Tolley®CPD

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BUDGET

(Lectures P826 – 10.06 mins; P827 – 11.29 mins; B826 – 11.51 mins; B827 – 8.36 mins)

Business Tax

Corporation tax rates

No changes were announced to the proposals that the main rate of corporation tax will reduce to 21% from 1 April 2014 and 20% from 1 April 2015, so these will proceed as originally planned.

It is worth noting that the measure will bring welcome simplification to smaller businesses who will no longer need to use the associated companies rules to determine their tax rate from 1 April 2015. Additionally, use of this measure will be abolished in relation to tax payment dates under the Quarterly Instalment payment scheme (QIPs), as the trigger to QIPs will be replaced by one looking at 51% (i.e. group relief) groups.

Annual Investment Allowance

AIA was increased to £250,000 for a temporary period of two years starting on 1 January 2013. A further increase was announced in the Budget, which will run through until a year after the original expiry date of 31 December 2014. The rates of AIA are therefore :

- £250,000 from 1 January 2013 until 31 March 2014 for companies, and 5 April 2014 for income tax businesses, and
- £500,000 from 1 April 2014 for companies and 6 April 2014 for income tax businesses until 31 December 2015.

Naturally there are transitional rules affecting periods spanning the date of change, but as this change comes more than 12 months after the last change, it is likely that most businesses will not see any additional complexity. In addition, small businesses are unlikely to be affected by the increase, as the lower limit was already ample for their capital expenditure needs.

It is presently the case that the limit will return to £25,000 on 1 January 2016, once again keeping the changes in limits over 12 months apart.

SME R & D relief scheme

This scheme continues to be an essential element of Government policy. The changes announced on Budget day enhance the payable tax credit which companies can claim when they have excess losses arising from R & D claims. Where losses cannot be relieved in the current period, companies can surrender the loss for a payment of tax credit. Until now, that amount has been capped at 25% of the original expenditure, so each time the rate of R & D relief has increased, the rate of payable tax credit has reduced correspondingly.

Budget 2014 announcements will move the rate of payable tax credit up from 11% to 14.5%, which equates roughly to 33% of the original cash spend. The new rate will apply to losses in relation to expenditure incurred on or after 1 April 2014.

For the purposes of SME R & D relief, an SME is one which meets the following:

- Fewer than 500 employees, and one of:
  - Annual turnover not exceeding €100 million (around £83 million), or
  - Balance sheet total not exceeding €86 million (around £71 million)

Enterprise Zone capital allowances

Special 100% capital allowances for certain expenditure in designated areas within enterprise zones were introduced in 2012. The scheme is very restrictive and applies only to new spend on expansion, and not to replacement plant and machinery. The scheme was due to terminate in 2017, and will now run through to 31 March 2020. There will also be a new EZ established in Northern Ireland.

Seed EIS

The time limit on SEIS will be removed by Finance Bill 2014, making this relief permanent with effect from Royal Assent. The associated CGT relief for investment in SEIS shares will also become permanent, with effect from 2014/15.

CGT rollover relief

Two changes affect CGT rollover relief, which is available to shelter gains on certain business assets.

Exclusion of intangible assets

No rollover relief will be available on the re-investment of proceeds in intangible fixed assets. This corrects a rewrite drafting anomaly, and parallels the treatment for companies introduced at the time that the intangibles legislation was introduced into corporation tax in 2002. Where claims for relief had been made prior to 19 March 2014, there will be a consequent adjustment to the carrying value for tax.

Extension to agricultural Basic Payment Subsidy

With effect from Royal Assent, entitlement to the new agricultural subsidy Basic Payment Scheme will become a qualifying asset for the purposes of CGT roll-over relief.

Business premises renovation allowance

Proposals were unveiled in December 2013 which will tighten up the BPRA scheme and prevent it being abused. The scope of qualifying expenditure will be restricted to building and renovation works and associated services, and works must be carried out within 36 months. Additional restrictions apply to the plant and machinery content, although there have been some changes since the original draft was released. BPRA will not be available if any other form of state aid has been or will be received.

Creative sector reliefs

The new reliefs introduced in Finance Act 2013 have been the subject of further attention. Proposals to make amendments include:

Video games relief

The provisions will be amended to ensure that they comply with the terms of the agreement on state aid. The agreement with the EU was some time coming, and the original proposals need some amending to bring them into line with the final agreement. The changes will also make clear that only those games for which relief has been claimed will be treated as a separate trade.

Television tax relief

The legislation in Finance Act 2013 will be amended to make clear that only those television programmes on which relief is claimed are to be regarded as separate trades.

Theatre tax relief

Finance Bill 2014 will include measures designed to provide a similar relief to those described above for theatrical productions and touring theatrical productions. Consultation with industry experts starts immediately after the Budget.

Construction Industry Scheme

The Chancellor announced on Budget day that the government will consult in summer 2014 on options to improve the operation of the CIS for smaller businesses and to introduce mandatory on-line filing for contractors. The government will also hold discussions with industry on revisions to reporting obligations and improvements in registration for joint ventures.

There will probably be a formal consultation document published towards the end of May with "roundtable" events to discuss proposals running from the middle of June to the middle of July. This will be an opportunity to look at the operation of CIS and in particular whether barriers to attaining gross payment status can be removed. This might mean fewer compliance tests and a lower turnover threshold for partnership / multi-director cases. There may also be scope to remove reporting obligations for large businesses and registration for international joint ventures.

Bank levy

A consultation on restructuring the bank levy will be issued at the same time as the Finance Bill, intended to pave the way for a more sustainable bank levy, which clearly signals that this tax is here to stay! Final legislation will be introduced during the passage of the Finance Bill, and any new rules would apply from 1 January 2015 (the banking levy year).

Businesses in the energy sector

Changes will be made by Finance Bill 2014 to prevent any company which benefits from Department of Energy & Climate Change (DECC) Renewable Obligations Certificates (ROCs) or Renewable Heat Incentive (RHI) schemes from also benefitting from tax supported venture capital schemes. Companies

will be excluded from both EIS and SEIS, and also from VCT schemes. The change will apply to shares issued on or Royal Assent for EIS and SEIS, and to money invested by a VCT on or after Royal Assent.

Employment allowance

This new allowance will provide relief for up to £2,000 from employer NIC from April 2014.It will apply to all businesses and charities, irrespective of size, and will be administered through RTI, reflecting in reduced liabilities showing on the Business Tax Dashboard.

Businesses need to claim the allowance by making the relevant tick on their payroll software. The allowance is not available to:

- Domestic employers who do not run a business
- Public bodies such as local authorities, and
- Other entities performing the same roles as Public Bodies.

It does offer a choice to directors of OMBs to consider increasing their pay to the personal allowance at reduced NIC cost.

Salary at NI threshold,

	£	
Profit	50,000	
Salary	(7,956)	
Taxable profit	42,044	
Corporation tax	8,409	
Net profit	33,635	
Dividend (net)	33,635	
Gross dividend income	37,372	
Tax liability on dividends	£779	
Total tax liability on £50,000 profit	£9,188	(18.4%)

Salary equal to 2014/15 personal allowance

	£	
Profit	50,000	
Salary	(10,000)	
Taxable profit	40,000	
Corporation tax	8,000	
Net profit	32,000	
Dividend (net) 32,000		
Gross dividend income	35,556	
Tax liability on dividends	£830	
Employee NIC on salary	£245	
Total tax liability on £50,000 profit	£9,075	(18.15%)

The saving of £113 is only available where the individual concerned has no other income. If the individual is above state pension age, no employee NIC is payable, providing a further saving of £245 per annum.

Personal Tax

National Insurance contributions 2014/15

Rates and limits for Class 1 contributions were announced in the 2013 Autumn Statement. The following rates and limits will apply from 6 April 2014.

Table 1 : rates and limits for NIC 2013/14 and 2014/15

	2013/14	**2014/15**
Lower earnings limit	£109	£111
Primary threshold (employee)	£149	£153
Secondary threshold (employer)	£148	£153
Upper Accruals Point	£770	£770
Upper Earnings Limit	£797	£805
Primary main rate	12%	12%
Primary residual rate	2%	2%
Secondary rate	13.8%	13.8%

Note that Class 2 collection will be merged into self assessment from April 2016.

Tax rates and thresholds 2014/15 onwards

The level of allowances and tax rates for 2014/15 were confirmed in December 2013. The main rates and allowances for 2015/16 were announced at Budget 2014.

Table 2 : rates and limits for tax 2013/14 to 2015/16

	Note	**2013/14**	**2014/15**	**2015/16**
Personal allowance		9,440	10,000	10,500
Age related allowance : lower amount	1	10,500	10,500	N/A
Age related allowance : higher amount	2	10,660	10,660	10,660
Transferable married allowance	3	N/A	N/A	1,050
Income limit for personal allowance		100,000	100,000	100,000
Income limit for age related allowances	4	26,100	27,000	Not known

Starting rate for savings	5	10%	10%	0%
Starting rate band	5	2,790	2,880	5,000
Basic rate band (20%)		32,010	31,865	31,785
Higher rate limit (40%)		150,000	150,000	150,000
Additional rate		45%	45%	45%

<u>Notes to Table 2</u>

1. The lower amount of age related allowance is available to persons born between 6 April 1938 and 5 April 1948.

2. The higher amount of age related allowance is available to those born before 6 April 1938.

3. Available to married couples and civil partners only when neither is a higher or additional rate payer. Only beneficial if one spouse is unable to use all of their personal allowance, although tax timing differences may also be beneficial.

4. Only the excess over the basic personal allowance is tapered

5. The rate applies to savings income within the band, provided the taxable non savings income does not exceed the limit of the band.

There is also to be a consultation on whether the availability of UK personal allowances to non residents should continue. Proposals include only giving an allowance to persons who have “strong economic connections with the UK”.

Pensions reform – defined contribution schemes

A wide ranging reform of pensions tax and regulation was announced in the Budget. The various components of reform and the commencement dates follow, but it should be noted that the changes apply to defined contribution (sometimes called money purchase) arrangements, and not defined benefit (final salary) schemes. These are by far the most common form of pensions provision.

Flexible drawdown

An individual may draw any amount from his pension drawdown fund provided he has a guaranteed amount of other income in retirement. The current minimum income (per annum) for this to be available is £20,000, and this reduces to £12,000 for those seeking flexible access to the fund from 27 March 2014.

Maximum drawdown pension

If an individual does not have at least £12,000 a year in other income guaranteed for life, he is restricted in the amount of drawdown pension that he can take each year, by reference to the Government Actuary’s annuity rates. This was originally set at 100% in 2010, but increased to 120% in 2013. The rate will rise to 150% for drawdown pension years starting on or after 27 March 2014.

Trivial commutation

If an individual has a total of less than £18,000 in pension savings (across all schemes of which he is a member) then the whole amount can be taken on retirement (although some of this is taxable) rather than having to treat 75% of it as a separate pension pot. The limit for trivial commutation is raised to £30,000 for commutation periods starting 27 March 2014 and after.

