taxable.

Comments - Although the appeal was dismissed on other grounds, the tribunal confirmed that the VAT exemption applying to securities related services is available to non-financial institutions, in the absence of any credit risk. This may prove useful in other circumstances.

Secrets v HMRC TC3255

Are vouchers, given away to customers, subject to VAT?

The publishers of newspapers had sought to increase their distribution by offering retail vouchers to customers who had paid for daily delivery over a period of 12 weeks. Under the VAT (Supply of Services) Order, SI 1993/1507, art 3, the supply of free vouchers for purposes other than the purposes of the business triggers a liability to output tax (calculated by reference to the cost of the vouchers). The issue was therefore whether the vouchers had been supplied in furtherance of the publisher's business. The drafting of article 3 did lead to the suggestion that 'if any such services are made available to customers for their personal use, then by definition the taxpayer will have made those services available to the customer for use for non-business purposes (the non-business purposes of the customers)'.

Decision:

However, the tribunal added that the Sixth VAT Directive art 6 (which art 3 implements) makes it clear that the relevant 'purposes' are 'the purposes of the taxpayer in making the services available to the third party, not the purposes of the third party in ultimately making use of the services supplied to him'. The tribunal then referred to the CJEU's decision in Danfoss [2009] STC 701 as authority for the proposition that most businesses arrange their affairs for sound business reasons and that all that was necessary to establish was whether the particular activity was conducted 'strictly for business-related purposes'. The tribunal concluded that the vouchers had been part of a highly effective business promotion and had been given out in the normal course of the taxpayer's business.

Comments - UK VAT provisions must always be interpreted in the light of the European provisions they implement. This is crucial in circumstances, such as here, where the UK drafting is misleading.

Associated Newspapers v HMRC TC3256

Retail vouchers

The taxpayer provided accounting and taxation advice. It also sold retail vouchers issued to it by retailers.

Decision:

The tribunal considered that the vouchers were both 'face value' and retailer vouchers for the purpose of VATA 1994 Sch 10A paras 1(1) and 4(1). Consequently, the consideration for the issue of the vouchers by the retailers to the partnership must be disregarded; therefore, no input tax on those supplies could be claimed under VATA 1994 s 24(1). However, the tribunal rejected HMRC's contention that the standard rate applied to the supply of the vouchers by the partnership. The tribunal noted that the partnership supplied vouchers for supermarkets which sold not only standard rated products but also exempt and zero rated products. Therefore, the rate must be calculated (and agreed between the parties) on a 'just and reasonable basis'. Finally, HMRC had indicated in a letter that the vouchers should be zero rated. The taxpayer argued that this constituted a ruling giving rise to a legitimate expectation. The tribunal found that even if the letter had constituted a ruling, it would not have been within HMRC's power to make such a ruling as it would have been contrary to VATA 1994 Sch 10A — which provides that the rate applicable to vouchers depends on the rate applicable to the goods and services such vouchers give right to. Consequently, the tribunal did not have jurisdiction to consider the public law issue of legitimate expectation (Abdul Noor v HMRC [2013] UKUT 71).

Comments - The VAT treatment of vouchers has generated a flurry of case law recently. This case is slightly different from the previous ones, as it focuses on the applicable rate. It is also a useful reminder of the limited jurisdiction of the FTT in relation to legitimate expectation.

Templar Business Center v HMRC TC3271

Supplies are closely related

The taxpayer, Brockenhurst College, provided vocational courses in catering and the performing arts. It ran a restaurant in which all the catering functions were carried out by students to enable them to learn the skills in a practical environment. Members of the public could eat in the restaurant and were charged about 80% of the cost of the meal. Similarly, performing arts course students put on shows in the college which members of the public could attend.

The college claimed a repayment of output tax in respect of supplies made of restaurant and entertainment services on the basis that they were covered by the education exemption in VATA 1994, Sch 9 group 6. HMRC disagreed, saying the supplies should be standard rated.

