Tolley®CPD

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Personal Tax

Benefits and Expenses

Following recommendations from the OTS, the government has published four consultation documents on employee benefits and expenses.

The core package consists of the following changes:

- Introducing a system of voluntary payrolling for benefits in kind.
- Introducing a statutory exemption for trivial benefits.
- Abolishing the threshold for the taxation of benefits in kind for employees who earn at a rate of less than £8,500 a year ('lower paid' employments), with action to mitigate the effects on any vulnerable groups disadvantaged by the reforms.
- Replacing the expenses dispensation regime with an exemption for paid and reimbursed expenses.

There is also a call for evidence on remuneration practices and the promise of further consultation on the rules on travel and subsistence expenses.

Payrolling benefits

The consultation considers the following questions posed by the OTS:

- Should payrolling be compulsory for all employers?
- If an employer payrolls, should it be compulsory for all benefits?
- If an employer payrolls a benefit, should it be compulsory for all relevant employees?

The proposals are:

- Payrolling should be voluntary.
- If an employer chooses to payroll a benefit it should be compulsory for all employees, with limited and defined exceptions (for example, employees on separate payroll).
- There should be consistent rules and processes and standardisation wherever possible. This could take the form of a set list of 'approved' BiKs where, if the employer chooses to payroll, any BiKs provided to employees by that employer that are on the list will need to be payrolled. Alternatively, a list of approved BiKs could be offered on the basis that the employer could choose which of these to payroll, so that there may be some BiKs on the list that the employer provides to employees which are not included in the payroll.
- Payrolling should start and cease only at the beginning of the tax year.

The document also asks whether employers would welcome the option to account for Class 1A NICs in real time where the BiKs are being payrolled.

Employers are asked to comment on how they would deal with issues such as payments or contributions for the private use of company cars made retrospectively, one-off large benefits in kind in the form of the transfer of an asset, and gym membership fees paid on behalf of the employee. Items with a large tax charge will require a significant deduction of tax in a single pay period.

Trivial benefits exemption

One of the recommendations of the OTS report was the introduction of a statutory definition of a trivial BiK supplemented by a set limit.

The Government intends to accept the OTS recommendation and will introduce a statutory exemption for BiKs that are 'trivial' in nature. This will mean that BiKs that fall within the exemption are not subject to tax or NICs and will not have to be reported to HMRC, with a consequent reduction in the number of P11Ds/P9Ds submitted. It will also provide employers and employees with clarity on the definition and tax treatment of a trivial BiK.

The purpose of the consultation is to seek views on defining a 'trivial' BiK and how a statutory exemption should be structured.

The Government proposes that the principles set out below should apply to the definition:

- It will not include cash or a replacement for cash such as a voucher or token.
- Any 'trivial' BiK must not be provided on a continual or regular basis across a tax year but should, instead, be a one-off or irregular item.
- There should be no pre-arranged entitlement to a trivial BiK; typical examples of a 'trivial' BIK might be the gift of a bottle of wine for a job well done, or a small gift, perhaps when an employee is ill or to mark a special celebration.
- It must be possible for an employer to determine a trivial BiK, and whether any liability to tax and NICs arises, in 'real time'. This will be particularly important where the employer decides to adopt voluntary payrolling of BiKs, with the taxable value of non-trivial BiKs put through the payroll process.
- It will not be possible for an employer to use any trivial BiK exemption in conjunction with salary sacrifice arrangements.
- If a BiK is already covered by a statutory tax exemption then these arrangements will not be disturbed; the trivial BiKs exemption will not be necessary for these types of BiKs.

As suggested by the OTS, there will be a monetary limit in the definition of a trivial BiK. Where a benefit that meets the principles for being a trivial BiK is provided to a group of employees the monetary limit will apply to the cost of the benefit provided to each employee. Views are sought on what that limit should be.

There will also be an over-riding annual exemption so once it has been exceeded all further trivial BiKs for that tax year are liable in full to tax and NICs and need to be returned to HMRC on forms P11D/P9D. An individual benefit that exceeds the upper limit for being treated as a trivial BiK will not count towards the annual exemption. An exemption limit has not yet been identified but as the exemption is intended to apply only to genuinely trivial BiKs provided on an irregular basis, a low limit will be appropriate.

The exemption will work on an 'all or nothing' basis. This will mean that a trivial BiK with a cost covered by the annual exemption will not have any liability to tax or NICs, but a trivial BiK with a cost that breaches the exemption limit will be subject to tax and NICs in full. As an example, if the exemption was set at £75, and the definition of trivial benefit had a monetary limit of £30, a first trivial BiK of £30 would be fully exempt from tax and NICs as would a second trivial BiK of £30, but a third of £30 would be liable to tax and NICs on the total amount.

The exemption will be available at each employment that provides trivial BiKs (within the statutory definition) held by an employee in a tax year. Employees with more than one employment will benefit from more than one exemption. However, no decision has been made on whether the exemption should be based on the annual cost or number of trivial BiKs provided in a tax year. Views on the following options are sought:

Option 1: An annual cost exemption per employee at each employment; or
Option 2: An annual numerical exemption per employee at each employment.

This would enable individual employees to receive a specified number of trivial BiKs tax and NICs free in a tax year. Individuals with more than one employment in the year that provided trivial BiKs would be able to benefit from the full exemption at each employment.

Consideration will be given at a later date whether specific anti-abuse rules will be required.

Abolition of the £8,500 threshold
The government has concluded that adopting the OTS recommendation to abolish the £8,500 threshold would deliver the greatest simplification for employers and HMRC.

Views are sought on whether there should be some form of transitional protection for particular groups of employees or employers likely to be affected by the removal of the £8,500 threshold

Exemption for expenses
The government accepts the OTS's recommendation of replacing the current dispensation regime with an exemption for allowable expenses that are paid or reimbursed by employers.

This means that employers would no longer be required to choose between applying to HMRC for a dispensation and reporting expenses payments to HMRC. Instead all employers would need to determine themselves whether the expenses they pay are subject to tax relief or not and treat them accordingly. The main points of the proposals are:

- The exemption will apply to all qualifying expenses paid or reimbursed by an employer.
- An expense will qualify if the employees would have been eligible for tax relief on that expense had they met the costs themselves.
- There is no intention to change the rules that determine whether or not tax relief is available for expenses incurred by employees – the proposed exemption is intended only to simplify the way in which employees receive that tax relief when their expenses are paid or reimbursed by their employer.
- The exemption will apply to all employers without any option to opt in or out.

- The current requirements to maintain records and perform checks where dispensations are in place will continue. One way of providing certainty for employers would be to provide one or more 'models' of acceptable record-keeping and processes for checking employee expenses.
- There will be targeted anti-abuse measures to deal with arrangements which seek to replace taxable pay with non-taxable expense payments.
- It would be necessary to provide for 'custom' scale rates which currently are dealt with through the dispensation process. Possible options are:
  - not permitting the use of custom scale rates under the exemption (but possibly broadening the range of benchmark scale rates to include any expenses for which custom scale rates are often requested);
  - retaining an application process solely for custom scale rates that are to be used under the exemption; and
  - allowing 'self-certification' of custom scale rates by employers, with clear rules on the sampling exercise that must be conducted to support those rates.
- one person companies and directors of small, close companies would not be permitted to be paid a scale rate for expenses under the exemption (but this would not affect those companies paying a scale rate to other employees).
- Transitional arrangements would be needed for current dispensations and custom scale rates.
- The timing of the introduction of the new rules is likely to be a year or so after the necessary legislation has been enacted.

New pension planning for small pension pots (Lecture P841 – 6.58 minutes)

New thoughts and ideas are emerging in the run-up to full pension scheme freedom applying from 6 April 2015. In the meantime this freedom already applies in certain limited situations.

One of these covers a *small pot* which can be taken out as a lump-sum subject to the following:

- Pension fund limit of £10,000 (but does not matter how many other pension pots may exist)
- Can be extracted on 3 occasions as a lump-sum of up to £10,000 each time
- Must be aged at least 60 and below 75

The overall return is very attractive whatever tax rate applies, and this can be utilised by all those with earnings of at least £30,000 to cover the gross contributions.

illustration for 40% taxpayer

Pension contribution £10,000

Tax relief @ 40% = £4,000

Net cost £6,000

Receive £10,000 as lump-sum. Tax @ 40% on £7,500 = £3,000. Net receipt £7,000.

Net profit £7,000 - £6,000 = £1,000

That can be repeated twice, so net profit is £3,000 ignoring pension provider charges which are understood to be in the region of £75 on each of the 3 occasions

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The overall net profit is shown below on 3 small pots of £10,000 each. No need to worry about the anti-recycling rules as they only apply where more than £12,500 of tax-free cash is taken which is then used to make another pension contribution.

tax rate:	20%	40%	45%
	£	£	£
gross contribution	30,000	30,000	30,000
tax relief	(6,000)	(12,000)	(13,500)
net contribution	24,000	18,000	16,500
lump-sum receipt	(30,000)	(30,000)	(30,000)
tax on 75% (£22,500)	4,500	9,000	10,125
net receipt	(25,500)	(21,000)	(19,875)
net profit	1,500	3,000	3,375

Contributed by Gerry Hart

RTI penalty appeals (Lecture P842 – 6.12 minutes)

In *Hogg Joinery v HMRC*, the taxpayer won on the grounds of having a reasonable excuse which was based on HMRC delays in issuing penalty notices.

The main points were:

1. Hogg Joinery appealed HMRC's decision to impose penalties of £400 for late submission of the Employer's Annual Return for the year ending 5 April 2013. The return was due to be filed online by 19 May 2013 and was filed online that September.

2. The appellants said that the 2012/13 return and those for the two earlier years were submitted online on time. They had two other businesses and their bookkeeper filed the returns for all three businesses at the same time and in the same way.

3. According to the appeal, problems started when the business changed from a partnership to a limited company. They questioned why they were not notified that the P35s had not been received until two years after the due date of the earliest one, especially when they had consistently paid on time.

4. When they were told in September that the previous two returns were outstanding they tried to submit them at once but it took three attempts and a full morning on the phone with HMRC to submit successfully.

5. Hogg Joinery said staff agreed that the error had arisen at HMRC and that they should have been notified sooner.

6. Tribunal judge Norma Baird said she was concerned at the attitude of HMRC in this case and that it was clear the appellants had tried to file their returns on time and that *“something went wrong”. “Clearly there was a problem with the way their online submissions were set up but whether this was of their own doing or due to a problem at HMRC’s end I am unable to say.”*

7. Justice Baird accepted that they made the claimed number of phone calls to HMRC and rejected HMRC’s claim that the appellants only contacted them once.

8. She also accepted that the appellants took *"all reasonable steps"* to rectify the situation they found themselves in. *“The whole situation ought to have been investigated and explained,”* she said.

9. She added that given the failure of HMRC to provide a clear explanation of events and to acknowledge the efforts made on the telephone to obtain information and assistance, she found find that: *“…in all the circumstances established that on the balance of probabilities they have a reasonable excuse for non-payment of the penalties.”*

In the other case of *Billett & Billett v HMRC* the taxpayer had neglected to send a P35 annual return after switching to RTI. The FTT awarded the taxpayer a partial victory over the late RTI filing penalty. Main points were:

1. The FTT ruled in part favour of a caravan park owner who faced difficulties in filing his annual return because of software problems using HMRC’s RTI system.

2. Geoffrey Billett was required to file the P35 return for Hill Farm Caravan Park for the year 2012/13 by a deadline of 19 May 2013. When the return had not been received by 19 September that year, HMRC issued a first late filing penalty of £400.

3. Billett challenged this because he had filed the return but had experienced problems due to migrating to RTI and that these amounted to a reasonable excuse for not filing on time.

4. The tribunal heard the caravan park business had migrated to RTI that April and adjusted its software, but their software provider QuickBooks did not allow them to file the return for the period 2012/13 while they were set up for RTI.

5. The appellant sought the assistance of QuickBooks to resolve the problem and the return was filed on 10 May.

6. When the taxpayer received the first penalty letter on 10 June he contacted HMRC and was advised to ignore it due to the ongoing software problems. Billett told the tribunal he assumed the problem had been resolved and took no further action.

7. HMRC agreed that the return was created prior to the deadline, but said it was still outstanding. They also accepted he had telephoned them but denied that he had been told to ignore the penalty letter.

8. The tribunal found that while HMRC had no record of receiving the P35 on 10 May, the taxpayer believed he had filed the return.

9. The Tribunal judge, Joanna Lyons, said HMRC's notes of the phone conversation in June made it clear that Billett was **not** told to ignore the penalty letter.

10. HMRC said at the time they had agreed an extension of the filing date to 25 June because of potential RTI migration issues. The FTT accepted that Billett had a reasonable excuse for the failure to file the return between 20 May and 25 June 2013, but not beyond.

Contributed by Gerry Hart

Whether PAYE had been deducted

Summary - The FTT allowed the taxpayers' appeal against a determination by HMRC that they were liable for PAYE which had not been paid by their employer.

Mr and Mrs Prowse were directors of a company which had been liquidated, leaving unpaid PAYE liabilities. HMRC made determinations shifting the liabilities to the taxpayers (under the Income Tax (PAYE) Regulations, SI 2003/2682, reg 72). HMRC contended that the conditions for demanding payment from the employees were met: the employees had received relevant payments; the employer had wilfully failed to deduct PAYE; and the employees knew of the failure. Mr and Mrs Prowse argued that the payroll was run by an unconnected third party and that there had been no wilful failure to deduct PAYE. Furthermore, the decision to switch from dividend payments to salaries (which had enhanced HMRC's suspicions) had been made before the company was in financial difficulties. Finally, the payslips were evidence of the deductions, which were not affected by the subsequent inability to pay as a result of the liquidation.