Small pension pots

Regardless of their total pension savings, where any pension pot is less than £2,000 the whole amount can be taken as a lump sum. This increases to £10,000 on 27 March 2014. The current maximum number of pension pots to which this rule can apply is currently two, but this will also increase from 27 March 2014 to three. The changes apply to amounts paid out on or after the date of change.

Longer term change

From April 2015, the rate of tax applying to pension funds released as a lump sum on retirement will reduce from 55% to the individual's marginal rate of tax, treating the full amount released as income of the year (apart from the normal 25% tax free lump sum). The rules will allow those retiring to decide how they plan to use their pension savings and all options will be possible. It is intended to make free face to face advice on the options available to anyone who wants it, and pension providers and trust based schemes will be required to make this advice available. A detailed consultation has been launched as part of the Budget measures.

Pensions liberation

This growing industry has been in HMRC's sights for a while, and a package of measures, some taking effect on 20 March 2014 has been announced to combat pensions liberation schemes. HMRC will be able to refuse to register schemes, and also de-register some existing schemes. Payments to employers will become unauthorised payments (attracting a tax charge of 40%), and a requirement (commencing in September 2014) that the administrator be a fit and proper person. Further consultation will take place on whether any additional measures are necessary to combat pensions liberation.

Employee share schemes – SIPs

The maximum value of shares that can be awarded under all-employee Share Incentive Plans (SIPs) will increase on 6 April to :

- £3,600 for the free shares that companies can award to employees, and
- £1,800 for the partnership shares that the employees can purchase.

In future, it will be possible to increase these limits by means of a Treasury Order rather than primary legislation. (Originally announced December 2013).

Employee share schemes generally

Further simplification in the administration of employee shares schemes generally will proceed in the Finance Bill, in line with the recommendations of the Office for Tax Simplification (OTS) and the announcements made in December 2013.

The main effect of the changes will move registration and approval of schemes from HMRC to the scheme administrators, who will self certify that the scheme meets the relevant requirements. Returns will move online, and there are some minor administrative changes to the qualifying conditions.

There are also to be changes to the rules affecting unapproved shares schemes which were also recommended by the OTS. Changes affecting Internationally Mobile Employees (IMEs) will be deferred until 2015 to allow more time for affected parties to adjust to the new rules.

Social investment tax relief

A 30% income tax incentive will be provided on investments in qualifying social enterprises. The measure was originally planned in Budget 2013, and will include capital gains tax relief, but further information is not presently available. It will be issued on 27 March 2014.

Major sporting events

The Finance Bill will include an exemption from tax for non resident athletes taking part in the Glasgow Grand Prix athletics event in 2014. There will also be enabling legislation to permit exemptions from income and corporation tax for major sporting events to be made by secondary legislation in future.

IHT and liabilities in the estate

Finance Act 2013 included legislation to prevent liabilities in an estate on death being deducted from the value of the estate if the amounts borrowed were invested in certain assets outside the scope of IHT, such as assets qualifying for business property relief. This measure will be extended in Finance Bill 2014 to include liabilities where the proceeds of the loan are held as a foreign currency bank account in a UK bank (which is also an asset outside the scope of IHT).

Remittance basis and split year treatment

There is a flaw in the legislation introduced in 2013 dealing with split years and capital gains tax for remittance basis users. The legislation will be corrected by provisions in Finance Bill 2014 which will ensure that any gains arising during the non resident part of the tax year are not liable to CGT.

Fuel benefit – company cars and vans

The fuel benefit multiplier for 2014/15 was due to rise by 2% over inflation, which is likely to see it confirmed at £22,000 (not mentioned in the Budget pack). For 2015/16 both the car and van fuel benefits will rise by inflation, using the September 2014 RPI inflation rate.

Company vans

The fixed rate benefit in kind on company vans will rise by RPI inflation (using September 2014 figures) for 2015/16. Once again, the amounts will be confirmed before January 2015.

Employer expenditure on health measures

As announced in Budget 2013, legislation will be introduced to exempt from income tax expenditure by employers on recommended medical treatment where an employee has been absent from work due to ill-health or injury. The exemption will be subject to an annual cap of £500 per employee, and is likely to come into effect in autumn 2014.

Taxation of company cars

The upward trend in company car tax rates has been maintained, with additional rises at the lowest levels of emissions announced in the Budget through to April 2019.

The changes are best illustrated by the Table of benefit rates as far as announcements have been made:

Emissions (g/km)	2014/15	2015/16	2016/17	2017/18	2018/19
Zero	0%	5%	7%	9%	13%
1 - 50	5%				
51 - 75	5%	9%	11%	13%	16%
76 - 79	11%	13%	15%	17%	19%
80	11%	13%	15%	17%	19%
85	11%	13%	15%	17%	19%
90	11%	13%	15%	17%	19%
95	12%	14%	16%	18%	20%
100	13%	15%	17%	19%	21%
105	14%	16%	18%	20%	22%
110	15%	17%	19%	21%	23%
115	16%	18%	20%	22%	24%
120	17%	19%	21%	23%	25%
125	18%	20%	22%	24%	26%
And then in increments of 5g = 1% until					
175	28%	30%	32%	34%	36%
180	29%	31%	33%	35%	37%
185	30%	32%	34%	36%	37%
190	31%	33%	35%	37%	37%
195	32%	34%	36%	37%	37%
200	33%	35%	37%	37%	37%
205	34%	36%	37%	37%	37%
210 and above	35%	37%	37%	37%	37%

Making good the private use of cars and vans

The legislation is to be amended so that where an employee makes good the private use of a car or van , this can only affect the benefit in kind if the payment is made during the tax year concerned. Payments after the end of the tax year cannot affect the benefit in kind for that year.

Beneficial loans limit

The limit on a cheap or interest free employer provided loan which does not attract a tax charge is currently £5,000. This limit increases to £10,000 with effect from April 2014. Provided the amount outstanding does not exceed the limit at any time in the tax year, there will be no benefit in kind charge on the employee. At the same time, the interest rate will reduce to 3.25% for 2014/15.

OTS proposals

Following a review by the OTS of benefits in kind taxation, four options for change will now be explored in more detail, with the intention of legislating for the following in 2015. They are:

- Abolishing the £8,500 threshold
- Introducing a statutory exemption for trivial benefits
- Introducing voluntary payrolling of benefits in kind
- Replacing dispensations with a Reimbursed Expenses Exemption.

Savings : ISA changes

The ISA rules have been significantly enhanced by Budget 2014 announcements, which will take effect on 1 July 2014.

The New ISA (NISA)

The overall subscription limit increases significantly to £15,000 for 2014/15 with effect from 1 July 2014. All existing ISAs will be merged into the NISA scheme, so there will be no distinction between old and new ISAs.

The underlying structure of ISA's will also be subject to significant change. Under the new rules, the full amount of the ISA can be held as a cash ISA (rather than being restricted to 50%). Stocks and shares ISAs and cash ISAs will effectively be merged to form a single new savings scheme invested in any mix of cash and stocks and shares that the saver prefers.

Available investments – NISA and JISA (and CTF)

The range of stocks and shares which can form part of an ISA will also be improved, to allow a wider range of securities to qualify, including retail bonds with less than five years before maturity and Core Capital Deferred shares issued by building societies.

Junior ISA limit

The Junior ISA limit (which is the same as the Child Trust Fund subscription limit) will also rise this year. The limit for 2014/15 will be £4,000.

VCT changes

The changes to the VCT rules are largely anti avoidance in nature and will prevent individuals from benefitting from relief on the investment when there is a scheme linking the investment to a share buy back or other banned return of capital. Legislation will also ensure that time limits on assessments adequately provide for HMRC to recover tax relief in all cases where VCT shares are disposed of within five years of acquisition.

Property tax

SDLT rates

For transactions after 19 March 2014, the rate of SDLT applying to disposals of residential property to a non natural person for more than £500,000 will be 15%. There are no other changes to SDLT rates. Where contracts were entered into before that date, the limit will remain £2 million.

ATED

The annual tax on enveloped dwellings will be extended over the next two years as follows:

- From 1 April 2015 a new band of ATED will be introduced in relation to properties with a value of more than £1 million but not more than £2 million. The annual tax charge will initially be £7,000 for these properties. Returns for the first year will be due by 1 October 2015 with payment due by 31 October 2015.
- From 1 April 2016, a further band of ATED will be introduced on properties valued at more than £500,000 but not more than £1 million. The initial annual rate of tax will be £3,500 on these properties. No transitional period has been announced in relation to these properties.
- All of the current exemptions and reliefs will apply to the two new bands.
- The amounts of ATED applying to properties valued at more than £2 million have been increased to reflect inflation. The new rates are :
    - Value over £2 million but not over £5 million : £15,400
    - Value over £5 million but not over £10 million : £35,900
    - Value over £10 million but not over £20 million : £71,850
    - Value over £20 million : £143,750

Private residence relief for CGT

Announced in December 2013, the CGT exemption for the final period of ownership of as property to which PPR has applied at any time during the period of ownership will reduce to 18 months from 6 April 2014. It has been 36 months for many years, and those considering selling up in the very near future may wish to consider the impact of this change on their decision. Obviously, the change will be most acutely felt by those who have lived in the property for a relatively short period of time.

Capital gains tax – non resident individuals

There are proposals for the 2015 Finance Bill to bring disposals by non resident individuals of residential property in the UK within the scope to CGT on gains accruing from April 2015.

VAT

Registration thresholds

The changes have been made by secondary legislation already. The new VAT threshold from 1 April 2014 is £81,000, and the deregistration threshold is £79,000, in both cases an increase of £2,000.

Note that the limit for simplified accounts for income tax (and cash accounting) is the limit at the end of the tax year, rather than the start of the year, so the limit for 2013/14 is now set at £81,000.

Prompt payment reform

The rules on the calculation of VAT where a prompt payment discount is offered by the supplier are to be reformed so that the VAT charged reflects the amount the customer pays for the supply. The change is necessary to align with EU rules, and will increase the VAT charged on the supply where the discount is not taken.

The change will apply from 1 April 2015, but there will be early implementation in the telecommunications, television and broadcast industry where there is no requirement to issue a tax invoice (domestic supplies) for which the measure will commence on 1 May 2014 to prevent loss of revenue.

VAT fuel scale charges for private fuel

Although this process is no longer part of the Budget, a table of the new rates was published on Budget day.

Anti avoidance

Employment intermediaries

Rules will be introduced to prevent the operation of “disguised employment” through onshore employment intermediaries. This is prevalent in some sectors, and predictably HMRC will require those who regard themselves as self employed through an intermediary to be treated as employed. This measure is distinct from the measures affecting salaried partners in LLP’s.

Offshore employment intermediaries have also been the target of attention, with legislation intended to “ensure that the correct amount of income tax and national insurance contributions are paid by offshore employment intermediaries.

Partnerships

This issue was consulted on during the summer of 2013, and draft legislation was issued for comment in December 2013. The guidance supporting the measure was updated and amended in February 2014, and the measures present a significant tax challenge to many professional businesses. The yields from the two measures are so substantial that it is unlikely that HMRC will soften much in the light of extensive criticism, and even a call from the House of Lords for the measures to be delayed.