Decision:

The First-tier Tribunal allowed the taxpayer's appeal, saying that the catering and entertainment services were essential to the college's principal supply of education. HMRC appealed.

The Upper Tribunal looked at article 132(1)(i) of the Principal VAT Directive which defines the scope of the exemption. It concluded that the main issue in the appeal was whether the supplies in question were closely related to the provision of education.

After reviewing cases that had come before the Court of Justice of the EU, the Upper Tribunal concluded that the First-tier Tribunal was correct to find that the restaurant and entertainment services were exempt because they were essential to the main supply of education. They were “not an end in themselves but a means of providing the students with a better education”. Nothing in EU law required the supplies to be consumed by the students.

HMRC's appeal was dismissed.

Comments - Mike Thexton, director of Thexton Training Ltd, said: “The First-tier Tribunal decision was at first sight surprising, because VAT usually deals in facts and disregards the context. However, recent cases have referred to the importance of the 'economic and commercial reality' — perhaps that is a subtle change of direction which we will see more of in future decisions. In the Upper Tribunal, Judge Berner concluded that the meals were consumed by the people who ate the food, but that was not 'what was really going on' — they were an essential part of a supply of education to the students who took part in preparing and serving them. The UK requires that a 'closely related supply' must be for the 'direct use' of the student; the judge considered that the educational benefit of taking part satisfied this requirement, even if the students didn't eat anything.”

CRC v Brockenhurst College, Upper Tribunal

Date of claim

The company submitted late VAT returns and late payment of tax for the periods ended 9/11 and 12/11. HMRC imposed default surcharges. In November of that year, the company submitted an amendment, saying that as a result of an overpayment for an earlier period, the tax for 9/11 and the subsequent surcharge should be reduced. It claimed that it had a reasonable excuse for the late return for 12/11 because of confusing calculations received from HMRC.

Decision:

The First-tier Tribunal agreed that the 9/11 surcharge should have been calculated on the lower amount of tax. The company's letter claiming the overpayment constituted a claim for the purposes of VATA 1994, s 80, although HMRC were correct to investigate its validity.

With regard to the 12/11 appeal, the tribunal agreed that documents sent by HMRC to the company had been ambiguous and had led to confusion. This was a reasonable excuse and the surcharge was cancelled.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: "The decision confirms (and it is hoped it will be accepted as policy by HMRC) that HMRC have the right to review the accuracy of any VAT652 error correction claims made by a taxpayer. As far as creating a VAT credit on the taxpayer's ledger is concerned, the key date is when the claim was submitted, rather than any future date, such as the date the claim was approved. This approach makes sense both in terms of logic and fairness."

Dunn and Dyer (Electrical) Ltd v HMRC TC2984

House!

The taxpayers, a number of bingo clubs, gave away promotional items to members. These were related to the number of times that the member paid an entrance fee to enter the main foyer of the club. The foyer was often used by members as a place to socialise where they could buy refreshments without having to enter the main hall and play bingo.

HMRC said that the input tax on the promotional goods should be treated as residual and was only partly recoverable because there was a direct and immediate link between the cost of admission and the supply of bingo and other supplies made in relation to door admissions.

Decision:

The First-tier Tribunal said it was necessary to identify a direct and immediate link to an activity. If the activity is exempt, the costs cannot be set off, but if it is partly taxable and partly exempt, the standard method of apportioning the input tax should be applied. In this instance, the tribunal ruled that the

costs of the promotions were directly and immediately linked to the taxable supply of admission charges, not to the clubs' general income. Therefore, the costs were fully recoverable as input tax.

The taxpayers' appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: “Cases dealing with partial exemption challenges in recent years have focused on establishing the 'use' of an expense in relation to a specific activity or source of income and have not been prepared to consider indirect links or benefits. The key issue here was that a person received the promotional items based on the number of taxable admission fees paid over a period of time — this was the only direct link that determined input tax recovery. However, decisions concerning input tax allocations by partly exempt traders are fact-sensitive and a different judge might easily have reached the opposite verdict in this case.”