Decision:

The FTT accepted evidence of the intention to reconcile the differences between the bank payments to the employees and the net pay at the year end. The FTT also noted that the fact that there was substantial unpaid PAYE on liquidation did not mean that PAYE had not been deducted. Referring to McVeigh [1996] STC 91, the FTT noted that giving and providing the P60 certificate and the P14 and P35 forms did not constitute deduction of tax; instead, this only recorded it.

However, the FTT noted that salaries had been set at the beginning of the tax year so that there was a 'pre-existing entitlement' to the salaries. Furthermore, the FTT accepted evidence that Mr and Mrs Prowse saw their financial affairs as being joint (albeit in part paid to separate bank accounts) after the required deductions of PAYE.

Comments - There was no evidence of misconduct in the discrepancies between bank payments made by the employer and the net pay the employees were entitled to. Still, life would have been much easier for the taxpayers if the amounts paid had been identical to their recorded net pay.

Prowse v HMRC TC3617

Assessing rental income

Summary - The FTT agreed with the taxpayer's claim that HMRC had miscalculated her property income when amending her self-assessment returns.

The issue was the amount of taxable rent paid by PSD to Mrs Chinyanga, a company of which she was a shareholder.

Decision:

The FTT observed that the burden of proof lay firmly with the taxpayer, 'who will have all the relevant information'.

The FTT noted that Mrs Chinyanga had purchased the property because PSD could not obtain a mortgage. Although a yearly tenancy agreement had been entered into, the real agreement was that PSD would pay such an amount as would ensure that Mrs Chinyanga would break even. Consequently, the amount accruing and due for each period of occupation was the amount actually received in that period. Furthermore, no bad debt arose. The FTT added that the mortgage charges had been incurred 'wholly and exclusively' for the purpose of the taxpayer's property business and were therefore deductible. The FTT concluded that the tax payable by Mrs Chinyanga would need to be recalculated accordingly.

Comments - The FTT agreed to disregard the tenancy agreement executed by the parties, for the benefit of an informal real agreement which had been implemented by them.

Stembile Chinyanga v HMRC TC3643

No discovery

Summary – The Tribunal found that the discovery assessments in respect of car benefit were not valid

Mr Ive ran a restaurant which he incorporated in 2001. The company leased two vehicles, a Land Rover in 2002 and a Range Rover in 2005. Both leases were in the company's name.

The lease rental payments were made by the company but charged to Mr Ive's director's loan account. He paid all fuel and maintenance bills privately and claimed a mileage allowance for business journeys.

HMRC made a routine compliance visit on the company in 2007. The officer noted that the cars were provided for Mr Ive and asked for information which the taxpayer's adviser provided. He denied that the cars gave rise to a benefit in kind charge.

In May 2010, HMRC issued discovery assessments for the years 2004/05 to 2006/07 on the basis that car and car fuel benefits had been omitted from the returns. The taxpayers appealed.

Decision:

The First-tier Tribunal found that HMRC knew about the Range Rover as a result of their 2007 visit to the company. Another letter from HMRC to the company, dated 11 November 2009, showed that the department was aware of the Land Rover. HMRC had been aware of the potential tax loss when the enquiry windows for 2005/06 and 2006/07 closed, so the conditions in TMA 1970, s 29(3) were not satisfied. On the 2004/05 discovery assessment, the tribunal said this too was invalid because it had been issued more than four years from the end of the relevant tax year (TMA 1970, s 34). Section 36 allowed the time limit to be extended to six years if the loss of tax had been caused by the taxpayer's careless behaviour, which was not a factor in this case.

All the discovery assessments were ruled to be invalid. Turning to the issue of benefit-in-kind charges due on the vehicles, the tribunal said that Mr Ive was liable. The cars could have been leased in Mr Ive's name but, for “doubtless legitimate commercial reasons”, the company leased them and then provided the use of them to him. The conditions of ITEPA 2003, s 114 were met. The taxpayer could claim relief for his personal expenditure, but this would not be allowed because there was no formal agreement between the company and Mr Ive concerning payments as a condition of private use.

The taxpayers' appeal against the discovery assessments was allowed.

The company had also appealed against assessments in respect of class 1A National Insurance on accommodation expenses. It claimed that an informal arrangement existed where the employees did not charge the company for the business use of their private car in exchange for the company paying their utility bills etc. The tribunal said there was insufficient evidence of such an agreement and dismissed the company's appeal.

Comments – The case revolved around certain benefits in kind including car benefit and the assessability thereof. The taxpayer considered he had done sufficient to ensure that a benefit in kind but the FTT found they had been leased and then provided for his use – therefore there was a benefit. Extreme care has to be exercised with the provision of cars as this case and several recent cases have illustrated.

MC and LJ Ive Ltd; M Ive v HMRC TC3529

Whether loan stock instrument was a relevant discount security

Summary - The Court of Appeal dismissed the taxpayer's appeal against the denial of a claim for loss on a relevant discounted security (RDS).

Mr Pike had set up a company which had issued to him £6m nominal redeemable loan stock. He had then transferred the loan stock to a trust and claimed a £3.4m loss on the disposal of the loan stock, on the basis that it was a RDS for the purpose of FA 1996 Sch 13. Whether the loan stock was a RDS depended on whether the amount payable on maturity or redemption would involve a 'deep gain'. This in turn depended on whether the issue price was relevantly less than the amount so payable. The issue was whether what Mr Pike described as a 'premium' payable on redemption was actually interest on the £6m.

Decision:

Agreeing with the UT and the FTT, the Court of Appeal found that the 'premium' payable on redemption was interest, as it was described in the loan stock instrument as 'accruing on a daily basis'.

Comments - The case confirms that substance matters over form in loan instruments. Although the loan stock instrument described the amount payable on redemption as a premium, it was deemed to be interest as it was calculated like interest. It is worth noting that the planning would have failed in any event, if it had been implemented after 26 March 2002. An amendment introduced by FA 2002 excluded a claim in respect of a loss on a transfer to a connected party.

N Pike v HMRC (A3/2013/1996)

Loan write-offs (Lecture P843 – 10.18 minutes)

The income tax position

One method of clearing an overdrawn directors loan is for the company to write it off, or waive it. This is particularly useful if the company cannot pay a dividend to the director that would enable him to clear the loan, for example if there are insufficient distributable profits. Although such a write-off would be regarded as employment income by ITEPA 2003, under Part 4 Chapter 6 ITTOIA 2005 the write-off of a loan to a participator in a close company is to be regarded as a deemed dividend. It is important to appreciate that the latter treatment takes precedence for income tax purposes and there is a specific box to record such write-offs on the SA101 Additional Information pages of a Self-assessment return (box 13 for the 2012/13) return.

Although it is treated as a dividend for income tax purposes, with the usual tax credit and dividend tax rates applying, it is only a *deemed* dividend. There is therefore no requirement for the normal formalities associated with a dividend, including the availability of distributable profits.

For a basic rate taxpayer, the tax credit will of course meet the income tax liability and, irrespective of the personal tax rate of the director, the making of and subsequent waiving of a loan can be a simple way of effectively paying a dividend to an individual director/shareholder, rather than having to pay a dividend to all shareholders of a particular class of share.

The National Insurance position

All of this sounds like good news for the director and company, but there is one important snag that is often overlooked when writing off loans: ITTOIA 2003 applies for income tax, but has no bearing on the national insurance position. In most cases, HMRC will argue that, for Class 1 national insurance purposes, the waiving of the loan comes within the definition of 'emoluments from an office or employment'. In such cases HMRC will seek to collect Class 1 NICs from the company, together with interest and penalties when the issue has only come to light as part of an enquiry.

In *Stewart Fraser v HMRC TC00923,* there was an unsuccessful appeal to the First-Tier Tribunal against HMRC's assessment to Class 1 NICs on several hundred thousand pounds of loan waivers, covering a period of several years. SF Ltd claimed that the waivers were made for Mr Fraser in his capacity as the major shareholder in the company, not because he was a director. HMRC's response was that if this were true, it would have expected to see the waivers discussed and approved at a shareholders' meeting.

The Tribunal found that there was no evidence to support the contention that the waivers of the loans were payments to Mr Fraser in his capacity as a majority shareholder. In particular, the AGM minutes showed that the shareholders had not been consulted. Instead, the loan waivers were approved by the directors.

If the waivers were not in respect of Mr Fraser's shareholding, then they were an emolument of his employment. This was reinforced by the fact that the loan accounts showed regular deductions to meet expenditure which would usually be paid out of regular remuneration.

This decision makes it clear, therefore, that if a company wants to have a chance of avoiding a NICs charge on loans written off, it is essential to approve the write-off at a general meeting of the shareholders or, alternatively, to pass a written resolution circulated by the shareholders (not the directors) under s.292 and s.293 CA 2006. Even so, HMRC may still argue successfully that the write-off is really reward for the person's work as a director, particularly where it is a sole director/shareholder company.

If the directors and shareholders are identical then HMRC may feel that Stewart Fraser applies and national insurance contributions are due.

The corporation tax position

A further issue is whether corporation tax relief is available on the write-off of the loan. In the past, companies have sometimes tried to claim relief either

a) Under the corporation tax 'loan relationship rules'; or

b) Under general principles, as a payroll cost, on the basis that it is only a *deemed* dividend for income tax purposes.

Regarding (a), the Revenue would often successfully argue that the write-off was not allowable for corporation tax purposes, as the making of the loan to the director failed the 'unallowable purposes' test in the loan relationships legislation. There was, though, uncertainty, which was ended by the changes in Finance (No.1) Act 2010: such loan write-offs on/after 9 December 2009 are specifically disallowed for CT purposes.

There has not been any legislation to similarly put beyond doubt the fact that a claim is not valid under general principles, as in (b) above, but the prevailing view among tax professionals seems to be that such a claim is unlikely to be successful. There may however be grounds for arguing a corporation tax deduction if HMRC insist on an NIC charge on "earnings".

Employment income charge on overdrawn directors' loan accounts

For those not dealing with directors' loan accounts regularly, there is often confusion as to how the s.455 CTA 2010 rules interact with the rules on beneficial loans contained in Part 3 Chapter 7 ITEPA 2003. The simple answer is that they are completely different bits of legislation governed by their own rules. In particular, a beneficial loan charge under ITEPA cannot be avoided by repaying the loan just before the end of the accounting period; similarly, the s.455 charge still applies, even if the director pays the Official Rate of Interest (currently 4% p.a.) on the loan.

The director, like any employee, is only outside the beneficial loan rules if the loan balance does not exceed £10,000 *at any stage during the tax year.* (Note that this threshold iwas £5,000 prior to 6 April 2014.) If this *de minimus* figure is exceeded then a benefit has to be calculated on the total balance outstanding during the year, not just the amount above £10,000.

As normal, this benefit will be calculated using the 'average method' (which uses an average of the opening and closing loan balances during the tax year), unless either the taxpayer or HMRC opts to use the 'strict' method (which analyses the balance that has been outstanding on a daily basis throughout the year).

Where a benefit charge does arise, it will need to be reported on the P11D in the normal way, and the company will be liable to Class 1A.

Avoiding a benefit charge

The benefit charge can be avoided where the director pays the Official Rate of Interest to the company. However, *this only applies if a legal obligation to pay the interest existed during the income tax year concerned*. Just voluntarily paying 'interest' without the legal obligation existing will not avoid the charge.

Where the legal obligation does exist, the interest needs to be paid **by the time that assessment for the year is finalised**, if no benefit is to be chargeable. However, where such interest is paid after that time, s.191 ITEPA 2003 allows the director to make a claim for the assessment to be recalculated to take the belated interest payment into account. (See EIM26255)

The onus is on the director to claim this relief. He or she can do so at any time up to the end of the general time limit (4 years) applicable to individuals making claims for repayment of income tax.

Capital Taxes

Incorporation relief on transfer of consultancy business

Summary - The FTT allowed a claim for incorporation relief.

HMRC had denied the appellant's claim for incorporation relief on the ground that no business had been transferred to the company. Mr Roelich had been exploiting his experience and contacts in the field of waste management. He would help landowners to maximise their income at the early stages of a development by way of land infilling, whilst assisting contractors to obtain the exemption from landfill tax. The evidence suggested that Mr Roelich always had several projects on the go, but that only a small percentage would be successful and provide him with income. Mr Roelich had reached an agreement with three contractors ('PV') that if they were successful in obtaining a contract to landfill on a site, as well as planning consent, he would be paid £5 per load of infill. He had then agreed to transfer his business to a company belonging to a work associate in exchange for an issue of shares. The question was therefore whether, as HMRC contended, all he had transferred was a right to future income.

Decision:

The FTT did not regard the contract with PV as an isolated activity. It was clear that the appellant viewed the land infill idea not only as a source of initial income for the developer and himself, but also as a method of getting involved with the project on a long term basis. The appellant was intent on exploiting all opportunities — although he may not have known at the outset what these would be. This was compatible with the existence of a business. Furthermore, it was clear that the appellant's business stemmed from his experience and contacts but that did not mean that the business could not be transferred as he could train others.

A more difficult question was whether the business had actually been transferred to the company. The FTT noted that the company had taken over some of the appellant's consultancy activities under various consultancy projects. This was evidence of his intention to transfer his business to it. The fact that the only valuable asset transferred was the PV contract did not mean that it was the only asset transferred. The FTT concluded that the shares had been issued as consideration for the transfer not only of the PV contract, but also of the rest of the business.

Comments - Identifying a going concern is often a challenge for the courts. The case is a useful reference for the incorporation of any type of consultancy practice. In this case, the taxpayer may have been able to avoid litigation by documenting the transfer more precisely. For instance, a sale agreement and a business plan with profit projections may have helped.

P Roelich v HMRC TC3704

PPR confusion (Lecture P844 – 12.36 minutes)

When you sell your home any resultant gain is subject to the principal private residence exemption. If you have occupied the property as your home for all the years that you have owned the property then the gain is fully covered by the principal private residence exemption. If you have only occupied the property for part of the time then a proportion of the gain will be covered by the exemption – on a time apportioned basis.