The Red Book indicates that there are some minor changes to the published drafts issued in December (and subsequently in March for salaried partners) which will be reflected in the Finance Bill when issued.

DOTAS and high risk promoters

This measure was announced at Budget 2013 and will require those businesses identified by HMRC as "high risk promoters" to provide extra information to the tax authority, and face substantial extra penalties for failure to comply with the regulatory requirements. The draft legislation was criticised for the very wide definition of high risk promoters, and the Budget material indicates that changes have been made in the light of responses to the consultation. We await details in the Finance Bill.

"Follower notices"

This measure was announced at the Autumn Statement 2013. HMRC will have the power to issue a notice to taxpayers who have adopted a tax avoidance scheme which has failed in another party's litigation, requiring them to amend a self assessment return, or to otherwise settle their dispute with HMRC along those lines. Taxpayers who fail to comply will face penalties, in addition to the disputed tax at stake. This will apply for the date of Royal Assent.

Accelerated payment requirement

This measure was announced in September 2013, but has been significantly enhanced in the Budget.

The initial plan was that where a taxpayer had participated in a failed tax avoidance scheme (by reference to another party's litigation) they should be required to pay the tax under dispute. They could then be permitted to take the case to law and win a repayment if successful.

However, the same rules will now apply to any taxpayer who has used a DOTAS scheme (as disclosed on his tax return) and any scheme which has been subject to challenge under the GAAR. This presents the possibility that when HMRC loses a case but is not satisfied with the outcome, taxpayers will need to take their own case to court to win repayment of the disputed tax.

However, it is also worth noting that many tax avoidance schemes operate by delaying the tax involved, rather than reducing the eventual liability, so it is arguable that this might be viewed as a welcome development.

The sums of money at stake are considerable. This is expected to have a long term yield of around £700 million, with significantly more than that collected in the interim.

Charities formed for the purpose of tax avoidance

Further consultation will take place on this issue, with a view to preventing charities being registered which are set up purely to support a tax avoidance scheme. Legislation will follow, we are told.

Tax administration

Scottish rate of income tax

Legislation will be needed to implement the Scottish rate of income tax within the structure of tax law. The measures will not deal with the administration of the tax itself (which is the subject of separate legislation) nor will it alter the amount of tax paid by either Scottish or other UK residents, so the issue is merely a technicality.

Collection of tax debt

In a proposal entitled "Direct Recovery of debts", HMRC proposes to bring forward legislation to recover tax and tax credit debt direct from debtors' bank accounts. Under the proposal, to be included in the Finance Bill 2015, debts of £1,000 or more will be recoverable direct from taxpayer accounts, subject to safeguards, which include a requirement to leave at least £5,000 in the bank account. Consultation on both primary and secondary legislation will take place over the summer.

Personal Tax

The latest case on dividend waivers (Lecture B829 – 10.11minutes)

The First-Tier Tribunal decision in *Donovan & McLaren v HMRC (2014)* is the latest in a series of cases involving dividend waivers. In this situation, they had the effect of equalising the dividend income of a husband and wife.

Mr Donovan and Mr McLaren each owned 40 ordinary shares in Victory Fire Ltd. The remaining 20 ordinary shares were held equally by their wives. On 6 April 2009, i.e. during the year ended 31 March 2010, the company declared an interim dividend of £3,200 per share. The two husbands promptly executed dividend waivers, renouncing their entitlement to dividends for a period of one day. As a result, the wives received £32,000 each which, together with the tax credit, meant that, in the absence of any other income for 2009/10, their basic rate thresholds had not been exceeded and so no further income tax was due. Nor did the wives have to submit tax returns.

On 8 April 2009, Victory Fire Ltd declared another interim dividend, this time of £825 per share. The wives executed similar dividend waivers and £33,000 was then paid to the two husbands.

Similar arrangements had been entered into for each of the nine previous accounting periods. Accordingly, over this 10-year period, the taxpayers' wives had received a much higher proportion of the dividends than might be expected from their 10% shareholdings.

When HMRC challenged the efficacy of the dividend waivers (and it is perhaps surprising that they did not do so sooner), their argument was that the waivers constituted a settlement for income tax purposes such that the income should be treated as that of the husbands and thus subject to higher rate tax.

The Tribunal found that, on the facts, the taxpayers had used their entitlement to dividends as part of a plan to ensure that the dividend income became payable to their wives. It was agreed that a definite plan, even though it was a relatively simple one, to use company shares to divert income falls within the meaning of an 'arrangement'. The judges were influenced by the couples' repeated dividend waivers over several years in finding that the intention behind the plan was tax-motivated. Their conclusion was that an arrangement – and therefore a settlement – clearly existed in this case.

It is always difficult to defend such a charge where the parties involved are husband and wife. The fact that the wife has received an advantage confirms that the settlement was one in which the settlor retained an interest. And there is no defence under S626 ITTOIA 2005 because, in the case of a dividend waiver, the whole benefit is a right to income. Consequently, the only way out is to argue that there was no element of bounty and that the planning did not constitute a settlement, but unfortunately that line was unsustainable here.

The definition of a settlement for income tax purposes in S620 ITTOIA 2005 has always been much broader than the equivalent term in the IHT legislation. However, it does not necessarily follow that *all*

dividend waivers would be treated by the Courts as an income tax settlement. In this instance, it would have been interesting if the Tribunal had discussed the validity of the dividend waivers or the mechanics of the interim dividends, but, as it happens, none of these points mattered. As always, the key thing to watch out for in the context of waivers of dividends is whether the company had sufficient distributable reserves to cover each dividend declaration in the event of a full payout.

Contributed by Robert Jamieson

UK source interest

Mr Perrin was UK resident and domiciled. Blackstar was an Isle of Man incorporated company (and the trustee of a retirement benefit scheme of which Mr Perrin was a beneficiary). Under a loan agreement, Blackstar made several loans to Mr Perrin, making payments from its Isle of Man account to Mr Perrin's Isle of Man account.

Decision:

The tribunal first noted that the fact that the agreement was under the jurisdiction of the Isle of Man did not disapply the general rule that the situs of a debt is where the debtor resides, as this is where recovery can be enforced. However, following case law, the place of the source of interest is not determined by the situs of debts and so factors need to be weighed in order to determine where interest arises.

The tribunal found that the law of the agreement and the place of payment, although relevant, carried little weight. The country of jurisdiction carried more weight. However, the facts that Mr Perrin was UK tax resident and that the debt could only be enforced in the UK were determinative.

Comments - The tribunal decided that interest paid by Mr Perrin to an Isle of Man recipient arose in the UK and was therefore subject to a deduction for UK tax (ITA 2007 s 874).

One can see why the taxpayer hoped that interest payable between two bank accounts situated in the Isle of Man, pursuant to an agreement subject to the jurisdiction of the Isle of Man courts, would be considered as not arising in the UK.

Andrew Collin Perrin v HMRC TC3363

PAYE and pilots

The FTT determined in principle that Mr Fryett , an airline pilot resident in the UK who flew on international routes for Cathay Pacific (a Hong Kong airline), was subject to PAYE.

Mr Fryett dealt with the Hong Kong office on all issues pertaining to his duties and reported to a Hong Kong based director. He paid tax in Hong Kong.

He argued that under the UK/Hong Kong double taxation agreement (DTA), the UK did not have taxing rights over his remuneration. HMRC contended that as a UK resident individual, Mr Fryett was taxable on his worldwide income, regardless of the DTA.

Decision:

The tribunal found that the expression 'may be taxed in the contracting state whose enterprise operates the aircraft' in the DTA did not give that state exclusive taxing rights. The fact that such exclusive taxing rights existed for other types of income under the same DTA did not change the position.

Furthermore, the tribunal noted that Mr Fryett was UK tax resident and so was taxable on his 'general earnings' under UK law, regardless of the fact that his duties were performed for a Hong Kong employer.

The tribunal concluded that the fact that PAYE had been operated by Mr Fryett's employer suggested that his employer had submitted itself to the UK's jurisdiction. Additionally, Cathay Pacific operated a large office in the UK, indicating a tax presence in the UK. The tribunal concluded that HMRC had been right not to issue an NT tax code as it could not be satisfied that no tax was payable.

Comments - The tribunal's analysis of the DTA and in particular the distinction between provisions which confer exclusive taxing rights and provisions which merely entitle a state to exercise them could be relevant to many situations.

Russell Fryett v HMRC TC3360

HMRC lose FURBS appeal

The taxpayer company, FML, set up a funded unapproved retirement benefits scheme for its director, Mr McHugh. Treasury stock with a nominal value of £162,000 and £1,000 cash was paid into the scheme in respect of Mr McHugh. Under the scheme, he was entitled to certain benefits on retirement from service. HMRC said the company was liable to pay Class 1 National Insurance contributions on the total amount paid.

The Upper Tribunal allowed the taxpayer's appeal, finding that the payments were not earnings within the Social Security Contributions and Benefits Act 1992, s 6(1) and therefore not liable to National Insurance. HMRC's appeal was allowed by the Court of Appeal, so the taxpayer appealed to the Supreme Court.

The issue before the court was whether the transfer of the cash and stock to the scheme amounted to a payment of earnings to or for the benefit of Mr McHugh within the meaning of SSCBA 1992, s 6. The taxpayer argued that the payment of earnings did not extend to the transfer to a trust of funds or assets in which the earner had at the time of the transfer only a contingent interest. It was agreed that the payment was for his benefit but was it “earnings”?

Decision:

The Supreme Court decided the transfer to the trust was not a payment of earnings to or for the benefit of Mr McHugh. Lord Hodge, who delivered the judgment, gave three reasons for the decision. First, it would be counter-intuitive that a person would earn remuneration both when his employer paid money into a trust to create a fund for his benefit and again when the fund was paid out to him. A retired worker received earnings in respect of his employment in the form of deferred remuneration when he received his pension. The payment from the trust was, in effect, deferred earnings and therefore the payment into the trust would not be earnings.

Second, HMRC's view could only be sustained by looking exclusively at what was paid and ignoring what the earner received. This denuded “the word 'earnings' of any meaning, so that the phrase 'earnings are paid' would amount to 'payments are made' in respect of any one employment”.

Finally, by treating the payment into the trust as earnings, HMRC failed to consider the existence of the contingency that, should Mr McHugh die, the fund would be paid to his wife.

Lord Hodge concluded that the transfer to the trust was not the payment of earnings for s 6(1) and National Insurance was not due.

The taxpayer's appeal was allowed and the decision of the Upper Tribunal reinstated.

Comments - Noting that this case had been under way for many years, David Heaton of Baker Tilly said: “It may be too late for companies to claim refunds of the National Insurance contributions that were incorrectly assessed.” He hoped that HMRC would “rectify the position for all those who suffered from the flawed policy”.

This was a lead case and the sums at stake were substantial. This judgment is a positive outcome for HR and finance departments, which have had to review their incentive arrangements following the Court of Appeal's decision.

Forde and McHugh Ltd v CRC, Supreme Court,

Deductibility of travel expenses

The FTT had to decide whether travel expenses incurred by a self-employed flying instructor between his home and the airport were deductible. Mr White gave flying lessons and examined students and other examiners at two airports. He used the premises of the two airports to debrief pilots. He would usually fly to another airport, land and then return to the airport where he started. He operated his business from home, where he kept his business records and equipment, and was registered with the Civil Aviation Authority.