Buckingham Bingo Ltd and others (TC3093)

Freemasonry and VAT exemption

The issue was whether the United Grand Lodge of England (UGLE) had aims of a 'philosophical, philanthropic or civic nature'. If this proved to be true, supplies it made to its members (who paid a subscription) were exempt from VAT (Sixth VAT Directive art 132(1)). The UGLE 'draws together' those practising freemasonry. The tribunal accepted that a 'a body whose aims are to promote or practise a rule of life is capable of having philosophical aims'. Furthermore, the proselytising side of freemasonry suggested that it was not exclusively inward-looking so that the 'public interest' criterion was satisfied. Additionally, the tribunal accepted that the UGLE's charitable activities had a philanthropic aim, even though they were also carried out with an expectation of future benefit to freemasonry.

Decision:

However, having noted that freemason rules did not concern the relationship between citizens and the state, the tribunal concluded that the aims of the UGLE were not of a civic nature. The tribunal also held that freemasonry 'just falls short' of being a religion. This was because freemasons may not all believe in the same supernatural being and their canons of behavior are not adopted to give effect to their faith. Having accepted that the aims of the UGLE were both philosophical and philanthropic, the tribunal dismissed the appeal on the ground that the UGLE had other aims — fraternity, self-improvement and mutual care — which were not qualifying aims and which were not incidental to the other qualifying aims.

Comments - This case is not only an excellent analysis of the way the exemption in art 132 should be applied, it also reads like a legal essay on religion, philosophy and civic duties.

United Grand Lodge of England v HMRC TC3302

Import duties erroneously paid

The issue was whether import duties which had been erroneously paid may be repaid under the Community Customs Code (CCC) art 236. Between July 2005 and September 2009, the taxpayer had paid import duties on bags originating from India. In July 2009, HMRC suggested that the bags should not have attracted duty as they should have benefited from a 'preferential tariff' since they originated from India. A repayment claim was submitted in September 2009. It was rejected by HMRC.

Decision:

The UT noted that no valid certificates of origin had been submitted within the ten months' period required under CCC art 90(b)(1). The UT also acknowledged that it was not HMRC's practice to require a certificate of origin, provided that box 36 of the import declaration (form 88) had been completed indicating that the goods were preferential goods. However, box 36 had been wrongly completed and duty had been paid on the basis that normal tariff arrangements applied. The tribunal rejected the taxpayer's contention that no customs debt had been created by the wrongly completed form on release of the goods into the UK. Furthermore, the UT insisted that there was no obligation on HMRC to audit customs forms to ensure that they had been correctly completed. The UT concluded that in order for a repayment claim to be successful, the conditions of art 90(b)(1) must be satisfied, which meant that the certificate of origin must be valid at the time of the repayment claim and so the claim must fail. The tribunal added that it was not open to it to modify the effect of the legislation on the grounds that it was inequitable or unfair.

Comments - Clearly an innocent mistake had been made, leading to unfair results. However, the tribunal chose to apply the legislation strictly, suggesting that the Community Customs Code is not open to purposive interpretations.

Lane Fouracres Associates v HMRC (FTC/49/2013)

Vans adapted for use by handicapped passengers

A trader supplied disabled customers with vans adapted to their requirements. The issue was whether the supplies should be zero rated on the basis that the vans had been 'substantially and permanently adapted to enable a handicapped person … who usually uses a wheelchair … to enter, and drive or otherwise be carried, in the motor vehicle' (VATA 1994 Sch 8 Group 12 item 2A note 5L).

Decision:

The tribunal rejected HMRC's contention that the term 'substantially' in the legislation required that, were it not for the adaptation, a disabled person could not use the vehicle. The tribunal then reviewed each of the challenged 'adaptations'. It accepted that ambulance ramp fixings enabled safe access to the vehicle. In relation to the swivel seats, the fact that they could be enjoyed by able passengers (who may wish to turn around to face other passengers) did not rule out the adaptation being for the requisite purpose. Swivel seats were installed at the request of disabled clients and enabled them to be carried in the vans. Similarly, grab handles enabled handicapped passengers to circulate safely within the vans.