If a property has been your principal private residence at any point you are always deemed to occupy the property as your main residence for the last 18 months of ownership – irrespective of the fact that you may live somewhere else in those last three years. This used to be three years for disposals in years up to and including 2013/14.

Apart from the 18 months rule above, a taxpayer can only ever have one principal private residence at any one time. So if you have a main home and a holiday home you may have two residences but you will only get principal private residence exemption on one of them at any one time. The facts will decide which of the properties is your main residence and consequently covered by the main residence relief.

The taxpayer can however override the facts and nominate which of his residences is his main residence for the principal private residence exemption.

This nomination must be made by written notice to an HMRC officer within two years of acquiring the second residence. If the taxpayer were to acquire a third residence the two year clock would start again.

The taxpayer has the right to vary a nomination notice by a further written notice to an HMRC officer – the variation can backdated up to two years.

In the case of a man and his wife living with him or of civil partners, there can only be one residence or main residence for both, so long as 'living together' and, where a notice specifying the main residence affects both spouses or civil partners, it must be given by both. If when a couple marry they each have a residence and they continue to use both, the two-year period for jointly nominating the main residence begins on the date of marriage (HMRC Capital Gains Manual CG 64525).

It is worth noting that the choice is not between two or more properties but between two or more *residences*. A property never occupied by the taxpayer as a residence cannot enter the equation. A nomination given more than two years after the *acquisition* of a property will not be late if made within two years after the property is first occupied as a residence.

Example

John and Jane Smith live in London with their three children. Four years ago they acquired a derelict barn in Norfolk with a view to converting it to a holiday home for the family.

The barn conversion was completed in early May 2014 and on the 12 May 2014 the council approved it for residential occupation. The family's first visit to the barn was on 24 May 2014 for the start of the half term break.

The two year clock for nomination purposes starts from 24 May 2014 – when they first started using it as a residence.

VAT point: Do not forget the VAT DIY claim on the barn conversion which must be submitted to HMRC within three months of completion (by 12 August 2014).

Form of notice (CG64520)

There is no statutory form for a notice under TCGA92/S222 (5) or for a variation of such a notice. However the following conditions must be fulfilled,

- A nomination by an individual must be made to an officer of the Board and must be signed by the individual.
- Spouses or civil partners who are living together can only have one main residence between them for the purpose of private residence relief. If a nomination affects both of them it must be made by notice in writing to an officer of the Board and must be signed by both of them.
- The signature of an agent is not sufficient.

Example wording of a nomination letter could be as follows:

> *"Dear Sir or Madam*
>
> *Mr John Smith (UTR #) and Mrs Jane Smith (UTR #)*
>
> *Capital gains – nomination of a main residence under s.222(5) TCGA 1992*
>
> *On the 12 May 2014 the local authority approved our converted barn for residential occupation. On 24 May 2014 we started using the barn as a second residence.*
>
> *The address of our two residences is now as follows:*
>
> *Residence 1 – .....*
>
> *Residence 2 – ....*
>
> *We hereby nominate Residence 2 as our main residence under Section 222(5) TCGA 1992 with effect from the date of this letter.*
>
> *Yours faithfully*
>
> *Signed by Mr and Mrs Smith"*

It is important that both the clients sign the nomination letter. I would also recommend including the date the second property became a residence of the family e.g. 24 May 2014. This is not necessarily the date of acquisition – it should be the date the property became a residence of the client which could be much later. Inclusion of this date just confirms that the nomination is being made within two years of acquiring the second residence.

Once Mr and Mrs Smith have nominated residence 2 they may switch to residence 1 at any time. This is effected by sending in a second letter confirming the variation of the original nomination. It would be perfectly reasonable to send in a second letter within a week or so of the above nomination. The objective of nominating residence 2 was to secure the last 18 months as Principal Private Residence relief – which the first letter has done. If you feel the larger gain is likely on residence 1 then it is best to shift the nomination back to residence 1 as soon as possible.

It is also important to appreciate that you do not need to reside in the second property for the period of nomination. That is not relevant to the nomination.

HMRC treatment of notice (CG64530)

If a notice or a variation of a notice is received, HMRC should acknowledge it but are unlikely to comment on its validity. They may ask further questions but they would only do so if there were obvious errors in the nomination letter.

It is only when a property is sold that detailed questions are asked concerning the validity of a nomination. This may be some years later so it is important that we retain evidence to support the validity of the nomination i.e. evidence of actual residence.

Unsuitable occupation for PPR Relief (Lecture P844 – 12.36 minutes)

Summary – The Tribunal found that the quality of the residence was not sufficient for PPR relief

In April 1999, the taxpayers bought a flat as an investment and let it. They decided to sell it in 2007 and accepted an offer in January 2008. As a result of delays, contracts were not exchanged until July. In the meantime, the taxpayers put up their main residence for sale and completed that on 1 July 2008. On the same day they moved into the flat, which was empty, and stayed there until 25 July, when that sale was completed.

The taxpayers claimed only or main residence relief on the flat under TCGA 1992, s 222 and s 223, on the basis that they lived in it for the last 25 days of their ownership of it and did not own another property in that period.

HMRC decided that 25 days did not amount to occupation and refused the claim. The taxpayers appealed.

Decision:

The First-tier Tribunal ruled that the quality of the taxpayers' occupation of the flat was not sufficiently permanent or continuous to justify the description of residence.

It was clear the flat did not suit their needs. Further, the taxpayers knew they would be taking possession of a suitable house within five weeks of occupying the flat.

The taxpayers' appeal was dismissed.

Comments – PPR relief is a commonly claimed relief but many taxpayers do not appreciate the importance of the conditions attached to the relief. We have another example of taxpayers attempting to get relief by occupying the property for a very short length of time – in this case at the end of their period of ownership. It was doomed to failure as the conditions were blatently not fulfilled.

Dr S Iles and Dr D Kaltsas v HMRC TC3565

Beneficial interest in property used by business

Summary - The FTT held that the taxpayer had given up her beneficial interest in a property used for business purposes.

The issue was whether the taxpayer (Mrs Watson) had a beneficial interest in a property, used for the purpose of running a petrol station, at the time of its disposal. This in turn depended on whether, upon becoming seriously ill, Mrs Watson had effectively retired from the partnership she had run with her husband and given up her interest in it.

Decision:

The FTT observed that matrimonial property and finance often gives rise to difficulties in identifying what property is owned by what party and in what share. It added that the legal title was not conclusive in respect of the beneficial interests. The FTT concluded from the evidence that it was clear that Mrs Watson had wished to retire from the partnership on becoming ill. This was reflected in the business accounts, which were drawn as the accounts of a sole trader from that point. The intention of the spouses was that Mr Watson would continue to provide for the family by carrying the business on his own account. The FTT concluded that Mrs Watson had not had a beneficial interest in the property at the time of its disposal.

Comments - Fortunately for the taxpayer, she was successful in establishing that she no longer held a beneficial interest in the property. It would have been preferable for the spouses to document the nature of their agreement upon the retirement of Mrs Watson.

L Watson v HMRC TC3738

Retrospective legislation and ECHR

Summary - The claimants' application for judicial review of provisions which had retrospective effect failed.

The taxpayers had implemented an SDLT avoidance scheme and sought judicial review of FA 2013 s 194(1)(a), (2) which amended FA 2003 s 45 with retrospective effect so that SDLT was chargeable on transactions implementing the scheme. The court noted that, in the event of several subsequent subsales, the aim of s 45 was to place the taxation burden on the person who would have the use and enjoyment of the property. HMRC had become aware of the scheme thanks to the disclosure of tax avoidance scheme (DOTAS) and HMRC had moved quickly to ensure that legislation would be passed with retrospective effect to stop it. HMRC had felt that this action would be compliant with the Protocol on unscheduled announcements of changes in tax law, published by the government in March 2011 and entitled Tackling tax avoidance. HMRC referred in particular to the repeated abuse in this area of tax and to the clear warning given by the government at Budget 2012 that 'morally repugnant' schemes such as those using subsales would be closed.

Decision:

The claimants contended that the provisions at issue breached ECHR art 6 (the right to peaceful enjoyment of possessions) and were inconsistent with the Protocol. However, referring to Huitson [2011] EWCA Civ 893, the court found that ECHR art 6 was not in point, as the legislation under challenge did not impose a liability to tax but rather removed an alleged, but not established, right to tax relief. The court added that the scheme probably did not work as no subsale had taken place. The agreement by the purchaser under the original contract to grant an option did not give the grantee the right to call for a conveyance. In any event, the court found that the provisions at issue did not contravene ECHR art 6. It rejected arguments that the taxpayers had relied on the Protocol and that it was not foreseeable that the government would adopt retrospective legislation to close a scheme representing only £7m of tax revenue. The court pointed to warnings given at Budget 2012 and to the fact that the government had already used retrospective legislation to stop similar schemes. More generally, the use of retrospective legislation was not in breach of the convention.

Comments - The case contains a useful recap on the recent use of retrospective legislation to stop anti-avoidance. It also confirms that retrospective legislation is not in breach of ECHR art 6.

R (on application of St Matthews (West) and others) v HMRC EWHC

Administration

Had the parties settled?

Summary - The FTT held that Mr Foulser had not settled his appeal.

The appeal concerned a denied claim for hold-over relief on the disposal of shares. It had been dismissed by the special commissioners, the High Court and the Court of Appeal. The matter then reverted to the FTT for the determination of the taxable gain.

HMRC contended that it had determined (albeit in error) that £1,202,494 out of the total liability of £8,499,641 should no longer be postponed and sought payment of that amount which had been received from Mr Foulser.

Mr Foulser argued that the letter from HMRC had been an offer to settle which he had accepted. The issue was therefore whether an agreement had been reached under TMA 1970 s 54.

Decision:

The FTT observed that s 54 does not prescribe the manner in which an agreement may be reached. Relying in particular on The law and practice of compromise by Foskett, it stressed that: 'The evidence must show that a definite offer has been made to settle on a "full and final" basis.' The FTT noted that the letter sent by HMRC to Mr Foulser's advisers was not worded as an offer and did not contain any indication that the payment requested was the only amount that could fall due. The expression 'in full settlement' only referred to the amount immediately due. However, Mr Foulser's letter in response — in which he said: 'I make a payment of £1,202,494 in full and final settlement of my self-assessment return for 1997/98' — did represent an offer. It was clear that Mr Foulser was tendering a payment in full and final settlement of his tax affairs for the relevant year and the absence of prior negotiation was no bar to a settlement being tendered.

The FTT however rejected the appellant's contention that HMRC had accepted his offer. HMRC had banked the cheque but it had also sent Mr Foulser a statement of account which made it clear that the tax postponed had not been written off.

Comments - The case provides a practical example of the way a tribunal will review the dealings between HMRC and an appellant in order to establish whether an agreement has been entered into for the purpose of TMA 1970 s 54.

Brian Foulser v HMRC TC3609

Fighting HMRC Penalties Where Tax Underpaid (Lecture P845 – 9.58 minutes)

There is evidence of HMRC attempting to charge penalties, and also asking for certificates of full disclosure and a statement of assets and liabilities, in cases where arguably there is no merit. Before looking at a recent example, we need to appreciate the basic penalty regime:

1. A penalty can be charged where a tax return, accounts or claim for a relief etc contains (a) a ***careless inaccuracy***, or (b) a ***deliberate inaccuracy*** (whether or not concealed), which leads to any of the following:

    - An understatement of tax; or
    - A false or inflated statement of a loss; or
    - A false or inflated claim to a tax repayment

2. It also applies where an assessment issued by HMRC understates the tax and the taxpayer fails to take reasonable steps to notify the error within 30 days.

3. The main features are:

    - No penalties where taxpayer has *taken reasonable care* to complete the tax return correctly but makes a mistake.
    - This replaces the previous term *negligence.*
    - Taxpayers given the benefit of any doubt in marginal cases.
    - First failure where there has not been reasonable care will count just as much as a repeated failure.

Definitions

Careless inaccuracy = failure to take reasonable care

Deliberate but not concealed inaccuracy = the inaccuracy is deliberate but the taxpayer does not make arrangements to conceal it

Deliberate and concealed inaccuracy = the inaccuracy is deliberate and the taxpayer made arrangements to conceal it (e.g. by submitting false evidence in support of an inaccurate figure)

Table of penalties

reason for penalty	*penalty*	*possible min. reduced penalty for unprompted disclosure*	*possible min. reduced penalty for prompted disclosure*
careless action	*30%*	*0%*	*15%*
deliberate but not concealed action	*70%*	*20%*	*35%*
deliberate and concealed action	*100%*	*30%*	*50%*
error in HMRC assessment	*30%*	*0%*	*15%*

Notes to table:

1. the careless action penalty is subject to suspension for a maximum of 2 years but only if compliance with a condition of suspension would help the taxpayer avoid further penalties for careless inaccuracy

2. there can be a special reduction of any of above penalties where HMRC considers there are special circumstances, not linked to ability to pay

HMRC Compliance Handbook

1. This provides plenty of guidance as to how the regime is likely to work in practice, but so far most of their specific examples are of the obvious type and are of little benefit. It is what they say in general terms that is particularly useful.

2. Para *CH81130* says that **actions regarded as not unreasonable** (and therefore not creating a penalty) include:

   - a reasonably arguable view of the law
   - arithmetical or transposition inaccuracies where the result is not odd
   - errors following wrong advice from HMRC, provided all relevant details and circumstances are given and the adviser and/or taxpayer can prove it
   - advice from a competent adviser

3. Para *CH81140* says that **failure to take reasonable care** includes:

   - Actions likened to negligence
   - Would a "prudent and reasonable person" have done that?
   - Repeated inaccuracies

Recent example of HMRC's approach

The facts

1. HMRC issued an enquiry notice into a tax return and asked several questions. They were all answered to their satisfaction other than in respect of a claim for loan interest relief on interest of about £2,000.