Decision:

Applying Samadian [2014] UKFTT 115 (TC), the FTT found that Mr White was not an itinerant worker but had places of business at his home and at the two airports where he taught and examined pilots. Although he could have taught at other airports, he had only done so on a single occasion and so he attended the two airports 'regularly and predictably' to carry out his business activities. The FTT therefore distinguished Mr White's circumstances from those of Horton [1972] Ch 157; Mr Horton's only place of business was his home and he worked in many other places with no predictability or regularity. Consequently, the travel expenses incurred by Mr White were not incurred wholly and exclusively for the purpose of his profession (ICTA 1988 s 74). The FTT added that the realisation by HMRC (on obtaining the flight log) that Mr White had made regular journeys between his home and the two airports amounted to a 'discovery' for the purpose of TMA 1970 s 29.

Comments - This case further refines the test for the deductibility of travel expenses. Following Samadian, it clarifies the distinction between an itinerant worker and a taxpayer who has more than one place of business.

Noel White v HMRC TC3354

Capital Taxes

Negligible value claim (Lecture P828 – 8.27 minutes)

Judgment was given on 11 December 2013 in the First-Tier Tribunal case of *Brown v HMRC (2013)*.

The taxpayer (B) had invested significant sums by way of share capital in a company called Microsharp Holdings Ltd at a time when it had some real value. However, in his 2005/06 tax return, B made a share loss relief claim under what is now S131 ITA 2007 on the ground that his shares had become of negligible value at the relevant date (5 April 2006). There was no possibility of the company paying a dividend (because it had accumulated trading losses totalling over £15,000,000) and there was a deficiency of assets. Accordingly, B claimed that his shares were worthless. It should be noted that, in order for a negligible value claim to be made, it is only necessary for the shares to be worth 'next to nothing' (ie. not necessarily nil), but it must be emphasised that, if they have some value, they are not of negligible value, even if that value is negligible compared with the claimant's acquisition cost.

In the light of all this, it looks as though B had a reasonable argument in justification of his claim, but there was a problem. Another individual, who, in 2003, had become the majority shareholder and principal director of Microsharp Holdings Ltd, kept putting money into the company in the hope that, as one commentator put it, 'everything would come good at the end'. As a result, the company was not on the verge of ceasing to trade and the possibility existed that it might at some stage become profitable (although this seems to have been a remote prospect). However, these are the sort of reasons which HMRC always try and put forward to suggest that the shares have not become of negligible value.

Despite this, the Tribunal decided that it was not necessary for the company to have ceased trading or to have been put into liquidation in order for the shares to be of negligible value. The fact that they had no market value was enough for B to qualify for his share loss relief.

Related property planning (Lecture P829 – 21.47 minutes)

Where a husband and wife each own shares in the same company and their combined holdings carry control, the IHT valuation rules ensure that there can be significant benefits in arranging for the spouse with the *smaller* holding to make the transfer which reduces their combined holdings to below the level of control.

Illustration 1

Vincent has a 49% shareholding in a family business and his wife owns a 2% shareholding in the same company. There are 100 ordinary shares of £1 each in issue. Prospective share values are as follows:

51% holding	£10,000 per share
49% holding	£5,800 per share
2% holding	£1,200 per share

If Vincent and his wife have decided to give away their shares, the position where Vincent makes the first gift is:

Vincent

		£
	49 shares @ £10,000 per share	490,000
Wife		
	2 shares @ £1,200 per share	2,400
		£492,400

On the other hand, if the wife makes the first gift, the position is:

Wife

		£
	2 shares @ £10,000 per share	20,000
Vincent		
	49 shares @ £5,800 per share	284,200
		£304,200

The wife should therefore make the first gift. This effect is a standard phenomenon within the context of IHT and should always be borne in mind. However, the position is complicated by the current rates of business property relief. If the company which Vincent and his wife control is a trading concern, a 100% relief would be available in either case to cancel out the transfer of value. This planning point is therefore most useful where the transfer involves shares in investment companies or in trading companies with significant excepted assets.

A problem faced by parents holding in excess of 50% of the voting shares of a large family company is that their children are often unable to afford to purchase their parents' shares in one go. If, instead, the parents make piecemeal gifts or sales of their shares to the children, they may still be vulnerable to a disproportionately large tax charge in connection with the transfer which reduces their related holdings to below the level of control.

Illustration 2

Sam Ltd is a family company with an issued share capital of 10,000 ordinary shares of £1 each. Shareholdings of various sizes are valued as follows:

60%	£170 per share
45%	£80 per share
15%	£25 per share

Sam owns 4,000 shares, while his wife holds 2,000. A 15% holding can be disposed of by either Sam or his wife in a number of different ways:

First possibility

Sam's wife gives 1,500 shares to her son. Thus:

		£
Before	2,000 x 170	340,000
After	500 x 80	40,000
		£300,000

Shares worth £37,500 (1,500 x £25) have been passed to the son, but the chargeable value of this gift (before reliefs) is £300,000.

Second possibility

Sam's wife sells 1,500 of her shares to the son for £37,500.

This will still be a transfer of value, unless the wife can show (see S10 IHTA 1984):

(i) that the transaction was not intended to confer any gratuitous benefit on any person;

(ii) that the disposition was such as might be expected to be made in a transaction at arm's length between persons not connected with each other; and

(iii) that the deal was done at a price which was freely negotiated at the time of the sale (or at a price such as might be expected to have been freely negotiated at that time).

Where, for example, the son was threatening to leave the company unless he was allowed to acquire some shares and where his services were valuable to the company, it is thought that there would not then be a transfer of value.

Administration

Unlucky opt out

The issue before the Court of Appeal was whether the First-tier Tribunal had jurisdiction to make an order that the costs of preparing hearing bundles for an appeal by Eclipse Film Partners should be shared equally between the taxpayer and HMRC. At that stage, HMRC did not question the jurisdiction of the First-tier Tribunal to make that order.

After the taxpayer's appeal was dismissed, its solicitors sent HMRC a schedule of its costs in preparing the bundles, seeking a contribution of £108,395.48. HMRC applied to set aside the order.

In May 2012, the First-tier Tribunal ruled that it did have jurisdiction, but subsequently the Upper Tribunal ruled that the first tribunal had no such jurisdiction.

The taxpayer appealed.

Decision:

Lord Justice Moses said that the appeal had been classified as complex. As such, the First-tier Tribunal had power to make an order for costs at the end of the appeal under rule 10(1)(c) of the Tribunal Procedure Rules.

However, it could not do so in this instance because in September 2009, the taxpayer had notified the tribunal that the proceedings were to be excluded from potential liability for costs. By opting out of the costs-sharing regime, the taxpayer “took a particular view as to the risks it was prepared to face in pursuing the appeal”.

The taxpayer's appeal was dismissed.

Comments - The cost shifting regime belongs solely to the confines of rule 10 and therefore only applies in very limited circumstances. A tax litigant faced with a costly case management direction should therefore seek the amendment of the direction, as no relief will be available through the cost regime.

Eclipse Film Partners No 35 LLP v CRC, Court of Appeal

Costs in favour of HMRC

The taxpayer was incorporated in 2007. It described itself as a general builders, plant hirers and material suppliers. G was the sole director of the company. The company submitted claims for input tax in respect of 54 invoices from four companies, with which G was connected.

HMRC refused the claims on the basis that they did not comply with the legislation and that they were not satisfied that the transactions had taken place.

The First-tier Tribunal dismissed the taxpayer's appeal. The company appealed, saying the First-tier Tribunal had not given proper consideration to the evidence and that it had erred in law in granting an order of costs against the company.

Decision:

The Upper Tribunal said that the first tribunal had provided clear, detailed reasons why it had rejected the director's evidence and had given sufficient attention to other evidence offered.

On costs, the Upper Tribunal supported the First-tier Tribunal's ruling in favour of HMRC. The first tribunal had concluded that it was unreasonable of the taxpayer to bring the appeal when it had known that the supplies related to the invoices had not taken place.

The taxpayer's appeal was dismissed.

Comments – Bearing in mind the decision in the FTT it is surprising that the company took it to the Upper Tribunal – it was unlikely that they were going to succeed in light of the decision at the FTT. It was incumbent of the company to prove that the transactions had actually taken place.

Reddrock Ltd v CRC, Upper Tribunal

Wrong button pressed resulted in penalties

The appellant, Peebles Baptist Church (PBC), employed one person, its minister. One of the members acted as treasurer, although she had little financial knowledge, and was responsible for dealing with PAYE. She was late submitting the 2010/11 P35 and claimed reasonable excuse.

The treasurer explained that the church had undergone a period of unrest caused by the dismissal of a minister who had created a lot of problems. This had caused her and other members to suffer ill health and led to her forgetting to submit the P35, although all the PAYE had been paid.

It was as a result of a call from HMRC on 19 September that she took action to submit the return. However, she pressed the wrong button and updated the form rather than sent it. She received a penalty notice on 26 September for the period ending 19 September and assumed the penalty period ended that day because she, wrongly, thought she had submitted the return. It was not until February, when HMRC contacted her again, that she submitted it correctly.

Decision:

The First-tier Tribunal accepted that the taxpayer had a reasonable excuse. The judge was curious to know why penalties covering only the period from May to September had been issued, when the total amount due should have been £900, ie to cover the period to 19 February 2012. He noted that the possibility of an additional £500 in penalties “came as a complete shock” to the taxpayer because it had received no notification from HMRC that additional penalties might be imposed.

In reply, the HMRC officer said she "had received no instructions on the matter" and "presumed that because the £400 penalty had been appealed by PBC before 20 February 2012 it had probably been decided not to levy the further penalty pending the result of this hearing".

The tribunal noted that at point 9 of HMRC's "your charter", the department undertakes to: "Do all we can to keep the cost of dealing with us as low as possible." The judge said:

"By not notifying the appellant of the potential for a further penalty they have created the possibility of two appeal hearings where only one would have been necessary. In this way if HMRC now issue a penalty notice for the further £500 they will have potentially doubled the costs for the appellant. Thus this section of the charter has not been adhered to."

The judge said the actions of the minister could not have been foreseen by the taxpayer. The resulting stress and trauma constituted a reasonable excuse for the whole period until February when the return was correctly submitted.

The taxpayer's appeal was allowed.

Comments – This case is a good demonstration of the importance of the Tribunal system and how the Tribunal will exercise judgement and fairness. It is also good to see a demonstration of the importance of the HMRC Charter of which little is heard in Tribunal decisions.

Peebles Baptist Church TC3204

Late appeal allowed

The taxpayer applied to be allowed to appeal out of time in respect of assessments for 2003/04 to 2005/06 issued in June 2009 and a closure notice for 2006/07 issued in August 2009. The assessments, which were estimated, were related to undeclared rental income.

HMRC admitted that they had a letter dated 13 August 2010 from the taxpayer's accountant informing them that the taxpayer wished to appeal and explaining why the application was late. HMRC had not confirmed either way whether they would accept the late appeal. The First-tier Tribunal decided that the letter should be taken as an open appeal.