The tribunal concluded that the vans were 'qualifying motor vehicles' for the purpose of the zero rating provisions.

Comments - HMRC had adopted a very narrow interpretation of 'qualifying motor vehicle'. The tribunal chose to apply an objective and purposive test. Similar traders should therefore ensure that any adaptations to a vehicle do enable handicapped people to be transported.

Concept Multi Cars v HMRC TC3250

Duty fraud: confiscation orders

The defendants had all pleaded guilty to the offence of being knowingly concerned in the fraudulent evasion of duty on goods (CEMA 1970 s 170(2)(a)) in relation to cigarettes imported by sea. They all consented to confiscation orders equal to the amount of duty which had been evaded.

Decision:

The court noted that a person cannot be liable to pay duty on tobacco imported by sea in a ship unless one of two conditions is satisfied: either he must be 'holding' the tobacco at the excise duty point; or he must both have 'caused' the tobacco products to reach the excise duty point and he must also have retained a connection with the goods at that point. As these two conditions were not satisfied, the defendants were not liable to the duty. Confiscation had been sought on the sole basis that the defendants had derived a pecuniary advantage in the total amount of duty evaded. As their liability to duty was not established, this was not the correct legal basis. The issue was therefore the validity of the confiscation orders. The court agreed that the defendants' acceptance of the facts itself constituted evidence on which the judge had been entitled to rely to impose a confiscation order. However, this did not apply where acceptance had been given (as was the case here) on the basis of unsound legal advice. The defendants had been wrongly advised that they were liable to the duty. The court added that playing an active part in the handling of goods so as to assist in their commercial realisation did not alone establish that a person had benefited from their criminal activity.

Comments - The defendants were clearly guilty of criminal activity and had consented to the confiscation orders, yet the confiscation orders were held invalid.

Mackle v Northern Ireland ([2014] UKSC 5)

Recreational purpose

The taxpayer has a dancing school where she and six self-employed class instructors teach belly dancing. She accepted that she was liable for VAT on the tuition given by the self-employed teachers, but argued that the tuition that she supplied personally was exempt under VATA 1994, Sch 9 group 6 item 2. She said she offered a serious course of study in a particular dance form that was equivalent to dance taught in schools and universities.

HMRC disagreed saying that there was no evidence that belly dancing was taught at schools and universities, and those institutions covered the broader subject of dance. Their courses were longer than those provided by the taxpayer, and entailed written work and examinations.

Decision:

The First-tier Tribunal accepted that the courses offered by the taxpayer were serious and detailed, but said they were recreational rather than educational. The judge agreed with HMRC that dance taught in schools, such as for AS and A level, included academic studies as well as the physical aspect of dance. The taxpayer could not show that belly dancing formed a component of any course taught at school or university.

The tribunal concluded that the taxpayer's supplies were not within the exemption in item 2.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent tax consultant, said: "A taxpayer seeking to gain VAT exemption in a particular subject under the private tuition rules must be able to provide some tangible evidence that the subject is taught in at least some UK schools or universities on a regular basis. In view of previous cases on this particular subject, the taxpayer had little chance of winning her argument."

Audrey Cheruvier trading as Fleur Estelle Dance School (TC3148)

Leaving the flat rate scheme? (Lecture B825 – 13.21 minutes)

Basic rules with the scheme

The flat rate scheme (FRS) was introduced in 2002, with the aim of simplifying the record-keeping requirements of a small business in relation to VAT.