2. The loan was obtained to enable the taxpayer to meet his obligations on a divorce settlement. That of course is not a qualifying loan, but he borrowed more than was initially needed and passed the excess to a limited company which he owned and worked for. The idea was to hold the funds in the company for its future use, and interest relief was claimed on that proportion of the loan.

3. HMRC argued that the intended future use of the funds did not result in meeting the criteria for a qualifying loan. That interpretation, although seemingly too narrow, was accepted by the taxpayer as the tax involved was less than £1,000 and in any event the funds were withdrawn by the taxpayer from the limited company soon after the end of the tax year of the enquiry.

HMRC's response to acceptance of an incorrect claim

HMRC made it clear that they thought penalties were appropriate, and that was not the only shock. The successful reply to HMRC was as follows:

1. *You refer to pre-return diligence. Our policy is always to carefully consider all claims we propose making in the tax return and we satisfy ourselves that the claim is valid before the tax return is finalised and sent to our client for signature.*

2. *Here we are talking about a claim for qualifying loan interest by reference to that part of the loan which was passed to the limited company for future business purposes.*

3. *In the circumstances we consider that the claim represented a reasonably arguable view of the law and, as such, no penalty arises in accordance with paragraph CH81130 of your Compliance Handbook.*

4. *Quite apart from that, the taxpayer clearly relied on our advice that the claim was technically valid when he signed the tax return which included the claim.*

5. *We note that you require completion of a Certificate of Full Disclosure and a Statement of Assets and Liabilities. Whilst our client will have no problems in signing the former, we are surprised that you consider a Statement of Assets and Liabilities is appropriate given that the interest erroneously claimed creates a tax liability of just under £1,000. The work and costs involved in preparing such a statement are surely out of all proportion and in the circumstances we trust you can confirm you will withdraw your request.*

Contributed by Gerry Hart

Penalty imposed for one day delay

Summary - The FTT held that a flat rate penalty imposed for the delivery, one day late, of an SDLT return had been validly imposed.

The deadline was a Sunday and so the appellant argued that it had not been 'possible or realistic' to file the return then. The appellant claimed that he had a reasonable excuse. A member of staff had forgotten to file the return and he had taken it home with the intention of filing it on the Sunday. However, he had been unable to gain access to the internet.

Decision:

The FTT rejected the argument, as 'leaving matters to the last moment was a recipe for disaster'. Referring to Hok [2012] UKUT 363, the FTT also explained that it did not have jurisdiction to decide on the fairness of a penalty.

Comments - The penalty was imposed for a single day delay in circumstances where no tax was payable, yet the FTT could not quash the penalty.

Shepherds Bookbinders v HMRC TC3641

Jurisdiction of FTT to hear appeals

Summary - The FTT struck out the appeal on the basis that it did not have jurisdiction.

The constabulary had submitted a claim for repayment of VAT incurred on the purchase of police vehicles under VATA 1994 s 33. It was accepted that the vehicles were acquired by the constabulary to carry out its non-business public duties. HMRC contended that the FTT did not have jurisdiction to hear the appeal, as s 33 was not specifically referred to in VATA 1994 s 83 (which sets out the jurisdiction of the FTT).

Decision:

The FTT accepted that the constabulary was a taxable person. However, as the vehicles had been purchased to carry out public duties, the VAT paid on them was not input tax. Furthermore, even if the VAT was input tax, it would not be recoverable as it would not be attributable to taxable supplies.

Comments - Although the appeal turned on tax issues, the FTT found that it did not have jurisdiction.

Suffolk Constabulary v HMRC TC3644

HMRC application for appointment of provisional liquidators

Summary - The Chancery Division granted HMRC its application for the appointment of provisional liquidators.

HMRC was applying for the appointment of provisional liquidators in relation to two companies, on the basis of the non-payment of VAT assessments and of future VAT assessments. The sums at stake were in excess of £16m. The court observed that the application was without notice and could therefore only be justified by exceptional circumstances, particularly since the companies would not have a chance to demonstrate that they had a good arguable case against the debt. HMRC contended that the two companies had traded on an uncommercial basis, the only benefit of the trade being the ability to retain VAT which resulted from false claims.

Decision:

Agreeing with HMRC, the court observed that the chain of supply was organised to ensure that no profit was generated but that the VAT collected was maximised in a way typical of MTIC fraud. The court found that: given the lack of integrity of the management of the two companies, the application was properly made without notice; the ease with which the defendants could have moved large sums of money offshore also justified such an application; the existence of the debt was undisputed; the debt remained payable despite the existence of appeals, and so HMRC was likely to obtain a winding up order; the appointment of provisional liquidators would ensure that records and assets were preserved in circumstances where the companies had no legitimate activities anyway; and no suitable alternative existed as all other alternatives, such as a freezing injunction or VAT deregistration, would not achieve the double objective of stopping the fraud and preserving the books and assets.

Comments - The case provides a practical example of the way a court will decide on the most appropriate course of action to stop tax fraud.

HMRC v Winnington Networks ([2014] EWHC)

PAYE for Employers: reduction in penalty notices for outstanding returns

Up to and including 2013 to 2014, employers who do not meet their filing obligations may be liable to an escalating penalty, based upon the size of the employer and the number of months for which the filing default persists. The penalty will be £100 per 50 employees for each month or part month the returning is outstanding from 20 May 2014 to 19 September 2014. So an employer with 50 or less employees where the return is still outstanding by 20 September 2014 will receive a penalty of £400.

As part of HM Revenue & Customs (HMRC) transition to in-year PAYE Real Time Information penalties for late and non filing, HMRC are changing their approach to issuing updated penalty notices for the same PAYE non filing default. These changes impact both the 2012 to 2013 and 2013 to 2014 tax years.

When a late return is actually received, in every case HMRC will issue a revised updated penalty notice showing the correct amount of penalty due.

2012 to 2013 Tax Year

HMRC will not now issue a third penalty notice (originally scheduled for issue at the end of May this year) to those employers who have not yet submitted their 2012 to 2013 return which was due on 19 May 2013. HMRC will continue to pursue any missing returns by virtue of the penalty notices already sent to those employers in September 2013 and January 2014.

HMRC would encourage any employer who has yet to file to do so as soon as possible or contact HMRC if they have no return to make.

2013 to 2014 Tax Year

The filing deadline for 2013 to 2014 returns of 19 May 2014 has recently passed.

HMRC will (as in earlier years) be shortly writing to those employers who they believe have yet to submit their outstanding 2013 to 2014 return to alert them to take immediate action in order to avoid any penalty that is due from building up any further. Employers who had no return to make for the 2013 to 2014 tax year should contact HMRC as soon as possible so that their records can be updated accordingly.

Employers who have yet to file their 2013 to 2014 return in real time, should do as soon as possible. For more information on filing the 2013 to 2014 PAYE final submission for the year please see:

PAYE final submission for the year and end-of-year tasks

For those employers who HMRC have agreed can send their PAYE information on paper and have yet to file their P35 Employer Annual Return should do so as soon as possible. For more information on filing the 2013 to 2014 P35 Employer Annual Return please see:

Filing your Employer Annual Return (P35 and P14s) for 2013 to 2014

HMRC will also be sending in September 2014 (as in previous tax years) a penalty notice to any employers who by that time has not filed their outstanding 2013 to 2014 return, which will be by then four months late.

HMRC will not now be issuing further 'interim' penalty notices for outstanding 2013 to 2014 returns which would have been issued in January 2015 and May 2015. HMRC will continue to pursue those returns that remain outstanding for the 2013 to 2014 tax year by virtue of the penalty notice issued in September and will finalise any penalty due upon receipt on the late filed return.

These actions are part of a series of measures which are intended to help in smoothing the transition to in-year penalties. This approach should help avoid any confusion between the end of year penalties currently in operation and the new in-year penalties which are due to commence in October 2014 with the first quarterly penalty notices scheduled for issue in January 2015.

Reasonable excuse: series of life events

Summary - The FTT found that the taxpayers had a reasonable excuse for the late filing of their returns but that they should have paid their tax on time.

The taxpayers were appealing against late filing and late payment penalties, claiming that they had a reasonable excuse due to a series of life events. In particular, a fire in their home had led to the discovery of asbestos and the sealing off of their study which contained their tax returns. The costs of the remedying works had spiralled out of control, leading to stress related medical issues for Mrs Breen. During the same time, Mrs Breen's mother had passed away and her children had suffered serious health problems. Dr Breen, her husband, was also given increased responsibilities at the hospital where he worked to the detriment of other duties.

Decision:

The FTT agreed with the concept that the accumulation of life events could constitute a reasonable excuse. The FTT pointed out that the tax records should have been boxed up before the start of the building works but accepted that Dr Breen had been under considerable strain and had therefore been unable to cope with his tax affairs.

Finally, the FTT observed that the Breens could have made payments on account (as they were in receipt of substantial income), even if the returns were not filed.

The FTT concluded that the Breens had a reasonable excuse for the late filing of their returns, in relation to the first two years under review only (as Dr Breen should have been able to manage his affairs by the later years) but dismissed the appeal against all the surcharges for late payment.

Comments - The FTT recognised the concept of a reasonable excuse made up of a series of life events which, individually, would not have represented a reasonable excuse. However, the notion that tax should have been paid even if returns could not be filed is worth noting.

Karen and Desmond Breen v HMRC TC3670

Timing of excuse

Summary – The Tribunal found against the taxpayer who had claimed a reasonable excuse based on a number of reasons none of which was sufficient

The taxpayer, a solicitor, submitted his self-assessment tax returns for 2010/11 and 2011/12 on time but was late paying the tax for each year. HMRC imposed penalties. The taxpayer made a time-to-pay arrangement with the Revenue but did not keep up the payments. He appealed against the penalties on the basis that he believed his liability for the years would be reduced by terminal loss relief which arose in 2012/13. In addition, he had problems with his accountants, and he had suffered a large and unexpected reduction in his work due to the decision in Harrison v Black Horse Ltd [2011] EWCA Civ 1128, which had an impact on the type of work carried out by this firm.

Decision:

The First-tier Tribunal said the taxpayer could not rely on the actions of his previous adviser as a reasonable excuse for the late payment of tax. On the outcome of the Harrison v Black Horse Ltd case, the tribunal said a "reasonably competent businessman" would have been aware of the concept of litigation risk, so this could not be considered reasonable excuse. On the future loss claim, this would reduce assessments for earlier years and relevant penalties only when the returns are amended. The correct time to consider whether there is a reasonable excuse for late payment of tax is when the sum is due, not later.

The taxpayer's appeal was dismissed.

Comments – The tribunal took the taxpayer'`s profession into account in determining certain of the adequacies of the reasons put forward for reasonable excuse. The courts have been very fair and generous in recent months in finding in favour of taxpayers. However in this case the Tribunal took a more robust view and the taxpayer was unsuccessful.

R Gardner V HMRC TC3607

Penalty reduced.

Summary – The Tribunal decided that although there were technical difficulties in filing a return there were insufficient further efforts so the penalty was not fully mitigated

The company encountered technical difficulties when trying to file its corporation tax return electronically for the period ended 31 March 2011. It therefore filed a paper return on 30 March 2012. HMRC said the return had to be submitted online and extended the deadline to 30 June 2012. The company filed the return as a pdf attachment by that date, but it was rejected by HMRC because the accounts were not in the correct format. The company filed another paper return but this was refused because it was not electronic.

The department imposed late filing penalties of £200. The taxpayer appealed on the ground that its 13 attempts to file electronically had failed because HMRC's systems did not work. HMRC said the problem was caused by the company's software.

Decision:

The First-tier Tribunal accepted that the company had tried to comply with the regulations by the extended deadline of 30 June. However, despite being told on 9 August that the paper return was not acceptable, the company had made no further effort to file the return online. The company had reasonable excuse for the period between 30 June and 9 August, but not after that. The penalty was reduced to £100.

The taxpayer's appeal was allowed in part.

Comments – This case demonstrates how the taxpayer must rectify the cause of the reasonable excuse as soon as possible to obtain the full effect of the reasonable excuse in mitigation of the penalty. Where this is not done the penalty is highly unlikely to be fully mitigated.

Springfield China Ltd v HMRC TC3508

Penalty for carelessness quashed

Summary – The Tribunal found the HMRC evidence could not be relied upon and allowed the appeal against a penalty for a careless inaccuracy

The taxpayer filed his 2010/11 self-assessment tax return online in January 2012. HMRC opened an enquiry because he had not included two sources of employment income totalling about £200,000. As a result the taxpayer had to pay additional tax of £3,241. The department also issued a penalty for a prompted careless inaccuracy.

The taxpayer appealed. He said he had included the employments in his return but that an error in HMRC's system had failed to capture the details. The Revenue argued that the taxpayer had not included the information in the return because he thought his employer would provide details and had deducted the tax due. The officer said the taxpayer had been careless not to refer to the tax return guidance. There were no faults in HMRC's system and, had the return been corrupted while the taxpayer was completing it, it would have been rejected.

Decision:

The First-tier Tribunal said the burden of proof was on HMRC to establish that the taxpayer was careless in completing his return. The judge said it was "difficult to envisage" the taxpayer completing his return without including his earned income. Further, since he had no other income, it would have been pointless completing one at all.

The tribunal agreed with the taxpayer that HMRC had "not established with sufficient certainty that, if the appellant did not complete the employed income pages, the system would necessarily show this". On the balance of probabilities, the judge found the taxpayer had not been careless.

The taxpayer's appeal was allowed.

Comments – We have had a number of cases dealing with penalties and other matters and HMRC's evidence or systems seem to be lacking. The comments of… "the burden of proof was on HMRC to establish that the taxpayer was careless in completing his return. The judge said it was "difficult to envisage" the taxpayer completing his return without including his earned income" are self-explanatory.