Decision:

In any event, the tribunal said the taxpayer should be allowed to appeal. This was because the assessments were not only estimated but also likely to be excessive. If they were "simply confirmed", the taxpayer might be made bankrupt. The tribunal noted that the taxpayer and his accountant had now prepared figures for the years in question.

It would therefore be "manifestly unfair" for the taxpayer to become bankrupt as a result of incorrect assessments.

The taxpayer's application for a late appeal was allowed.

Comments – Although clearly very delayed in actions by the taxpayer the Tribunal applied equity and it can be seen from their comments that if they had not made the judgement the consequences would have been dire and a demonstration of a system which could have catastrophic consequences if applied automatically and without proper human intervention.

F Elazoua v HMRC TC3215

Too late to appeal

The taxpayer did not submit its 2010/11 P35 so HMRC issued a penalty of £800 in February 2012 and further penalties in May and September. In addition, a penalty of £400 for non-submission of the 2011/12 P35 was imposed. The taxpayer did not appeal within the specified period, so applied for permission to make a late appeal.

Decision:

The First-tier Tribunal dismissed as unreasonable, the taxpayer's excuse that it had a "backlog" of post, saying "this might excuse a few days' delay but not three to six months". The fact that the taxpayer employed only two part-time staff members who were both paid below the PAYE threshold was not relevant — Regulation 73(1) of the Income Tax (PAYE) Regulations demanded that a P35 be submitted by employers before 20 May after the end of a tax year. The penalties under TMA 1970, s 98A gave no reduction for employers whose employees were below the PAYE threshold. However, when the tribunal asked HMRC about their practice in this respect, they said:

"where all employees were below the threshold for PAYE and National Insurance contributions, HMRC's practice was to reduce the penalty for each tax year to the higher of £100 and the total PAYE and National Insurance due (if this was less than the penalty charged)."

The tribunal noted that such mitigation was a matter of HMRC discretion and could be exercised only after the P35s were filed.

It concluded that the penalties were validly issued and that permission for a late appeal should not be given.

The taxpayer's appeal was dismissed.

Comments – The comments of the FTT are self explanatory.

The Redhill Islamic Centre Trust (TC3196)

Unclear advice

The taxpayer appealed against a penalty for the late submission of his end of year employer return. He claimed reasonable excuse on the ground that he was no longer an employer. He said he had called the employer helpline many times to deregister as an employer but was constantly referred to other numbers or HMRC's website. He received reminders for tax that was not due and tried unsuccessfully to file the return.

Eventually, an HMRC adviser told him to download the basic tools programme, which he did and then succeeded in submitting the return.

Decision:

The First-tier Tribunal concluded that the taxpayer experienced great difficulty in trying to send the return. HMRC's advice was unclear, especially on filing where there are no employees.

Although he was told the scheme could not be closed and he had to file nil returns, it could have been shut once he had given notice that there were no employees. He did not have to wait until the end of the tax year.

The taxpayer had reasonable excuse and the penalties were cancelled.

The taxpayer's appeal was allowed.

Comments – The success of the tax system depends upon the integrity of the software which is used and HMRC should help when required otherwise taxpayers acquire penalties without justification. It needs to be remembered that different taxpayers have different levels of knowledge of the tax system and accordingly require different levels of assistance. Accordingly the Tribunal held that the taxpayer had a reasonable excuse.

L Howard v HMRC TC3154

Auto Enrolment (Lecture P830 – 15.59 minutes)

Staging dates

Table 1: List of staging dates by PAYE scheme size or reference

PAYE scheme size or reference	Staging date
350-499	1 January 2014
250-349	1 February 2014
160-249	1 April 2014
90-159	1 May 2014
62-89	1 July 2014
61	1 August 2014
60	1 October 2014
59	1 November 2014
58	1 January 2015
54-57	1 March 2015
50-53	1 April 2015
Fewer than 30 with the last 2 characters in their PAYE reference numbers 92, A1-A9, B1-B9, AA-AZ, BA-BW, M1-M9, MA-MZ, Z1-Z9, ZA-ZZ , 0A-0Z, 1A-1Z or 2A-2Z	1 June 2015
Fewer than 30 with the last 2 characters in their PAYE reference number BX	1 July 2015
40-49	1 August 2015
Fewer than 30 with the last 2 characters in their PAYE reference number BY	1 September 2015
30-39	1 October 2015
Fewer than 30 with the last 2 characters in their PAYE reference number BZ	1 November 2015
Fewer than 30 with the last 2 characters in their PAYE reference numbers 02-04, C1-C9, D1-D9, CA-CZ or DA-DZ	1 January 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers	1 February 2016

00 05-07, E1-E9 or EA-EZ	
Fewer than 30 with the last 2 characters in their PAYE reference numbers 01, 08-11, F1-F9, G1-G9, FA-FZ or GA-GZ	1 March 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers 12-16, 3A-3Z, H1-H9 or HA-HZ	1 April 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers I1-I9 or IA-IZ	1 May 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers 17-22, 4A-4Z, J1-J9 or JA-JZ	1 June 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers 23-29, 5A-5Z, K1-K9 or KA-KZ	1 July 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers 30-37, 6A-6Z, L1-L9 or LA-LZ	1 August 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers N1-N9 or NA-NZ	1 September 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers 38-46, 7A-7Z, O1-O9 or OA-OZ	1 October 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers 47-57, 8A-8Z, Q1-Q9, R1-R9, S1-S9, T1-T9, QA-QZ, RA-RZ, SA-SZ or TA-TZ	1 November 2016
Fewer than 30 with the last 2 characters in their PAYE reference numbers 58-69, 9A-9Z, U1-U9, V1-V9, W1-W9, UA-UZ, VA-VZ or WA-WZ	1 January 2017
Fewer than 30 with the last 2 characters in their PAYE reference numbers 70-83, X1-X9, Y1-Y9, XA-XZ or YA-YZ	1 February 2017
Fewer than 30 with the last 2 characters in their PAYE reference numbers P1-P9 or PA-PZ	1 March 2017
Fewer than 30 with the last 2 characters in their PAYE reference numbers 84-91, 93-99	1 April 2017
Fewer than 30 unless otherwise described	1 April 2017
Employer who does not have a PAYE scheme	1 April 2017
New employer (PAYE income first payable between 1 April 2012 and 31 March 2013)	1 May 2017
New employer (PAYE income first payable between 1 April 2013 and 31	1 July 2017

March 2014)	
New employer (PAYE income first payable between 1 April 2014 and 31 March 2015)	1 August 2017

Action Plan

The Pensions Regulator's website (www.thepensionsregulator.gov.uk) has an excellent chart which sets out each step and the appropriate time schedule for each for any given staging date. It is an excellent idea to introduce clients to this early, and for clients to nominate a contact for the Pensions Regulator. Automatic emails will then be sent through the run up to the staging date, reminding employers what they have to do next.

The first step is to identify the staging date and nominate a contact for the pensions regulator (TPR) to contact. TPR will then follow up with emails about what employers need to do and when.

Issues for practices

Research by the Pensions Regulator indicates that around 75% of very small businesses intend to rely wholly on their accountant for help with auto enrolment. In addition TPR also estimates that the cost for an employer with 1 – 4 employees of setting up the necessary systems to operate auto enrolment is £9,100. This is the cost to get the business into a position of being able to start deducting contributions. In addition, even if all of the employees opt out, these costs must be borne, as employees are auto enrolled and then permitted to opt out.

Choosing a provider

Although strictly this step comes a little later, current advice is that a provider will need an absolute minimum of six months to do the necessary work to have the scheme ready to go on staging date (this applies to small schemes – larger schemes will need considerably longer). It is also worthwhile establishing what information the provider will need and in what format at the very beginning, as many are very inflexible, and some will charge substantial amounts just for the IT to report employees and contributions aligned with payroll. You may also find that your payroll software is not being upgraded to deal with auto enrolment, or that it cannot provide the data in an appropriate form for the scheme provider to process.

Note that if you are not authorised to provide investment advice, you will need to advise your client to seek an appropriate adviser for this element.

Assessing employees

Although the staging date is determined by the number of employees in the PAYE scheme, not all employees may need to be enrolled in a pension scheme, so the next step is for the employer to identify the categories of staff from the employment or payroll records. The number of employees used is the number as at 6 April 2012.

What to assess

There are two qualifiers for staff to be within auto enrolment

- Is the member of staff over 22 and under state pension age?
- Do they earn over £9,440 a year?

If the answer to both is yes, the employer will have to automatically enrol them into a pension scheme and make contributions towards it.

The financial limit shown applies to 2013/14. It is likely that it will increase from 6 April 2014 to £10,000 (= personal allowance).

Staff earning £9,440 or less

Staff aged 16 to 74, earning over £5,668 (likely to be £5,772 from 6 April 2014 = LEL) up to and including £9,440 a year have the right to opt in to the automatic enrolment pension scheme. This is a similar process to automatic enrolment, and the employer will have to contribute to their pension.

Those aged 16 to 74 who earn £5,668 a year or less have the right to join a pension scheme. They can only join after the staging date.

Staff aged under 22 earning above £9,440

Staff aged 16 to 21 who earn more than £9,440 have a right to opt in to the automatic enrolment pension scheme. Again, the employer will have to contribute to their pension if they decide to opt in.

Monitoring changes in employee status

Once the initial identification work has been done, the employer will need a process to monitor when employees move categories. This is particularly important when:

- Employees attain the age of 22, and
- Employees with pay either less than £5,668, or less than £9,440

Employers will need to implement a process so that changes in employee status can be identified and acted upon immediately, so that the relevant employer responsibilities are met (see below).

Agency staff

In the absence of a contract to the contrary, members of agency staff supplied to other businesses will be a worker engaged by the person who has responsibility for paying them, or who actually pays them. This means that agency staff will normally be auto enrolled by the agency.

One-person companies

If an individual is a director of a company and the company has no other employees, that individual is not a worker by virtue of any office that they hold or contract of employment under which they work. The company is therefore not subject to the employer duties in relation to that individual.

However, if the company takes on a second worker, and both the director and the new employee work under a contract of employment, then both the director and the new employee will be workers for the purposes of the employer duties and the company will have responsibilities in relation to both of them.

Where a small company has two directors it is subject to auto enrolment, so the exemption is for single director companies only.

Consultants and freelancers

TPR seems to take a different view from HMRC as to whether individuals who are paid by an organisation are workers for the purposes of auto enrolment or not. Some advisers report that people who are self employed for tax purposes have still been classified as workers for this purpose and therefore are within the auto enrolment rules.

Summary Table

Annual earnings (2013-2014)	Age		
	16-21	22-state pension age	State pension age -74
Less than £5,668	Has a right to join a pension scheme (referred to as "entitled worker")		
£5,668 to £9,440	Has a right to opt in (referred to as a "non-eligible jobholder")		
Over £9,440	Has a right to opt in	Automatically enrol*	Has a right to opt in

* Referred to as an eligible jobholder

Where an employee has a right to "opt in", the employer will be required to make contributions for him, exactly as if mandatory auto enrolment applies. Where the employee only has a right to join the scheme, the employer is not required to make contributions.