The basic principles of the FRS are as follows:

- it is only available to a small business with VAT exclusive annual taxable turnover of less than £150,000.
- instead of paying VAT based on output tax less input tax, a business will apply a given flat rate percentage to its gross (VAT inclusive) business income – the percentage is based on the category of business to which it belongs. The business still charges VAT to its customers in the normal way. It does not reclaim input tax – apart from in the case of capital goods in some cases – see 'tips'

Example 1

James has taxable sales of £149,000 per year (all standard rated) and very little input tax to claim (£500 per year). If he adopted the FRS, he would qualify for the 12% rate (other business services). Should he use the scheme?

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

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

Under normal VAT accounting, his VAT bill would be:

Output tax (£149,000 x 20%) = £29,800

Input tax = £500

Payable = £29,300.

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

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

Leaving the scheme

Be aware that the limits for when a business must leave the scheme are higher than for the joining levels. This is a useful planning point for a growing business.

VAT Regs 1995, SI 1995/2518, Reg 55(M) : "A flat rate trader ceases to be eligible to use the scheme when:

- at the anniversary date of when he joined the scheme, the total value of his income in the period of the year just ended was more than £230,000 ; or
- there are reasonable grounds to believe that the total value of his income in the next 30 days will exceed £230,000

However, a trader does not need to leave the scheme if he can persuade HMRC that the total value of his income in the next 12 months will not exceed £191,500."

Note – until the VAT rate change on 4 January 2011, the amount of £230,000 was £225,000 and £191,500 was £187,500. In considering the above limits, the sale of capital assets (goods or services) is ignored.

Extract from HMRC Notice 732 – para 11.2: What if the increase in my turnover is a one-off?

If, when you do your annual check you find that your turnover has gone above the £230,000 limit but you expect that your turnover in the next year will fall below £191,500, you may be able to remain on the scheme with our agreement. If you wish to remain on the scheme in those circumstances, apply in writing toHMRC.

You will need to demonstrate that:

- your VAT inclusive total turnover in the coming year will not exceed £191,500
- the increase was the result of unexpected business activity which has not occurred before and is not expected to recur - If you successfully tender for an annual contract that takes you over the threshold, this cannot be classed as unexpected.
- the increase arose from genuine commercial activity.

An interesting issue is whether the legislation, which uses the phrase 'the total value of his income' is referring to VAT inclusive or exclusive figures. HMRC certainly think it is VAT inclusive – their interpretation at para 12.2 of Notice 733 says a taxpayer must leave the scheme if………at the anniversary of your start date the total value of your tax inclusive supplies in the year then ending (excluding sales of capital assets) is more than £230,000.

This conclusion is probably reasonable because VAT is a component of income, even though we as accountants tend to refer to turnover and sales on a VAT exclusive basis.

Mark Saggers Media Ltd (TC2815) – case victory for HMRC

The company exceeded the FRS exit threshold on 31 March 2010 and HMRC withdrew it from the FRS on 18 May 2010 but reinstated it again on 19 May 2010 after being persuaded by the director that a major broadcasting contract had been lost in early 2010, so expected total sales in 2011 would be much lower than £191,500. However, a new contract was acquired due to the contacts of Mr Saggers in the sporting and media world, which led to sales again exceeding £230,000 in 2011 and 2012. HMRC withdrew the company from the scheme on 31 March 2011 and the tribunal supported this decision. The taxpayer felt the company should be allowed to remain in the scheme.

Comment:

This case illustrates that the concession to remain in the scheme on the basis of future turnover being less than £191,500 is only relevant when a business loses an income source in the year that the limit was exceeded and the source will definitely not be replaced with other work on contracts in the future. The director was clearly a successful sports commentator who made himself available for new contracts when his earlier contract was terminated, so the reality was that he replaced one commercial contract that was well paid with a similar one from another radio station. The request to remain in the scheme based on future turnover being less than £191,500 including VAT is only relevant if eg a sale (or sales) in the earlier year was a genuine one-off transaction that will not be repeated, or possibly where the business owner has made a deliberate decision to reduce his volume of future business eg an architect working four days a week instead of five as a lifestyle choice.

Contributed by Neil Warren