A Banks v HMRC TC3592

Delays hinder success

Summary – The Tribunal held that as continuing failure after HMRC warnings reasonable excuse could not fully apply

The taxpayer appealed against penalties imposed for late payment of her tax for 2010/11 and 2011/12 by the due date and for fixed and daily penalties for the late submission of her 2010/11 tax return. The First-tier Tribunal judge adjourned the appeal in respect of the daily penalties for late returns pending the hearing in the Upper Tribunal of Donaldson (TC2720).

On the 2010/11 return submitted late, the taxpayer believed she had filed it, but HMRC later told her that a number of steps remained to be carried out at the point she believed she had completed the process.

Decision:

The tribunal accepted that it was reasonable for an ordinary person without any computing or tax knowledge to make that error. However, having been alerted to the problem by HMRC, she made further errors. She completed the 2011/12 return instead of the 2010/11 one and she did not properly read HMRC's subsequent letter to her. As a result, she did not have reasonable excuse and nor were there special circumstances.

On the late payments of tax, the taxpayer expected the outstanding amounts to be collected through PAYE. The tribunal said it was understandable for her to believe this to be the case until a letter in May 2013 from HMRC explained that the amounts had to be paid by cheque or bank transfer because her return had been late.

In summary, for 2010/11, the tribunal refused the taxpayer's appeals against the fixed penalties for late filing and the three fixed penalties for late payment. For 2011/12, the tribunal allowed the appeals against two penalties for late payment of the tax shown as due on the original return. However, it refused the appeal against the penalties for late payment of the tax shown as due when the return was later amended.

The taxpayer's appeal was allowed in part.

Comments – This is another example of the taxpayer against the system. As tax professionals we are aware of the complexities of the system and the need for full operation of the process. Less informed taxpayers are not so aware of the process. Although she had problems HMRC had alerted her to errors she was not fully compliant subsequently and accordingly the taxpayer was only successful in her appeal in part.

C Perrin v HMRC TC3614

Too ill

Summary – The Tribunal applied fairness in an appeal based on reasonable excuse of the illness of the adviser as it had been the subject of another appeal in the interests of consistency

The taxpayer, a vet, employed one person. He relied on his friend and accountant, M, to deal with his tax and PAYE affairs. Due to illness, M did not submit the taxpayer's 2010/11 PAYE return. HMRC imposed penalties against which the taxpayer appealed.

HMRC argued that the taxpayer was aware of M's declining health and should have taken steps to ensure his tax obligations were discharged.

Decision:

The First-tier Tribunal accepted HMRC's point about the taxpayer being aware of M's health, but said it "clearly deteriorated much more markedly in the later stages of 2010 and into 2011". The legislation made clear that reliance on a third party did not on its own offer reasonable excuse. However, in this case, the accountant's illness rendered him incapable of carrying out the work he was engaged to do. The tribunal also took into account that HMRC had accepted M's illness as reasonable excuse in another case and, in the interest of proportionality, fairness and transparency, it seemed wrong for HMRC to accept this as reasonable excuse for one person but not someone else.

In the interest of consistency, the taxpayer's appeal was allowed.

Comments – The case is self-explanatory and demonstrates the principle of fairness applied by the Tribunal.

P Collins v HMRC TC3606

SDLT: time limit for amending return

Summary - The UT found that HMRC had opened and closed an enquiry.

Portland Gas had entered into an agreement for the grant of a lease, taken possession of the premises and paid the SDLT due. The rent was subsequently reduced prior to completion and Portland Gas had sought a partial repayment of SDLT. Both the amendment and the claim for repayment were rejected by HMRC on the ground that they were received more than 12 months after filing. Portland Gas appealed to the FTT, which struck out the appeal on the ground that it did not have jurisdiction. The issue was whether HMRC had opened and closed an enquiry, as the FTT had jurisdiction to hear appeals against closure notices under FA 2003 Sch 10 para 35.

Decision:

The UT found that HMRC had opened an enquiry by seeking policy advice on the time limit. In the UT's view, this amounted to the undertaking of an 'examination' or 'investigation'. Consequently, its last

letter informing Portland Gas that the application was out of time constituted a closure notice. Coolatinney Developments [2011] UKFTT 252 was authority for the proposition that neither the notice of enquiry nor the closure notice must be in any particular form.

The UT set aside the FTT's decision to strike out and sent the matter back to the FTT for a substantive hearing.

Comments - A notice of enquiry and a closure notice can be in any form, with the result that HMRC can find itself inadvertently issuing such documents.

Portland Gas Storage v HMRC (FTC/123/2013)

The saga continues…

Summary – The Tribunal has allowed permission to appeal in the case of Dong v NCA

On 21 May 2012 the Serious Organised Crime Agency ("SOCA"), now the National Crime Agency ("NCA"), raised various assessments on the appellant ("D"). He applied, under TMA 1973 s 55(3), for postponement of the tax assessed and appealed the assessments to the First-tier Tribunal ("FTT"). In January 2014 the FTT determined that the amount to be postponed on D's appeal was 0% (see [2014] UKFTT 128 (TC)). TMA 1970 s 55(6A) states "Notwithstanding the provisions of sections 11 and 13 of the Tribunal, Courts and Enforcement Act 2007 ["TCEA 2007"], the decision of the tribunal shall be final and conclusive". It was common ground if s 55(6A) was effective, the FTT decision was final. Nevertheless D applied for permission to appeal contending that TMA 1970 s 55(6A) did not apply on the basis that it was inserted by the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009, SI 2009/56 ("the 2009 Order"), Sch 1, para 34(8) and that provision was beyond the scope of ("ultra vires") its enabling Act, the FA 2008, and therefore unlawful. NCA conceded the 2009 Order, Sch 1, para 34(8) was unlawful. The following issues arose for consideration, whether (i) the FTT had jurisdiction to determine whether para 34(8) was unlawful; (ii) the FTT should adjourn the proceedings; and (iii) para 34(8) was actually ultra vires of its enabling Act.

Decision:

A first instance tribunal, such as the FTT, must not apply unlawful secondary legislation. Either the tribunal must make that determination itself (in which case of course the secondary legislation was not actually quashed although it had been set aside), or it could adjourn the proceedings to permit the parties to take the issue to the Administrative Court which had the power to quash the secondary legislation once and for all. Whilst it was crystal clear that the FTT had no inherent jurisdiction, as it was a statutory body and only had the jurisdiction conferred on it by Parliament and thus had no powers of judicial review or power to quash secondary legislation, when Parliament enacted TCEA 2007 s 11 it must have intended the FTT to act lawfully when making a decision whether or not to grant permission to appeal. Therefore, Parliament must have intended the FTT to consider the vires of secondary legislation and refuse to apply any which was unlawful. Neither the FTT nor a government official could apply unlawful secondary legislation when making their decision. Indeed, it would be a bizarre position if the FTT were, on the basis of an Order which Parliament had not authorised to be

made, to refuse to recognise a right of appeal granted by Parliament by statute; EN (Serbia) v Secretary of State for the Home Dept, KC (South Africa) v Secretary of State for the Home Dept [2009] EWCA Civ 630, [2010] QB 633 and Chief Adjudication Officer v Foster [1993] 1 All ER 705 considered.

To put the parties to the expense and delay of an approach to the Administrative Court would be inappropriate in the present case for the following reasons. First, as NCA had conceded para 34(8) was unlawful, it appeared likely they would not defend the proceedings in the Administrative Court. Second, the FTT was part of the new structure where there was an appeal to an Upper Tribunal in which High Court judges (sitting as judges of the Upper Tribunal) could be allocated to hear it. Third, the tax chamber of the FTT, throughout its existence, had had jurisdiction to determine the vires of both primary and secondary legislation under EU law and was therefore experienced in making such determinations. Lastly, the tribunal had the benefit of the Court of Appeal's reasoning in a very similar case. Accordingly, the most appropriate course, rather than adjourning the proceedings, was for the FTT to determine the lawfulness of the 2009 Order, Sch 1, para 34(8) for the purpose of the application for permission to appeal, albeit the FTT had no jurisdiction to quash the legislation.

FA 2008, s 124 gave the Treasury powers to make the 2009 Order, Sch 1, para 34(8), under which s 55(6A) was inserted into the TMA 1970. The question was whether para 34(8) strictly construed was a provision “in connection with appeals against HMRC decisions” as that was the limit of the enabling provision in FA 2008 s 124(1)(b). However, even if s 55 in general was such a provision, para 34(8) was not. The Treasury was not authorised by s 124(1)(b) to remove a right of appeal against an FTT decision on postponement of tax. Accordingly para 34(8) was ultra vires the enabling Act and was therefore unlawful. Section 55 would be applied without the amendment made by para 34(8). That meant under TCEA 2007 s 11 the FTT did have power to grant D permission to appeal; R (on the application of ToTel Ltd) v First-tier Tax Tribunal [2012] EWCA Civ 1401, [2013] STC 1557 applied.

Application for permission to appeal allowed

Comments – This is a useful summary of certain of the Tribunal procedures.

Dong v National Crime Agency (No 2) TC 3502

Unforeseeable complications

Summary – The Tribunal held that the unforeseeable complications were a reasonable excuse

The taxpayer did not file its 2010/11 employer return (due on 19 May 2011) until December 2011. HMRC imposed late filing penalties.

The company secretary appealed, saying she was the person responsible for filing the return but had been on maternity leave at the time it was supposed to be filed. She explained that there had been complications with the birth of her baby and she had not been able to return to the office until October/November 2011.

Additional problems had been caused when the company moved and its computer hard drive was damaged resulting in the company losing its entire database.

Decision:

The First-tier Tribunal noted that the company's PAYE payments and company tax were up to date. The judge decided that the company secretary's pregnancy may have been a foreseeable event, but the complications she suffered could not have been predicted. He decided this constituted reasonable excuse for the late filed return and added that HMRC's failure to issue penalties before September "contributed to the delay".

The taxpayer's appeal was allowed.

Comments – This case is a good illustration of how certain absences are predictable and will not constitute a reasonable excuse. However when other events conspire to create additional problems then these can constitute a reasonable excuse.

Rockwell Management Ltd TC3597

Business Taxation

Discontinuation of a trade on incorporation

Summary - The FTT found that a trade had been permanently discontinued so that the annual investment allowance (AIA) was not available.

Mr Keyl had traded as a self-employed air conditioning engineer. On the advice of his accountant, he incorporated a company which started trading on 1 April 2009, as his business year end had been 31 March 2009. Mr Keyl claimed AIA in connection with the purchase of a new van in July 2008.

AIA was not available if the expense was incurred in 'the chargeable period in which the qualifying activity is permanently discontinued' (CAA 2001 s 38B). HMRC therefore argued that AIA was not available on the purchase of the van as a result of the incorporation of the taxpayer's business.

Decision:

Relying in particular on Sethia v John (1947) 28 TC 153, the FTT observed that Mr Keyl's transfer of his business to a company amounted to a permanent discontinuance of his trade and the carrying on of a new trade by the company. The fact that he continued to provide maintenance under existing contracts did not change the position.

The FTT also rejected the argument that the trade had ceased on 1 April 2009 and therefore not during the chargeable period. Mr Keyl's business was no longer in existence on 1 April 2009. If his business had continued beyond 31 March 2009, sole trader accounts would have been prepared.

Referring to Abbey National BS v Cann [1990] 1 All ER 1085, the FTT observed that Mr Keyl's trade must have been discontinued in the 'scintilla of time before midnight' and that his new company must have started its trade 'in the scintilla of time after midnight'.

Comments - The case confirms the known principle that incorporation of a trade is a discontinuance for tax purposes. It is also a reminder that the decision to incorporate a business should not be taken lightly. In this case, if Mr Keyl's accountants had reviewed large transactions entered into by the business in the relevant tax year, they may have advised him to postpone incorporation to the following year.

David Alexander Keyl v HMRC TC3619

Tax consolidation: non-resident intermediary companies

Summary - The CJEU held that legislation precluding tax consolidation where intermediary companies were non-resident was in breach of the European Treaty.

SCA and MSA are both incorporated in the Netherlands. They own, directly and indirectly, German subsidiaries which own Dutch 'sub-subsidiaries'.

SCA and MSA and their respective Dutch sub-subsidiaries applied to be treated as two single tax entities under Dutch tax law — so that their profits could be consolidated at group level. This was denied on the basis that the intermediary companies were incorporated in Germany.

Decision:

The court observed that Dutch law treated groups differently depending on whether the parent company held its subsidiaries via Dutch intermediary companies or non-Dutch intermediary companies. This difference of treatment was prima facie in breach of the European law principle of freedom of establishment (TFEU art 43).

The court also noted that the exemption mechanism under Dutch law meant that a resident parent company could never take into account a loss linked to a holding in one of its subsidiaries, and so there was no risk that the same loss could be used twice. Distinguishing the case from Papillon C-418/07, the court therefore concluded that the restriction could not be justified by the need to preserve the cohesion of the tax system.

Similarly, in case C-40/13, which was heard at the same time, single tax entity treatment had been denied on the basis that Dutch resident sister companies were held by a non-resident parent company. The court found that such denial was also in breach of the principle of freedom of establishment in the absence of a risk of double use of losses.

Comments - It is now an accepted principle of European tax law that group tax consolidation should be possible even where intermediary subsidiaries are not resident in the relevant member state. The case is useful in limiting the circumstances in which the defense of 'cohesion of the tax system' can be relied upon to justify a restriction to consolidation.

Joined cases Inspecteur van de Belastingdienst v SCA Group Holding, MSA International Holdings and MSA Nederland (C-41/13)

Goods were not processed

Summary - The UT held that premises owned by the clothing company Next did not qualify as industrial buildings for the purposes of capital allowances (CAA 1990 s 18).

Next Distribution Ltd, one of the Next group of companies, provided warehousing and distribution services for Next Retail. It claimed industrial building allowances on two warehouses which had been built in 1997 to 1999 to store goods.