Employer obligations

All employers with at least one employee must:

- Register with the The Pensions Regulator. This is an online process. This must be done within 4 months after the staging date (extended to five months from 1 April 2014).
- adhere to the safeguards (described later).

In addition, the following is necessary for the various categories of employee.

Eligible jobholders

- The employer must automatically enrol an eligible jobholder into an automatic enrolment scheme on the eligible jobholder's automatic enrolment date (as defined).
- The employer must give the eligible jobholder information telling them:
  - they have been, or will be, automatically enrolled and what this means for them, and
  - their right to opt out and their right to opt back in.
- The employer will also have to give information about the eligible jobholder to the scheme.
- The employer must pay employer contributions to the scheme.

Opting out

The eligible jobholder may choose to opt out of scheme membership once they have been automatically enrolled. 'Opting out' has a specific meaning in the new employer duties. It refers to the provision of a mechanism under the law which has the effect of undoing active membership, as if the worker had never been a member of a scheme on that occasion. It can only happen within a specific time period know as the 'opt-out period'.

An employer will continue to have responsibilities towards the individual who has opted out. One of these is to automatically reenrol them every three years, if they are still an eligible jobholder working for that employer.

If an eligible jobholder is already an active member of a qualifying scheme on their automatic enrolment date, the employer does not need to take any further action, other than to give them information about the scheme of which they are a member.

Non-eligible jobholders

Non-eligible jobholders do not need to be automatically enrolled. However, they have a right to opt in to an automatic enrolment scheme, if they choose, so an employer still has duties in relation to them.

- An employer must give their non-eligible jobholders certain information about opting in to an automatic enrolment scheme and what this means for them.
- The employer must give this information to the non-eligible jobholder within one month (from April 2014 six weeks) of the date on which they first become a non-eligible jobholder. Normally at this point the employer's staging date or, after staging, the non-eligible jobholder's first day of employment, or date their circumstances change.

This requirement does not apply if the employer has previously given this information, for example because the non-eligible jobholder has previously opted out of an automatic enrolment scheme with that employer.

Opting in

If a non-eligible jobholder chooses to opt in to a pension scheme, they must do so by giving the employer an 'opt-in notice'. On receipt of a valid opt-in notice, the employer must enrol the non-eligible

jobholder into an automatic enrolment scheme by following the automatic enrolment process. In which case, the employer must pay employer contributions to the scheme.

Entitled workers

Entitled workers do not need to be automatically enrolled. However, they do have a right to join a pension scheme. The pension scheme the employer chooses to use can be a different scheme to the one they may be using for automatic enrolment.

- An employer must give their entitled workers information about joining a pension scheme and what this means for them.
- The employer must give this information to the entitled worker within one month (from 1 April 2014, six weeks) of the date on which they first become an entitled worker.

Joining

If an entitled worker chooses to join a pension scheme, they must do so by giving the employer a 'joining notice'. The employer must then arrange membership of a scheme for them.

The employer will have to deduct contributions on behalf of the entitled worker and pay these into the scheme. However, the employer does not have to pay into the scheme themselves, unless they choose to do so, or have chosen a scheme that requires an employer contribution.

Safeguards for all workers

There are a number of safeguards in place to protect the rights of individuals to have access to pension saving. These apply to all workers, irrespective of their category, although as with the duties, different safeguards apply to different categories of workers.

- They do not take any action or make any omission by which the eligible jobholder ceases to be an active member of the qualifying scheme. For more information about the criteria that must be met for a scheme to be a qualifying scheme.
- They do not take any action or make any omission by which the scheme ceases to be a qualifying scheme
- They do not take any action for the sole or main purpose of inducing a jobholder to opt out of a qualifying scheme, or a worker to give up membership of a pension scheme (this is known as 'inducement')
- During recruitment, they or their representatives do not ask any questions or make any statements that either states or implies that an applicant's success will depend on whether they intend to opt out of the pension scheme (this is known as 'prohibited recruitment conduct')
- They do not breach employment rights for individuals not to be unfairly dismissed or suffer detriment on grounds related to the new employer duties.

Summary table – types of worker and which safeguards apply

Category of worker	Safeguards applicable
Eligible Jobholders	All
Non eligible jobholders	All
Entitled worker	• Inducement • Prohibited recruitment conduct • Employment rights for individuals not to be unfairly dismissed or suffer detriment on grounds related to the new employer duties
Any other worker	• Prohibited recruitment conduct • Employment rights for individuals not to be unfairly dismissed or suffer detriment on grounds related to the new employer duties

Rates of contribution

The minimum rate of contribution as a percentage of the employee's gross salary will rise over time; this is known as phasing. Both the employer and the employee element are subject to a minimum rate as follows:

Date	Employer minimum contribution	Total minimum contribution
Employer's staging date to 30 September 2017	1%	2%
1 October 2017 to 30 September 2018	2%	5%
1 October 2018 onwards	3%	8%

Guidance for ICAEW members

There is a series of helpsheets on the ICAEW website which are available only to registered members. These include advice about letters of engagement, risks and what a practice can advise on if they are not registered to give investment advice. www.icaew.com and choose the quick link to Auto enrolment.

There are two factsheets:

- Auto-enrolment - Workplace Pension: Opportunities and Risks
- Auto-Enrolment – Service planning for workplace pension

Contributed by Rebecca Benneyworth

Business Taxation

Partnerships – LLP employed partners (Lecture B828 – 20.16 minutes)

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

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

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

Further amendments were announced on 21 February 2014 and 7 March 2014. The House of Lords were calling for the measures to be delayed until April 2015 but at the time of writing the measures are due to take effect from 6 April 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 : At the time the condition is considered, it is reasonable to expect that at least 80% of the total amount payable by the LLP in respect of M's performance, during the relevant period, of services for the LLP in M's capacity as a member of the partnership will be "disguised salary" (i.e. it is a forward looking test).

Originally the draft legislation referred to "wholly or substantially" rather than 80%. HMRC examples did however make reference to an 80% test when applying the "wholly or substantially test. On 7 March 2014 the draft legislation was amended to include the 80% in the legislation.

The test is a prospective one which will initially be considered on 6 April 2014 or date of joining if later. 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. Presumably HMRC believe ordinary partnerships should have been applying the normal employed v self employed tests anyway.

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

Example

LLP member X has a fixed salary of £35,000 plus 10% of LLP profits above £300,000.

We would have to consider the profit projections of the LLP to ascertain whether condition A is met for member X. If the LLP profit projections at 6 April 2014 were £350,000 then X's profit share will be £40,000 of which £35,000 is fixed i.e. 87.5%. Condition A is met.

If the projected profits were £400,000 then X's profit share would be £45,000 of which £35,000 is fixed i.e. 78%. With profit projections of £400,000 condition A is not met and member X is not caught by the new rules.

HMRC 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).

HMRC Guidance

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).

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 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. If the junior partner plays a full role in running the practice then Condition B will be breached and the junior partner retains their self employed status.

HMRC 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.

HMRC 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. No vote means no significant influence.

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: 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.

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.

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.

HMRC 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.

All three conditions met?

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.

If all three conditions are met the affected "partner" will cease to be a partner. He will be treated as leaving the partnership and the normal cessation rules will apply.

With a year end of 31 March 2014 the affected "partner" will be self employed for 2013/14 and employed for 2014/15.

If the year end was 30 April 2014 then the affected partner is treated as leaving the partnership on 5 April 2014. He or she will have a 23 month final basis period with overlap relief to set off against these final profits. The LLP will have a partner for 11 months of the year and an employee for one month.

Progression from junior to equity partner

When a senior employee is identified as a future partner they will normally be offered a junior partner role first with a view to becoming equity within two to five years. During this time they will often have a fixed salary (in the main) with no requirement to provide capital until they are offered equity. There may be a variable element in addition to the fixed salary but this is unlikely to represent 20% of their total profit share.

On the face of it these junior partners will meet conditions A and C.

We must therefore ensure that condition B is breached. If the junior partners attend the partners meeting, have a vote at the meeting and generally participate in the running of the practice then that should be sufficient to breach condition B and secure self-employed status. If they also had clearly defined roles in important areas such as practice development this would also help their cause.

Corporation tax assessment on VAT repayment

Shop Direct Group (SDG) challenged the assessment to corporation tax of a VAT repayment of nearly £125m, together with interest of nearly £175m. SDG had been assessed under ICTA 1988 s 103 in relation to post-cessation receipts of trades and in relation to interest payments arising from a loan relationship under ICTA 1988 s 18.

Decision:

The Court of Appeal unanimously dismissed the appeal. In relation to the post-cessation receipts, each of the companies which had made the relevant overpayments of VAT had transferred their trades. The first issue was therefore whether the charge to corporation tax imposed by s 103 applied only to a post-cessation receipt by the original trader. Briggs LJ considered that the charge applied to any recipient, on the basis that the provision was widely drafted and that it could not have been intended that substantial classes of post-cessation receipts should be left untaxed. His lordship also noted that the history of s 103 pointed to such an interpretation. He also rejected contentions that the repayments 'did not arise from the carrying on of a trade', noting that the receipt of the repayment by SDG had neither lost its character as a result of an intra-group restructuring, which had led to a repayment to a different company, nor as a result of the complex mechanics of the actual repayment. In relation to the tax due on interest received by SDG, the court rejected arguments that these did not arise from a money debt. It stressed that HMRC's obligation to repay SDG was its primary statutory obligation and so SDG's right could not be a right to compensation. The fact that the quantification of the sum due required extensive research into historical data did not change the position. Nor did the complex mechanics of the repayment change the fact that the debt was owed by HMRC to SDG, which was therefore a creditor.

Comments - The amounts at stake were huge. The case clarifies the charge to corporation tax of post-cessation receipts and interest payments in circumstances where the recipient is not the original trader.

Shop Direct Group v HMRC (A3/2013/1532)

Section 171A election

The taxpayer failed in its appeal against HMRC's decision to reject a joint election made under TCGA 1992 s 171A. Section 171A allows notional transfer of assets within a group to enable capital losses to be set off against capital gains in circumstances where the losses and gains arise in different companies.

The appellant had been issued loan notes as consideration for the disposal of a company. As part of a restructuring, the appellant and a company which had realised a capital loss were brought within the same group. The loan notes were then repaid and the appellant (treating the repayment of the loan notes as a disposal) entered into a joint election under s 171A with the loss making company.

S 171A applies when a group company 'disposes of an asset to a person who is not a member of the group'. The first issue was therefore whether the satisfaction of a debt constitutes a disposal of that debt by the creditor within the scope of s 171A.

Decision:
The tribunal answered in the negative, holding that parliament would have expressly included such disposals if it had been its intention that they should be covered.

Additionally, the tribunal held that there was nothing transferred by the appellant when the loan notes were repaid and so there was no disposal of debt.

Finally, the tribunal held that a purposive interpretation of s 171A did not displace the requirement for a disposal to a person outside the group.

Comments - Clearly, the intention of parliament when enacting s 171A was to enable sister companies to set off capital gains and capital losses, yet the tribunal felt that the provisions could not apply where the 'disposal' is a repayment of a debt.

DMWSHNZ v HMRC (FTC/30/2013)

CIS: standard of care

The FTT had to decide whether a business had taken reasonable care in its compliance with the construction industry scheme (CIS). The FTT noted that the standard 'does not require that mistakes must never be made' and that the standard must be 'appropriate and proportionate to the particular contractor's business'. The tribunal pointed out that the mistake identified by HMRC had been the only mistake made over a seven year period, stressing that a business of the size of J&M would not have a dedicated CIS function. J&M's subcontractor, JB (a registered subcontractor under the CIS) had used stationery suggesting that it was trading as a limited company. However, JB had explained that it was old stationery for a company that had been dissolved. J&M had therefore continued to make gross payments to JB. The FTT found that J&M's error as to the identity of its subcontractor had been made in good faith. The very fact that J&M had enquired meant that it had taken reasonable care.

Comments - In reminding HMRC that getting it wrong is not necessarily a sign of lack of care, the decision may be a useful reference for many taxpayers. That said, CIS contractors would be well advised to always check very carefully the identity of their sub-contractors — as HMRC will show little leniency.

There are going to be changes to Construction Industry Scheme consulted on this summer.

J&M Interiors v HMRC TC3323

VAT

TOMS and online travel providers

HMRC's unsuccessful appeal concerned the liability to VAT of Secret Hotels, which arranged holiday accommodation through an online website. The decision focused on hotel rooms. Hoteliers would enter into an 'accommodation agreement' with Secret Hotels for the marketing of their rooms on the website. Customers (both travel agents and holidaymakers) would book a hotel on the site and pay the whole amount of the booking. Secret Hotels would then pay a lower amount to the hotelier.

The issue was the VAT liability of Secret Hotels in respect of the supply of hotel accommodation. HMRC sought to apply the tour operators' margin scheme (TOMS) to Secret Hotels on the basis that it was a travel agent acting as principal (under the Sixth VAT Directive art 306.1(a)). This would have meant that Secret Hotels was taxable in the UK, where it had its place of business, on the margin made on each transaction.

Secret Hotels contended that it acted as an agent and was receiving commissions from hoteliers for each booking, and therefore TOMS did not apply (art 306.1(b)). It argued that VAT was payable in the countries where the hotels were located and so, under the reverse charge mechanism, the company did not have to pay any VAT.

Decision:

At the Supreme Court, Neuberger LJ considered that, under both domestic and EU law, the agreement created an agency relationship as clearly set out by its wording. Arguments that the economic reality of the arrangements was inconsistent with an agency relationship were roundly rejected. In particular, the one-sided character of the contract (for example, Secret Hotels fixed its own commission) could be explained by the fact that Secret Hotels had a substantial business and was intent on protecting its goodwill. This was also why it needed to protect itself against the risk of non-provision of accommodation by hoteliers and appointed local agents to look after holidaymakers. Similarly, the fact that Secret Hotels sometimes prebooked and paid for hotel rooms did not alter the analysis. Secret Hotels did so to maximise commissions and to maintain its goodwill and payments were recoverable.

Comments - The decision brings much needed clarity to the application of TOMS to online tour operators. These should ensure that the contract clearly creates an agency relationship which is not contradicted by the behaviour of the parties.

Michael Conlon, partner in Hogan Lovells tax team, said: 'The case highlights the different roles of the national courts and the CJEU. Whilst the CJEU's rulings on the interpretation of EU law are binding, the national courts are responsible for interpreting contracts and for characterising the legal relationship which they create between the parties. In this respect, the Supreme Court has followed its recent landmark decisions in WHA and Aimia Coalition Loyalty.

'The court's comments on the need to decide VAT cases according to the economic and commercial reality is also interesting. The court observed that as the hotel owned the accommodation and the

holidaymaker was the customer, there was no conflict between the economic reality and the agency analysis. The court relied also on Newey, where the CJEU stated that the contract was an important factor in the analysis provided it reflected economic reality.'

HMRC v Secret Hotels2 [2014] UKSC 16

New garage: annexe or new dwelling?

The taxpayer had built a new garage on the grounds of his existing house but separate from it. The tribunal decided that the construction should be standard rated as an annexe and not zero rated as a new dwelling (VATA 1994 Sch 8 Group 5).

Decision:

The tribunal noted that where 'the physical features do not provide a clear indication of whether or not a structure is an annexe, it is necessary to conduct a wider enquiry and consider matters such as the planning permission and intended use of the new building in order to establish its status.'

The FTT had found that the purpose of the new building was to enhance the functionality of the existing structure whilst enhancing its character and concluded that the new building was an annexe, excluded from zero rating by note 16(c). The UT agreed with the FTT's finding of fact.

Finally, agreeing with the taxpayer, the tribunal accepted that Notice 708 (entitled Buildings and construction) can be understood as suggesting that in order to be an annexe, a building must be attached to the main building. However, the tribunal noted that the notice could not override the law. Cantrell No. 2 [2003] STC 486 was clear authority for the proposition that an annexe does not need to be physically attached to the main building.

Comments - The case is a useful reminder that physicality (in particular, whether the new building is attached to the main building) and functionality are not the only factors to be taken into account.

Neil Warren, independent VAT consultant, said: “The legislation specifies four conditions of a new dwelling, and one is that it must be capable of being sold independently in its own right. This rule catches out many builders — and the same rule about disposal also applies to claims under the DIY scheme. A lot of farmers build a new house or bungalow on their land, but it is not classed as a new dwelling for VAT purposes if it can only be sold as a package with the main farmhouse or other buildings.”

Colchester v HMRC (FTC/43/2013)

VAT exemption for 'eligible bodies'

The FTT held that SAE was an eligible body (VATA 1994 Sch 9 Group 6) providing exempt supplies of education. This was on the basis of its relationship with Middlesex University (MU).

Decision:

Having extensively reviewed recent case law, the tribunal concluded that the factors from the decision in School of Finance and Management [2001] STC 1690 (SFM) were not exhaustive. Also, some of these may be irrelevant or contrary to EU law, so other factors may need to be considered depending on the circumstances.

The tribunal gave particular weight to the following factors: (i) MU had acknowledged SAE as an accredited institution and then as an associate college; (ii) SAE and MU had a longstanding relationship (despite the fact that their agreement could be terminated); (iii) 90% of the education provided by SAE was higher education of a similar character to that provided by MU, which had been monitoring diplomas awarded by SAE until August 2011, when it had started awarding diplomas to SAE students directly; and (iv) finally, SAE students received MU degrees at MU ceremonies.

The UT concluded that SAE was a college of MU and therefore entitled to the VAT exemption.

Comments - Following recent case law, in particular HIBT (2007) VAT decision 1978 and LCC [2012] FTT 342, it has proven rather challenging to identify the relevant factors when deciding whether a private body providing education in collaboration with a university qualifies as an 'eligible body'. This case hopefully brings some much needed clarity.

SAE Education v HMRC TC3358

Membership subscriptions exempt

The FTT had to decide whether membership subscriptions of a trade association constituted exempt supplies. The case was remitted by the UT to the FTT. The UT had held that the FTT had been wrong to regard the 'primary purpose' test (for the purpose of VATA 1994 Sch 9 Group 9 item 1(d)) as a subjective one, by reference to the views of directors and members. The UT held that the test was objective and required examination of the 'stated objects and activities of the body in question'.

Decision:

The FTT concluded from the evidence that the association had a predominant purpose, providing a political lobbying body representing tour operators based in Europe. The FTT recognised that the association had other objects and carried out other activities; however, 'none of those constituted aims or purposes which were at least on a par with those lobbying activities'. Consequently, membership subscriptions were exempt.

Comments - The case reminds us not only that the test for purpose is objective, but also that a 'predominant' purpose eclipses other purposes. Interestingly, a key piece of evidence of the objective purpose of the association was a note taken by a C&E officer during a visit to the association.

European Tour Operators Association v HMRC TC3353

Whether a purchase was made for business purposes

The issue was whether the purchase of a boat had been made for the purpose of a business. Under the Sixth VAT Directive (arts 167 and 169), a taxable person carrying on an economic activity is entitled to deduct input tax on goods used for the purposes of his taxed transactions. As the owner of two racing boats (and a restaurant), Mr Lai had attended various P1 world championship power boats events and had come to the conclusion that these events represented a catering opportunity. He contended that he had purchased a third boat for this purpose in 2009.

Decision:

The tribunal rejected the contention that securing catering contracts was Mr Lai's principle intention when he purchased the boat. Although it accepted that Mr Lai had had in mind the possibility that the acquisition of the boat might help with obtaining a catering contract, this could not have been his sole purpose as the whole idea was 'a dicey proposition'. The tribunal also noted that Mr Lai had already made useful contacts thanks to his ownership of two racing boats and that he had not really pursued the award of catering contracts. The tribunal added that even if the purpose of the boat acquisition had been to use it to obtain catering contracts, that would not have been an intention to use it for business. Mr Lai had incurred substantial expenditure on the boat (￡250,000) with very little prospect of covering its cost and the proposed activity was not an extension of Mr Lai's business. Although he was an experienced restaurant manager, he had no experience of catering for large numbers from mobile dispensaries. The tribunal concluded that the present appeal could be distinguished from the ECJ's decision in INZO [1996] STC 569, in which 'a speculative venture had been pursued in a serious organized manner'.

Comments - The tribunal's view is best summarised by the following extract: 'Buying a lottery ticket is not in our view a business venture, even though it may be defensible and turn out to be profitable.' A subjective intention or hope to start a business is not sufficient in the absence of sound business planning.

Lai's v HMRC TC3352

Tea time

The proprietor was in business running a tea shop and also selling teapots, mugs and other items. Under the terms of the shop's lease, she could only serve reheated or cold food, as well as hot or cold drinks. She decided to join the VAT flat-rate scheme in May 2008, choosing the category “retailing not listed elsewhere” (7.5%) rather than “catering services including restaurants and takeaways” (12.5%). HMRC said the latter rate should apply.

Decision:

The First-tier Tribunal said that the business should have taken into account lease restrictions when deciding which category of the flat-rate scheme to use. The proprietor had to comply with the terms of the lease and subsequent planning requirements. For the first year of use of the scheme, the “retailing

not listed elsewhere" should apply. However, after that, the business's turnover in respect of catering overtook its retailing trade, so the catering services category should be used.

The taxpayer's appeal was allowed in part.

Comments – This case demonstrates the care needing to be taken with the use of the Flat Rate Scheme and the relevant categories of trade.

The Vintage Tea House Ltd (TC3160)

VAT: management of defined contribution pension schemes

A company (ATP) supplied certain services to occupational pension funds. The Danish authorities refused to exempt ATP's supplies from VAT.