HMRC refused the claims.

The First-tier Tribunal dismissed the companies' appeal, so they appealed to the Upper Tribunal. The taxpayers said the goods stored in the warehouses were subject to a process and therefore qualified for industrial building allowances under CAA 1990, s 18(1)(e) and (f) (now CAA 2001, s 271 to s 274).

Decision:

In the Upper Tribunal, Mr Justice Richards referred to several cases which had concerned the subjection of goods to a process. These included Kilmarnock Equitable Co-operative Society v CIR 42 TC 675, Buckingham v Securitas Properties Ltd 53 TC 292 and Girobank plc v Clarke [1998] STC 182. He concluded that "the unpacking of goods received in large quantities, and their repackaging in parcels of smaller quantities, involving no treatment or adaptation of the goods in question" did not constitute goods being subjected to a process.

The taxpayers' alternative argument was that the buildings qualified under s 18(f)(iv). That is, the buildings were used for the purposes of a trade, namely the storage of goods on their arrival in the UK from a place outside the UK. The judge turned down the contention. Referring to Copol Clothing Ltd v Hindmarch [1984] STC 33, he said for this to succeed, the goods would need to be in transit and they were not.

The taxpayers' appeal was dismissed.

Comments - HMRC issued a press release emotively headed "Tribunal tears up Next's tax relief claim", stating that the decision "safeguards about £2.8m of revenue". Baker Tilly's David Heaton said: "The clear implication is that Next was up to something nefarious and HMRC have protected the public from being ripped off by another large business, when it was simply claiming what it thought was due in respect of a normal investment."

Next Distribution Ltd, Next Group plc, The Paige Group Ltd v CRC, Upper Tribunal

Business premises renovation allowances (BPRAs) (Lecture B841 – 12.42 minutes)

In a written statement on 18 July 2013, the Exchequer Secretary to the Treasury announced that HMRC would be conducting a technical review of the BPRA legislation in an endeavour to make the policy purpose of the rules clearer. In addition, recent DOTAS disclosures indicated that schemes containing features aimed at exploiting the relief in ways which Parliament had not intended were becoming more common. As part and parcel of this review, the Government were keen to eradicate these arrangements.

The detailed legislation, which was introduced in FA 2005, is found in Ss360A – 360Z4 CAA 2001. In essence, it provides a 100% relief for capital expenditure incurred in converting or renovating business premises which have been empty for at least one year in order to bring them back into business use. The empty business property must be located in a designated disadvantaged area of the UK. The rules were initially due to run for five years from 11 April 2007, but regulations were made in 2012 which extended the relief to qualifying expenditure incurred before 1 April 2017 (for corporation tax) or 6 April 2017 (for income tax).

Boarded-up rows of derelict shops and empty business premises are, sadly, a common sight in many deprived areas of the UK.

As mentioned above, the objective of the BPRA regime is to return these empty properties to productive use. The Government's stated policy purpose in this regard is 'to foster the regeneration of deprived areas in the UK by encouraging private investment in those areas in order to increase local enterprise and employment'.

HMRC are known to be undertaking exhaustive enquiries into the disclosed schemes and it would appear that a common theme for many of them is that they contain what the Government call 'a varying balance of genuine expenditure on actual regeneration and some features that have elements of artificiality, possibly aimed at ramping up qualifying expenditure and accelerating tax relief in ways that could be regarded as inappropriate'.

This then is the background to the changes which have been included in the Finance Bill (Cl 61 FB 2014). The first area where the Government are seeking to tighten the rules is in connection with what constitutes 'qualifying expenditure'. They say:

'HMRC have become aware that many of the recently disclosed BPRA schemes seek to include costs more associated with marketing a completed and successful income-producing property investment (with virtually guaranteed returns and/or greatly minimised risks) rather than simply the actual ("bricks and mortar") capital costs incurred in connection with the renovation of an empty building in a deprived area.'

As a result, new S360B(2B) CAA 2001 has been added to the legislation which now limits 'qualifying expenditure' to expenditure incurred on:

- building works (ie. the direct cost of labour and materials);
- architectural or design services (this will include expenditure relating to the detailed design of the building and its future layout);
- surveying or engineering services (this will include the cost of services to check the structure of the building and of specialists checking for problems like asbestos);
- planning applications (this will cover the cost of obtaining essential planning permissions to alter, for example, a listed building along with any legal fees); and
- statutory fees or statutory permissions (eg. the cost of building regulation fees, the cost of closing roads in order that essential works can be carried out and the cost of obtaining any necessary permissions from utility companies).

Although expenditure on plant or machinery is not intended to qualify for BPRAs, an exception has been made for certain fixtures which are part of the refurbished building. These are now listed at length in S360B(3A) CAA 2001 (as inserted by Cl 61(5) FB 2014).

HMRC have also identified two timing issues in relation to BPRA claims which have given rise to concerns on the part of Government. Hitherto, claims have been made:

- that expenditure qualifies for relief even though, at the date of the contract, the building had not been empty for at least one year; and
- that expenditure contractually incurred should qualify for immediate relief, despite the fact that some of the agreed works may not start for several years.

New S360B(3D) CAA 2001 (as inserted by Cl 61(7) FB 2014) therefore makes it clear that any expenditure incurred before the building has been empty for at least one year must be excluded and new S360BA CAA 2001 provides that, where qualifying expenditure has been incurred, the works, services and other matters to which the expenditure relates must be completed within 36 months. For example, in this latter context, if a return containing a claim for £100,000 of qualifying expenditure has been submitted and, after 36 months, works and services to a value of only £90,000 have been carried out, the relevant tax assessment will need to be revised for the remaining £10,000 of expenditure which is treated as though it had never been incurred.

Under the BPRA regime, a balancing adjustment arises in the usual way on a disposal, but the original legislation emphasised that there is *no* balancing adjustment if the disposal takes place more than seven years after the time when the converted or renovated business premises were first used or were first available for letting. The Finance Bill reduces this period to five years (Cl 61(9) FB 2014).

These amendments take effect for expenditure incurred from 1 (or 6) April 2014 (Cl 61(12) FB 2014).

Contributed by Robert Jamieson

Extension of enhanced capital allowances (ECAs) (Lecture B842 – 5.38 minutes)

Cl 60 FB 2014 gives the Treasury the power to extend by Treasury Order the duration of four 100% ECA schemes. They are:

- S45D CAA 2001 (expenditure on cars with low CO_2 emissions);
- S45DA CAA 2001 (expenditure on zero-emission goods vehicles);
- S45E CAA 2001 (expenditure on gas refuelling equipment); and
- S45K CAA 2001 (expenditure on plant or machinery for use in Enterprise Zones).

The first three regimes will be extended by three years from 31 March 2015 to 31 March 2018.

The Enterprise Zone legislation was originally due to terminate after five years on 31 March 2017, but the lifespan of the FA 2012 rules will now be extended through until 31 March 2020.

Contributed by Robert Jamieson

Common errors on capital allowance claims (Lecture B843 – 13.38 minutes)

Claiming a balancing allowance when selling last asset in the 8% pool

A balancing allowance will arise in the final chargeable period when no AIA or FYA or WDA are given and so the balancing allowance is the mechanism whereby all unused relief is made available. There is no automatic balancing adjustment simply because a business no longer owns any assets in the pool.

So if a company bought a Range Rover Sport for £70,000 this would be entered into the 8% pool as its CO_2 emissions would be greater than 130g/km. After three years of WDA the tax WDV is £54,508. At the start of year four the Range Rover is sold for £35,000. Even if this was the only asset in the 8% pool the company would not receive a balancing allowance. Claiming such an allowance would be an **error**.

The company would simply set the £35,000 proceeds against the pool balance of £54,508 leaving a balance of £19,508 which is then subject to the 8% WDA. The company will have to wait a very long time to fully relieve the £19,508!

The final chargeable period for a single asset pool is the period in which the asset is sold. So there is an advantage in having a single asset pool in terms of accelerating the point at which a balancing allowance can be obtained. In planning terms, unincorporated businesses can achieve this by having some private use but this is not easy to achieve with incorporated businesses as there is no concept of private use.

A balancing charge will arise if the proceeds exceed the total of expenditure brought forward plus new expenditure in the year. It can arise in any chargeable period, not just in the final period. It would be possible to have a situation where AIA has been claimed on new expenditure and then a balancing charge arises in relation to the pool.

Thinking the choices are MV or WDV for plant on successions

Succession is a word used to describe a situation where one person takes over a qualifying activity from someone else e.g. incorporation or sale. There are special plant rules in this situation although these rules only apply where no person carrying on the trade beforehand continues to carry it on afterwards.

There are effectively three possibilities:

- property transfers at cessation and are used for the purposes of the new qualifying activity without being sold. In this case, the assets are treated as transferring across at market value
- property is sold for value (any value) and this value is then used as the disposal proceeds in the capital allowances computation
- the predecessor and successor are connected and they elect for the assets to transfer at tax written down value, regardless of the actual consideration paid (although consideration does have to be paid). Such an election must be made within two years of the date of the succession

Example

Mark is a sole trader whose business has grown and who has decided to incorporate. He owns plant worth £50,000 which cost him £75,000 and has a tax written down value of £30,000. He has three options

- sell for value and compute the capital allowance accordingly. Of course, this is really an option with many different variations! He could sell for £1 and get a balancing allowance in the final period of the sole trade of £29,999. He could sell for £75,000 and get a balancing charge of £45,000. Or any variation in between.

- He could transfer the asset for value and then elect for tax written down value to be used thus avoiding any balancing adjustments

- Give the asset to the company without consideration being paid and bring in the market value of £50,000 so giving rise to a balancing charge of £20,000.

The £1 consideration option is widely used when incorporating. Failure to consider this option would be an **error**.

Thinking that "invoice date" is the date of addition for asset purchases

Q: How many people think invoice date is the date of addition for capital allowance purposes?

A: Too many!

With the huge swings in the AIA recently it is important that we put an asset addition in the correct accounting period. Unfortunately many people think invoice date is the key date for addition purposes and base their tax computations on the invoice date. The invoice date is not at all relevant and those that treat it as the addition date have just made an **error** – and this can expose the client to penalties.

Capital expenditure should be treated as incurred as soon as there is an unconditional obligation to pay it. This is so even though some of the expenditure may not be due until a later date.

The date on which it becomes unconditional is not necessarily the date of the contract itself. In law, a person may in fact become legally required to pay either on delivery or within a prescribed time after the delivery. In such cases, HMRC broadly consider that the obligation becomes unconditional when the asset is delivered (IRInt 54 – *Tax Bulletin* 9). As such, the delivery date is generally the date which triggers the incurring of the expenditure for capital allowances purposes. HMRC guidance at CA 11700 indicates a rather more complex approach to this issue, however. That guidance distinguishes between a 'promissory condition' (when the condition refers to a term within a contract) and an event upon which the whole contract is conditional.

The HMRC guidance goes on to consider cases in which there are no specific payment terms:

'Where a sale is made without specifying payment terms, the transaction is governed by Section 28 Sale of Goods Act 1979 which states that "unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the seller must be ready and willing to give possession of the goods, and the buyer must be ready and willing to pay the price in exchange of possession of the goods".

This means that the obligation to make payment arises when delivery is made unless there is an agreement specifying some other arrangement.'

The legislation seeks to prevent the early granting of allowances in situations that have been contrived. If the unconditional obligation to pay is accelerated to 'a date earlier than accords with normal commercial usage' then the amount may not be treated as incurred on that date but rather on the date by which the payment is actually required to be made. This will apply where 'the sole or main benefit which might have been expected to be obtained' from the artificial arrangements would be the acceleration of tax relief.

To determine whether a contract is or is not a normal commercial contract, inspectors are instructed (at CA 11800) to make a comparison with the normal practice for making contracts for the type of asset in question. They are instructed that they should only apply these anti-avoidance provisions where the amounts involved are substantial.

Under the general rule, it would be possible for expenditure to be treated as incurred for tax purposes long before a payment was actually due. This would arise if there was an unconditional obligation to pay but a long delay in actually making the payment. The legislation therefore addresses circumstances where any part of the payment falls due more than four months after the date on which the obligation to pay becomes unconditional. In such a case, any part of the expenditure falling after that four-month date will be treated as incurred on the date on which the actual payment falls due.

Where, for example, payments are made on a monthly basis then all payments due up to the four-month date will be treated as incurred when the obligation to pay becomes unconditional. The later payments will be treated as incurred on the due date of the payments.

Hire purchase

The typical characteristic of such a purchase is that the person acquiring the asset pays for it in instalments and the seller retains ownership until the last instalment has been paid. Lease purchase transactions are similar in nature to hire-purchase, i.e. the lessee of the asset obtains immediately the use of the asset, and at some time in the future also acquires ownership. Provided the lessee does have an ultimate right to acquire the asset, capital allowances will be given to him, rather than to the lessor. According to HMRC, hire purchase may (for tax purposes, at least) be considered synonymous with lease purchase.

For capital allowances to be available on plant and machinery, the person incurring the expenditure has to own the asset in question as a result of incurring it. To achieve this in cases of hire purchase, plant or machinery subject to a hire purchase contract is deemed to be owned by the person incurring the capital expenditure, and not by any other person. This rule applies at any time when the person is entitled to the benefit of the contract so far as it relates to the asset in question.

There is a special rule about when the expenditure is treated as incurred. Once the asset is brought into use for the purposes of the activity, the person is treated as having incurred all the capital expenditure in respect of the asset that he will be incurring under the contract from that time on. HMRC illustrate this with the following example (CA 23310):

'Bob enters into a contract on 24 May 2014 to buy a computer from Robbie. He pays £5,000 on 24 May 2014 when he enters into the contract and then there are 5 payments of £1,000 at yearly intervals. He brings the computer into use on 4 July 2014. Bob is treated as owning the computer from 24 May 2014

onwards, the date of the contract, and Robbie is treated as ceasing to own it. Bob can claim PMAs on the initial payment of £5,000 then. He can claim PMAs on the 5 payments on £1,000 each of which he has still to make when he brings the computer into use on 4 July 2014.'

Not appreciating when connected businesses have to share an AIA

With an AIA of £500,000 from April 2014 there is certainly plenty to go around! There are however occasions where businesses must share the AIA – this is quite often overlooked and may result in significant **errors**.

The AIA is available if expenditure is incurred by a qualifying person. A qualifying person is defined as:

- an individual,
- a partnership where all members are individuals or
- a company

This definition excludes any partnership which has one or more corporate partners.

The business is free to allocate the AIA as it wishes. So it would be allocated in priority to expenditure which will only attract the lower 8% rate of writing down allowances before being allocated to the 18% assets.

General exclusions

No AIA will be available:

- for the chargeable period in which the qualifying activity is permanently discontinued;
- for cars;
- for expenditure incurred for the purposes of a ring fence trade;
- in certain circumstances where there is a change in the nature or conduct of the trade and a tax-saving motive;
- where existing plant (or plant received as a gift) is brought into use for the purposes of a qualifying activity; or
- where plant that has been provided for long funding leasing is brought into use for other purposes.

Anti-avoidance provisions

There are significant anti-avoidance provisions which seek to restrict the availability of AIA in particular circumstances.

The first gives one AIA to a company in relation to all qualifying activities; the company can choose how it allocates this.

The second restricts the availability of AIA for groups of companies – defined as a parent company for one or more other companies and those companies. All of those companies are allowed one AIA between them again to be allocated as they see fit. P is the parent company of C if it is the parent undertaking at the end of the chargeable period. Parent undertaking is defined as in s1162 Companies Act 2006 as follows:

(a) it holds a majority of the voting rights in the undertaking, or

(b) it is a member of the undertaking and has the right to appoint or remove a majority of its board of directors, or

(c) it has the right to exercise a dominant influence over the undertaking—

(i) by virtue of provisions contained in the undertaking's articles, or

(ii) by virtue of a control contract, or

(d) it is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking.

The third restriction is where there are two or more groups of companies controlled by the same person and related to one another. All of the companies in those groups are allowed only one AIA between them. The group is the parent undertaking as defined in the previous sections and all its subsidiaries with the test being considered at the end of the chargeable period.

The fourth restriction applies the same basic rules to other companies under common control and related to one another with the AIA being split between those companies too.

The legislation defines the meaning of control as that found in s574 (2) CAA 2001 being:

In relation to a body corporate ("company A"), "control" means the power of a person ("P") to secure—

(a) by means of the holding of shares or the possession of voting power in relation to that or any other body corporate, or

(b) as a result of any powers conferred by the articles of association or other document regulating that or any other body corporate,

that the affairs of company A are conducted in accordance with P's wishes.

The legislation then defines what it means to be related in this context. Company 1 (C1) is related to company 2 (C2) if one <u>or</u> both of the shared premises condition and the similar activities condition are met. Where C1 is related to C2 it is also related to any other company with which C2 is related. The same extension applies for groups.

The shared premises condition is met if at the end of chargeable period of one or both, the companies carry on qualifying activities from the same premises. The similar activities test is met is more than 50% of the turnover of each company falls within the same NACE class (NACE classification being the EU common statistical classification of economic activity).

The fifth restriction occurs when two qualifying activities are carried on by a person other than a company, are controlled by the same person and are related to one another. The AIA is split between the different qualifying activities, whether those activities are undertaken by one person or many persons with the allocation to be agreed as the persons see fit. For this purpose, control is defined as follows. Broadly an individual controls any activities that he or she carries on and control of a partnership is as defined in s574(3) CAA 2001 being the right to a share of more than half of the assets, or of more than one half of the income, of the partnership. Related means the same as it does for the previous legislation above.

Finally, legislation is inserted which makes it clear that it is not possible to claim both AIA and FYA (where it is still available on energy saving assets). Also, no AIA is available if anyone does anything with the

main purpose or one of the main purposes being to obtain AIA. Where AIA has been given in such cases, it can be withdrawn. If expenditure is qualifying AIA expenditure, any additional VAT liability which arises at a later date (for example under the Capital Goods Scheme) will also be qualifying AIA expenditure.

Not understanding the definition of a car for capital allowance purposes

Cars are divided into three categories: low emission cars with CO_2 emissions of up to 95g/km; cars with CO_2 emissions of up to 130g/km and cars with emissions over 130 g/km. The first category (known as a QUALEC) will get a 100% first year allowance. The middle category will go into the 18% plant and machinery pool with other plant and machinery and the final category will go into the special rate pool to get 8% WDA. Owner's private use adjustments will be relevant when dealing with sole traders or partnerships.

It should be noted that the QUALEC is transferred to the 18% pool at the end of the year – albeit at a nil balance. Consequently when the QUALEC is sold the sale proceeds are set against the 18% pool.

If a QUALEC has private use it stays in its own column. The 100% FYA is adjusted for private use. The balancing charge on eventual sale would also be adjusted for private use.

So, what is a car? It will be obvious in most cases but there are some issues. A car is defined as a mechanically propelled road vehicle <u>other than</u>

- a motorcycle (not including quad bikes as these have four wheels)
- a vehicle of a construction primarily suited for the conveyance of goods or burden of any description
- a vehicle of a type not commonly used as a private vehicle and unsuitable for such use

If we thought any of the above was a car that would be an **error** as we have just missed an AIA claim.

Some observations from the HMRC guidance on cars can be made:

- the second point above refers to the *construction* of a vehicle and not with the way it is used. The fact that the manufacturer might describe a vehicle as a commercial vehicle is not going to be conclusive. Modifications might be taken into account as long as they are permanent.
- The third point above refers to vehicles not commonly used as private vehicles and unsuitable for such use. This would include vehicles with fixed flashing lights, dual controls, rooftop signs or loud speakers.
- A motorhome is a car, as confirmed by the Courts
- Taxis are cars unless they are London black cabs i.e. Hackney carriages
- Offroad cars will typically be cars (with one or two potential exceptions) as will double cab pickups.

Accounting requirements of FRS 102 (Lecture B844 – 20.58 minutes)

Entities can choose to adopt IAS 39 in full in place of the FRS 102 sections on financial instruments. They would probably only do this to gain hedge accounting treatment for options used as a hedge (see later) so not of great relevance to SMEs.

FRS 102 divides financial instruments into:

1. Basic (cash, bank accounts, commercial paper and bills, debtors and loans receivable, loan commitments, some non-convertible preference shares and regular 'non-puttable' ordinary shares). These instruments are generally measured at cost or amortised cost, however publically traded shares or where the share's FV can be reliably measured are booked at FV with changes recognised in the profit and loss account.

2. Complex (all other financial instruments such as derivatives, investment in convertible debt) which are measured at fair value with changes generally taken to the profit and loss account. Examples of derivatives a client might use are currency forward contracts to fix an exchange rate for a future purchase or sale of foreign currency, or an interest rate swap to convert variable rate borrowings into fixed rate or vice-versa.

Tax treatment of financial instruments

Loan relationships and derivatives (e.g. bond holdings, loans and receivables, forwards, swaps and options) are taxable on a company when an entry is made in the profit and loss account or 'comprehensive income' (statement of total recognised gains and losses).

This means, for example, that when a currency forward contract is recognised at fair value the profit or loss is potentially taxable/deductible, but there are regulations that can prevent this where it is used for hedging purposes (see later).

Shares are only taxed on disposal and don't forget that trading companies disposing of shares in other trading companies do not pay tax on such disposals if they owned at least 10% for (broadly) 12 months.

If the shares will be taxable on disposal, deferred tax must be recognised if they are fair valued via the profit and profit and loss account under FRS 102.

Derivatives and hedging activity

As seen above, tax would arise on recognising the gains or losses on, for example, currency forward contracts in either the profit and loss account or statement of comprehensive income (STRGL), but HMRC recognises that this would be inequitable if the derivative is being used for hedging activity

This would also apply to foreign loans hedging non-monetary assets where currency gains and losses are recognised in either the profit and loss account or statement of comprehensive income (STRGL) and this is mitigated in the 'Disregard Regulations'.

Disregard regulations

The effect is that 'old UK GAAP' is applied and that gains and losses on derivatives/loans used as hedges are not taxable until they are either realised or the item they are hedging becomes deductible for tax purposes. This matches the gain or loss on the derivatives/loans with the item they are hedging. No election is needed - the regulations apply automatically where applicable.

The regulations cover different types of hedges.

Reg 3 – hedge of whole or any part of ships, aircraft or shares using a <u>loan</u> relationship (so probably to hedge any currency risk).

Reg 4 – exchange gains and losses from <u>derivatives</u> hedging ships, aircraft or shares

Note that Paras. 3 and 4 cannot apply to dealers in these assets

Reg 7 – currency contracts

Reg 8 – commodity contracts

Reg 9 – interest rate contracts

Each means that where the contracts are used in a hedging relationship, gains and losses are disregarded unless

- the company makes an election to set aside a Regulation (see below), or
- the change in the fair value of the item being hedged is recognised in the profit and loss account or comprehensive income (in which case there is a natural netting off in the accounts and no special rules are required).

Disregarded gains and losses are taxable when the item being hedged affects, or starts to affect, profits, or on realisation of derivative if earlier and it relates to an item not immediately deductible for tax purposes when recognised.

Deferred tax is needed until the gains or losses are recognised for tax purposes.

Disregarding the regulations

For currency contracts (Reg. 7), commodity contracts (Reg. 8) and interest rate contracts (Reg. 9) used in a hedging relationship, the company can make global, irrevocable elections to set aside the Disregard Regulations for all similar contracts.

The effect is that gains and losses recognised on derivatives are taxable / deductible immediately they are recognised (i.e. the loan relationship rules apply to them).

If relevant contracts are held when FRS 102 is adopted must make the election by end of previous period. For example, if a company is adopting FRS 102 in its year ended 31 December 2015 it must have elected by 31 December 2014.

If no relevant contracts were held at start of period of FRS 102 adoption then elect within 90 days of becoming party to a contract for the first time.

The advantage of making the election is that no adjustment needs to be made to accounting profits for tax purposes (unless the gain or loss has been recognised in other comprehensive income), so there is a minimal risk of an error in the tax return.

If using the disregard regulations, the company must remember to bring the disregarded gains and losses into a later tax return.

Summary

Whilst this area seems very complicated at first, there are relatively few principles covered. If you can follow the examples in the online seminar, this will stand you in good stead when dealing with a client company's derivatives.

Contributed by Malcolm Greenbaum

VAT

HMRC confirm exempt green fees!

HMRC Brief 25/2104 provides an update on HMRC policy following the decision by the Court of Justice of the European Union in Bridport & West Dorset Golf Club in December 2013.

Background

Bridport and West Dorset Golf Club is a non-profit making members' golf club. Under EU Law supplies by non-profit making bodies of services closely linked and essential to sport to persons taking part in sport are exempt from VAT. In UK law, where the body operates a membership scheme, any supplies to individuals who are not members are excluded from the exemption on the basis that the fees received represent 'additional income' for the purposes of EU Law.

The Bridport appeal concerned green fees paid by visitors (non-members) **–** Bridport had made a claim for repayment of VAT on green fees arguing that the exclusion of supplies made to non-members was not permissible under EU law.

The European Court of Justice (CJEU) found that where a supply is made by a non-profit making body it is immaterial whether it is provided to a member of the body or a visitor. It took the view that a Member State has no power to exclude certain groups of recipients of services from the benefit of the exemption -'additional income' could not be construed in such a way that it would lead to such a restriction in the scope of the exemption.

The CJEU also rejected the argument that the exclusion of supplies to non-members was permissible on the basis that it had the effect of reducing distortion of competition between members clubs and commercial organisations.

Implications of the Judgment

As a result of the CJEU judgment, HMRC accepts that supplies of sporting services to both members and non-members of non-profit making sports clubs qualify to be treated as exempt from VAT. This is provided that the services are closely linked and essential to sport and are made to persons taking part in sport. HMRC will legislate by 1 January 2015 to reflect this.

Claims for Overpaid VAT

HMRC intends to deal in two phases with claims for the repayment of overpaid tax for previous periods:

I. Phase 1. Members' clubs that decide to reimburse non-members who were incorrectly charged VAT on sporting services supplied to them (including members' golf clubs that incorrectly charged VAT on green fees) and will adopt the reimbursement arrangements explained in Sections 9 & 10 of Notice No. 700/45 'How to correct VAT errors and make adjustments or claims'.

Where a members' golf club or other non-profit making sports club considers it has overpaid VAT on sports related services it may make a claim to HMRC under section 80 of the VAT Act 1994 for repayment of VAT incorrectly accounted for. Such claims are subject to the conditions set out in Notice 700/45. This means that clubs will need to demonstrate that they have made arrangements to reimburse the VAT to non-members who actually paid it, and make a legally binding commitment to do so in a timely manner.

Claimants who intend to reimburse non-members need to ensure that their claim is adjusted to reflect any over claim of input tax by application of their partial exemption and/or capital goods scheme calculations as appropriate before advising HMRC they wish to proceed under Phase 1.

HMRC will meet eligible claims under the terms of sections 9 & 10 of Notice 700/45 providing the conditions are met. HMRC reserves the right to examine the quantum of the claim, including the requirement to apply revised partial exemption and capital goods scheme calculations as appropriate. All Phase 1 claims should be sent to the following address:

VAT Bridport Claims S0483
PO Box 200
BOOTLE
L69 9AH

II. Phase 2. Clubs that do not adopt reimbursement arrangements

HMRC are examining the scope for restricting repayments to clubs not making arrangements to reimburse the paying non-members to avoid the unjust enrichment of members' clubs. Further advice will be issued on these claims after a conclusion has been reached on this point.