Decision:

The CJEU ruled that the term 'special investment funds as defined by member states', in art 13B(d) (6) of the EC Sixth Directive, may cover pension funds such as those at issue in this case if they were funded by the persons to whom the retirement benefit was to be paid, if the funds were invested using a risk-spreading principle, and if the pension customers bore the investment risk. The court also ruled that the term 'management of special investment funds' in art 13B(d)(6) covered services by means of which an undertaking established the rights of pension customers vis-a-vis pension funds, through the opening of accounts in the pension scheme system and the crediting to such accounts of the contributions paid. That term also covered certain accounting services and account information services, such as those listed in Annex II to EC Directive 85/611/EEC. The VAT exemption laid down in art 13B(d)(3) for transactions concerning payments and transfers covered services by means of which an undertaking established the rights of pension customers through the creation of accounts within the pension scheme system and the crediting to those accounts of the contributions paid, and any transactions which were ancillary to those services or which combined with those services to form a single economic supply.

Comments - The judgment of the CJEU follows the preceding advocate general's opinion. As Pauline Hawkes-Bunyan (Deloitte) observes: 'The CJEU has concluded that DC schemes have the essential characteristics of other investment vehicles that allow investors who bear the risk of the investment performance and cost of the fund to pool resources and so to spread the exposure across a wider range of investments. It followed that, like other such funds, DC schemes should be treated as "special investment funds" for VAT purposes, meaning that the "management" of them can qualify for exemption under EU law. The decision contains guidance on the types of services that could be exempted and indicates that comparable services supplied in relation to DC schemes in the UK should also qualify for exemption. Businesses that make (or receive) supplies connected with DC schemes will need to consider the impact of this decision on those supplies.'

ATP PensionService A/S v The Skatteministeriet (C-464/12)

Reduced rate for energy saving materials

The FTT found that the supply of bespoke box sash windows, together with the fitting of draught stripping, constituted separate supplies for VAT purposes.

HMRC accepted that supplies of draught stripping qualified for the reduced rate of VAT (VATA 1994 Sch 7A Group 2). However, it argued that where a customer purchased both sash windows and draught stripping, the taxpayer made a single taxable supply of a window with draught stripping, which was therefore standard rated.

Decision:

The FTT noted that the two supplies were offered as separate and independent products in the company's brochure and that some customers chose to purchase only one of them. Additionally, the supplies were priced separately on invoices. Referring to the CJEU's decisions in Card Protection Plan (C-349/96) and Levob (C-41/04), the FTT considered that, from an economic standpoint, the supplies could not be said to be 'so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split'.

Futhermore, rejecting contentions that the supply of the draught stripping was ancillary to the supply of the replacement window, the FTT accepted that the draught stripping may enhance the functionality of the window, but also stressed that draught stripping was an aim in itself which would improve the functionality of any window fitted into the relevant frame.

Comments - The VAT treatment of supplies which include an energy saving element has been the object of many cases. In treating the simultaneous supply of two products, which are intended to be enjoyed together, as two separate supplies, the case may be a useful reference for other traders who supply energy saving materials together with other products.

Envoygate (Installations) Ltd v HMRC TC3361

Whether advertising or event organising services

The FTT decided that the service of arranging an enclosure at an air show in the UK, to which the recipient of the supply could invite customers and the press, constituted advertising services and not the service of organising exhibitions. The UT first noted that the service of arranging the enclosure was a single composite service and that 'events' and 'advertising services' must be mutually exclusive categories.

The FTT found that 'the essential characteristic of FGS's supply was that it was something which enabled the recipients of the services to inform current and potential customers of the existence and quality of their company's products and services with a view to encouraging and arranging sales. It was essentially an advertising service.'

Furthermore, the supply was not an 'event' as it did not provide culture, art, sport, education or entertainment. The fact that other people enjoyed the services provided by FGS was not relevant; they were not consumers of the services as they did not pay for them. Consequently, the exception to the place of supply rules which applies to exhibitions did not apply (Sixth Directive art 9(2)). The supplies were therefore made in Italy, as this was where the company receiving the supply was established (Sixth Directive arts 43 and 59).

Comments - The line between advertising and event organising is often difficult to draw and it was particularly blurred in this case. The judgment contains a very thorough analysis of the provisions on place of supply of services in force since January 2010.

Finmeccanica Group Services v HMRC TC3364

VAT default surcharge: reasonable excuse

The FTT allowed the appeal of an elderly taxpayer with poor memory who claimed reasonable excuse.

The taxpayer had been in the default surcharge regime since the first quarter of 2007. He had submitted his quarterly return for the second quarter of 2013 ten days late and had made his payment three days late. A surcharge liability notice extension had therefore been issued and HMRC insisted in its submissions that the taxpayer had a history of defaults.

Decision:

The FTT found that the evidence showed that the director responsible for the returns was elderly (77 years old) and 'prone to bouts of forgetfulness'. The FTT therefore accepted the taxpayer's contention that he had been labouring under the mistake that the quarter date was one month later. On discovering his mistake, the taxpayer had paid the tax immediately. The FTT concluded that the taxpayer had made a genuine error and that he had a reasonable excuse.

Comments - It was clear from the evidence that the taxpayer's mistake (and therefore his belief) had been genuine. The FTT was therefore prepared to ignore past defaults. This may be a useful precedent for many taxpayers

Award Framers International v HMRC TC3365

Calculation of appropriate percentage for repayment claim

The subject of the appeal was a claim for repayment of an excess of output tax under FA 2008 s 121, following the decision in Fleming [2008] UKHL 2. VAT had been charged and accounted for on supplies of catering and food by hospitals, which were either zero-rated or exempt. The issue was the calculation of the appropriate percentage of overall supplies to which the repayment applied.

Decision:

Firstly, the FTT agreed with the appellant that the exempt supplies of catering to students should be taken into account in the computation (effectively added to the numerator), increasing the recoverable percentage from 15% to 18%. This was because the food supplied to students was part of the appellant's business activities (not its public activities) and the supply of catering was ancillary to the exempt supply of education. Secondly, the FTT agreed that any extrapolation over a 23 year period must take into account 'changed patterns of dining'. Sandwiches and cold takeaway meals had replaced hot meals consumed in the canteen. Thirdly, the FTT decided that the repayment claim could not be extended to hot takeaway food, which was zero-rated, until May 1984. This was because the taxpayer had effectively waived its right to a repayment by explaining that the relevant amount would be 'very difficult to estimate'.

Comments - The approach adopted by the tribunal when calculating the recoverable proportion represented by VAT overpaid may be a useful example in other situations where a trader is entitled to a repayment in relation to only part of supplies made over a lengthy period of time.

NHS Dumfries and Galloway Health Board v HMRC TC3381

Repayment supplements payable by HMRC (Lecture B830 – 12.35 minutes)

Opening example

Example 1

A publisher making zero-rated books sales (repayment VAT returns) submitted its September 2013 VAT return on 7 October – it is now 30 November and the repayment has still not been paid by HMRC (£20,000). HMRC have made no enquiries into the figures on the return.

Solution

The business should be entitled to a repayment supplement of £1,000 (5% of the repayment amount or £50 whichever is greater), on the basis that HMRC have delayed the repayment by more than 30 days.

The basic rules

Going back to Example 1, I made the assumption that the business is fully up to date with its VAT affairs ie there are no outstanding returns for earlier periods. If that is not the case, then a supplement will not apply to the September claim. In terms of the mechanics of paying a supplement, this is determined by the HMRC computer as an automatic process, so there is no need for an application to be made by a taxpayer, unless he feels a supplement should have been paid but wasn't (HMRC Notice 700/58, para 2.1, step 6; also para 3.4).

What happens if HMRC query the figures submitted on a return, and want to do a verification visit? This is where the issues get a bit clouded because the 30-day clock stops ticking from the time that HMRC

first contact a taxpayer until the point when they conclude their enquiries. However, in age of severe HMRC staff cutbacks, meaning they struggle to deal with a heavy workload, what would happen if they take three months to conclude their enquiry, a delay that has not been caused by slow or inadequate responses from the taxpayer?

As a practical suggestion, it is important to keep a detailed log of dates and times of how the enquiry progresses and ask the question at the conclusion of the process whether there has been an unreasonable delay at any point due to HMRC inefficiency and therefore the 'inefficient days' should be included in the overall total of 30 days for supplement purposes. As a practical example, I dealt with a deregistration issue earlier this year where the process was slowed down to tortoise pace by the fact that the first officer dealing with the case took early retirement, and another officer who took it over relocated to a new office and didn't do a very smooth handover of his outstanding work. If there was a repayment supplement regime in place for deregistration issues, then a full claim would have been justified here.

Box 1 highlights some assurances given by HMRC in relation to dealing with repayment VAT returns.

Box 1……..repayment VAT returns - what a taxpayer can expect from HMRC

You can expect us to:

- reduce burdens on your business and reduce our own running costs by resolving queries wherever possible using information already in our possession
- arrange verification visits for the earliest mutually convenient date and time
- monitor closely the time taken at each stage of processing a claim from date of receipt until date of authorising payment and, where that exceeds a net total of 30 days and all qualifying conditions are met, to pay a repayment supplement automatically
- carefully identify and note any unreasonable delay by us - always counting the time against ourselves for repayment supplement purposes, and
- deal quickly and courteously with any complaint or appeal

Note – the above points are extracts (not a complete list) from HMRC Notice 700/58, section 5.

Delayed VAT652 repayments - Our Communications Ltd case

A VAT652 form (or written letter as an alternative method) will be submitted to HMRC in relation to errors made on past VAT returns within the last four years if the errors cannot be corrected on the next return submitted by the business because the amount of tax involved exceeds the error correction limits. For a small business, the limit is £10,000 but this figure can be as high as £50,000 for a larger business if the net amount of tax over or underpaid is both less than £50,000 and also less than 1% of the net outputs figure shown in Box 6 of the return where the correction is being made.

For many years, it was accepted that a repayment supplement did not apply to a VAT652 claim until the issue was challenged by Our Communications Ltd in the First Tier Tribunal (FTT) in relation to a £1.5m claim that was delayed by HMRC (case ref: TC2281). The company focused on the wording of the legislation at s79, VATA1994 (see Box 2), and felt that the words ‘or claim’ applied to VAT652 overpayments. HMRC disagreed and felt that a ‘VAT credit’ could only relate to a return. The taxpayer won the case, based on the wording of s79, and the tribunal felt that the Parliamentary aim with the repayment supplement process was to encourage ‘efficiency’ in HMRC’s handling of all claims, and this should apply to both VAT returns and error corrections. However, the FTT decision was overturned by the Upper Tribunal (case ref [2013] UKUT 595 (TCC)), which felt that s79 only applied to returns.

Box 2 – the legislation on repayment supplement – VATA1994, s79(2)

The said conditions are:

a) that the requisite return or claim is received by the Commissioners not later than the last day on which it is required to be furnished or made; and
b) that a written instruction directing the making of the payment or refund is not issued by the Commissioners within (the relevant period), and
c) that the amount shown on that return or claim as due by way of payment or refund does not exceed the payment or refund which was in fact due by more than 5 per cent of that payment or refund or £250, whichever is the greater

Note – the Upper Tribunal was persuaded in the case of Our Communications Ltd that the wording of ‘or claim’ was not relevant to a VAT652 error correction claim and only to tax repayments claimed on VAT returns. In relation to 2(b) above, the ‘relevant period’ is the day after the end of the accounting period for the return, or the date it is submitted to HMRC, whichever is later.