Existing Claims

Where a submitted claim has already been rejected by HMRC and the claimant has not appealed, that claim cannot now be resubmitted. Any claims submitted now will be a new claim subject to the four-year time limit.

Rejected claims that were appealed to the First Tier Tribunal, however, are still open.

If a claimant wishes to claim any additional amounts in respect of non-members that were either overlooked or the result of calculation errors for accounting periods in the original claim, that claim can be amended. However, this only applies where the amendment is, for example, the correction of an arithmetical error or the inclusion of elements, non-members, etc. that were within the contemplation of the original claim. If the claimant wishes to claim for something not within the contemplation of the previous claims or for new accounting periods, a new claim will need to be submitted just for these items.

New Claims

All new claims will be subject to the four-year time limit in section 80(4) of the VAT Act 1994.

Claims made should be adjusted for any amounts due to set-off under section 81(3) of the VAT Act 1994 (outstanding debts, assessments, etc.) and section 130 of the Finance Act 2008 (outstanding debts under any other head of taxation). In particular, claimants will need to adjust for any resultant over claim of input tax by application of the appropriate partial exemption calculation. In some cases, it may be necessary to revisit Capital Goods Scheme adjustments.

All new claims should be sent to the same address as for Phase 1 claims above.

<u>All Claims (whether New or Existing claims)</u>

Finally, it should be noted that where amounts of overpaid output tax are repaid and not re-imbursed to affected customers, there may be direct tax implications. For example, trading income from non-members is taxable and therefore any surplus of non-member income that remains after the deduction of relevant expenses is liable to Corporation Tax.

Construction works: part of old building retained

Summary - The FTT found that construction works to a building which had been substantially demolished qualified for zero rating.

The appellant, a building contractor, had undertaken works under planning permission for the demolition of most of a late Victorian building, and the construction of a commercial unit and a residential unit. The issue was therefore whether the works fell within the scope of VATA 1994 Sch 8 (Group 5).

Decision:

The FTT noted that although the planning consent did not contain any express condition that the front and side facades must be retained, it was clear on the face of the plans that this was a requirement. Furthermore, this requirement was confirmed in an email from the council. The FTT also accepted evidence (in particular 'before and after' photographs) that the rear wall had been demolished. The FTT concluded that the original building had 'ceased to be an “existing building”' (under VATA 1994 Sch 8 Group 5 note 18(b)). The appellant had therefore made supplies in the course of construction of a building, part of which was a dwelling. Supplies in relation to the dwelling were zero rated.

Comments - The case is a practical example of the way a tribunal will ascertain the content of a planning consent in order to decide whether a new building has been constructed for VAT purposes.

BS Design & Management v HMRC TC3622

Place of supply of holiday accommodation

Summary - The FTT held that the place of supply of hotel accommodation to EU travel agents not established in the UK was the UK.

Mr and Mrs Baldwin ran a hotel in the Isle of Wight. Until the autumn of 2011, Mr and Mrs Baldwin's returns were prepared on the basis that all their supplies of accommodation — whether directly to individuals or to travel agents established in the UK, as well as abroad — were liable to VAT. Following the receipt from HMRC of a request to complete an EC sales statement, the Baldwins had thought that no VAT was due on supplies to travel agents established outside the UK. They were appealing against HMRC's decision to impose VAT on these supplies.

Decision:

The FTT observed that under both the Sixth Directive (art 47) and VATA 1994 (Sch 4A), the supply of holiday accommodation in the UK is made in the UK regardless of the place of establishment of the recipient. The FTT added that the tour operators' margin scheme (TOMS) does not affect the operation of art 47. The FTT finally explained that the Baldwins were not required to submit an EC sales statement, as the recipients of hotel accommodation were not liable to VAT under the reverse charge procedure since their supplies took place in the UK.

The FTT agreed with the appellants that the legislation is complex and that HMRC should not have sent them an EC sales statement form. However, this could not affect the application of the law to their supplies.

Comments - The taxpayers had clearly been misled by HMRC, where its staff were at times confused about the application of the place of supply rules. Taxpayers and their advisers should beware of the fact that HMRC officers can misapply the law, particularly when it has been subject to change (as was the case with the place of supply rules).

Mr & Mrs Baldwin v HMRC TC3615

Energy saving materials and composite supplies

Summary - The FTT held that whether the supply of energy saving material was part of a composite supply depended on the way it was invoiced.

Itchen's business was the renovation of sash windows with a focus on 'protecting our heritage'. Itchen also provided 'weather stripping' to reduce heat loss by the installation of compression strips or brushes which made sash windows airtight.

Decision:

Applying Card Protection Plan (C-349/96), the FTT had to decide whether Itchen supplied energy saving materials which were subject to a reduced rate of VAT (VATA 1994 Sch 7A) or whether the supply of

weather stripping was ancillary to the main supply of renovation services — and was therefore standard rated. The FTT accepted evidence that a typical customer would call Itchen to deal with draughty windows. The FTT also referred to HMRC's Notice 708/6, which states that the installation of thermostatic valves by a builder, who has supplied construction services, can be a separate supply. It noted that if Itchen had supplied the overhaul services and the weather stripping services at separate times, they would have been treated as separate supplies. Furthermore, weather stripping was not ancillary to the general overhaul of a window, nor was the overhaul of a window ancillary to weather stripping.

The FTT concluded that only when the supplies were invoiced separately should they be taxed separately. Where the services were invoiced together, the FTT held that the purchaser was buying a 'single composite service of overhaul of the window'.

Comments - The FTT relied on the way the services were invoiced. Suppliers of energy saving material, which supply it alongside other services, should therefore invoice it separately to benefit from the reduced rate.

Itchen Sash Window Renovation v HMRC TC3645

VAT on toasties and meatballs

Summary -The Court of Appeal dismissed Subway's appeal against HMRC's decision to treat its supplies of toasted sandwiches and meatball marinara as standard rated, rather than zero rated.

'As Arnold J [in the UT] put it, human beings have to eat, but they don't have to eat in restaurants or to have their food cooked by others.' These were the opening remarks of the court, which explained why food supplied in restaurants or hot 'take away' food is standard rated, whereas other food is zero rated (VATA 1994 Sch 8).

Subway argued that by treating its supplies as standard rated, HMRC infringed the European law principle of fiscal neutrality, as similar products had been found to be zero rated in previous decisions.

Decision:

The court agreed that supplies 'which are identical or similar from the point of view of the customer and meet the same needs of the consumer' (Rank C-259/10) were treated differently and that 'there appears to have been a breach of fiscal neutrality'. The court added, however, that Subway's supplies were clearly standard rated under UK law and that the principle of fiscal neutrality could not be relied upon to challenge the UK's decision as to where to draw the line.

Furthermore, the varying decisions of the courts were isolated and numerically insignificant and there was no EU law right for a taxpayer 'to be treated in the same way as other taxpayers who have secured a historic windfall'.

Comments - The appellant was one of 1,200 Subway franchisees, so the sums at stake were therefore substantial. The court also repeatedly regretted the lack of practical guidance provided by the government, since the Pimblett [1988] STC 358 decision until at least 2012.

Sub One (t/a Subway) v HMRC (A3/2012/3400)

Detaining of goods pending forfeiture

Summary - The Supreme Court confirmed that HMRC has the power to detain goods pending the outcome of an enquiry.

Custom officers had entered the warehouses of Eastenders and First Stop to inspect consignments of alcoholic goods. Eastenders' employees were unable to provide documents evidencing that duty had been paid on the goods, whilst the 'duty paid' stamps on the goods held by First Stop were defective. The officers therefore decided to detain the goods found in both warehouses pending the outcome of further enquiries.

Some of the goods were forfeited at the end of the enquiries and some were returned. The appeal turned on the returned goods. Both companies applied for judicial review of the decision to detain the goods.

The issue was therefore whether HMRC had the power to detain goods pending determination of whether or not they were liable to forfeiture.

Decision:

The Supreme Court, agreeing with the Court of Appeal, found that since the goods were not in fact liable to forfeiture, their detention did not fall within the scope of CEMA 1970 s 139(1). The officers were however carrying out a lawful inspection of the goods for the purpose of determining whether the appropriate duties had been paid, and had reasonable grounds to suspect that duty had not been paid. They were therefore entitled (under s 118C(2)) to detain the goods for a reasonable period in order to complete the enquiries necessary to make their determination.

Comments - Their Lordships opened their judgment with a reference to the Johnson's Dictionary definition of excise in 1755 ('a hateful tax, levied by wretches'). The Supreme Court did however find in favour of HMRC: goods can be detained pending forfeiture. Traders should therefore ensure that they hold the required documentation at all times, as failure to present it may result in temporary detainment.

R (on the application of Eastenders Cash and Carry) and R (on the application of First Stop Wholesale) v HMRC UKSC

VAT on discount cards

Summary - The CJEU found that the sale of discount cards was subject to VAT.

Granton had issued and sold 'Granton' cards to customers. The cards entitled their holder to goods and services on preferential terms from retailers and businesses, such as restaurants, cinemas, hotels and saunas, which had concluded an agreement to that effect with Granton Advertising.

The Dutch tax authorities had assessed Granton on the basis that the sale of the cards was subject to VAT. The issue was whether Granton cards were 'other securities' for the purpose of the Sixth Directive, art 13(B)(5) and were therefore exempt from VAT.

Decision:

The court observed that a Granton card had no nominal value and that it cannot be exchanged for money or goods from the affiliated businesses. It therefore considered that the sale of a Granton card did not constitute a financial transaction within the meaning of the case law on art 13(B). Furthermore, the taxable amount was the consideration paid for the cards and so the calculation of the tax due should not raise any difficulties. Finally, the scope of the exemption must be interpreted strictly. The court concluded that the cards were not 'other securities'. The court added that the cards were not 'negotiable instruments' (art 13(B) (3)), as they did not operate as a way of transferring money, unlike payments, transfers and cheques.

Comments - The issue of vouchers and reward cards has already caused many disputes. In the light of this decision, organisations which issue similar cards may want to structure arrangements with affiliated businesses differently.

Granton Advertising v Inspecteur van de Belastingdienst (C-461/12)

VAT repayment claim by the recipient of a supply

Summary -The UT held that the FTT has no jurisdiction to hear a claim for repayment of VAT wrongly paid by the recipient of the relevant supply.

The premises of a golf club (ET) adjoined those of another golf club (GC). ET paid GC an annual fee to allow ET's members to play on GC's golf course. GC charged VAT on the fee. However, following the Canterbury Hockey Club decision [2008] ECR I-7821, ET considered that the fees should have been exempt.

GC obtained a repayment of part of the VAT and ET applied to HMRC for the repayment of the balance. HMRC denied the claim on the basis that a repayment claim (under VATA 1994 s 80) could only be made by the person who had accounted for the wrongly charged output tax.

ET appealed to the FTT and HMRC applied to have ET's appeal struck out. The FTT refused HMRC's application and directed that the case be stood over until resolution of the Bridport case.

Decision:

The UT noted that s 80 made no provision for a claim by the recipient of a supply who has borne the tax. However, it added that Reemtsma [2008] STC 3448 was authority for the proposition that the principle of effectiveness required taxpayers to be able to recover VAT directly from the state in circumstances where recovery from the supplier was 'impossible' or 'excessively difficult'.

However, this did not mean that the recipient should be able to appeal to the tax tribunals in circumstances where an ordinary claim for repayment could be brought against HMRC.

The UT concluded that the FTT had been wrong to dismiss HMRC's application.

Comments - Although the appellant lost, the suggestion that the recipient of a supply should be able to recover, from the state, VAT wrongly charged by his supplier is encouraging.

HMRC v Earlsferry Thistle Golf Club (FTC/74/2013)

Private dancer

Summary – The Tribunal concluded there was a single supply with multiple elements

The taxpayer, an adult entertainment club, had a dance floor, seating and a bar on its upper floor. It had six booths downstairs in which self-employed dancers could give private dances to customers.

The dancers received tips from patrons for dancing on the dance floor and fees for private performances. They paid a 25% fee on their earnings from private dances to the club for the use of its facilities.

The taxpayer said that the commission represented payment for a supply of land and was exempt from VAT. HMRC ruled that the payments were consideration for a supply of standard-rated services from the club to the dancers.

Decision:

The First-tier Tribunal concluded that the club made a single supply to the dancer in return for the commission. There were multiple elements to the supply, such as heating, lighting, the use of the booth, but these were not "economically divisible" from the rest of the supply.

On whether the supply was one of land, the tribunal said the provision of advertising, music, lighting, heating, cleaning, management, security and the use of the upper floor and its facilities "added value to the simple provision of land". On this basis, the supply should be "characterised as the provision of services rather than the passive supply of land".

Comments - Neil Warren, independent VAT consultant, said: "There was a possible argument that the club could have been providing two services to the dancers, ie the land and the additional services, to

create a mixed supply outcome with output tax apportionment being necessary. However, such a split would have been artificial so the tribunal had to decide whether there was a single supply of land or a single supply of other services which were standard rated. The decision is consistent with other trading situations where land is involved. For example, it has been accepted for many years that a 'rent a chair' arrangement in hairdressing salons is not a land supply."

Dazmonda Ltd trading as Sugar and Spicev HMRC TC3473

Plainly unfair

Summary – The tribunal concluded that the penalty was disproportionate and as there was no provision allowing it to mitigate or reduce the penalty, it had to set it aside.

The taxpayer was one day late making its VAT payment for the December 2007 period. Apart from one other late payment in the same year of assessment, the taxpayer had an unblemished record since it registered for VAT in 1986. HMRC issued a default surcharge of £70,000 (reduced from £95,900). The taxpayer appealed.

Decision:

The First-tier Tribunal noted that the amount of the penalty imposed under the default regime depended on the number of times a taxpayer had paid late. In this case, the surcharge of £70,000 was "plainly unfair". The judge compared the amount with that imposed on the taxpayer in Enersys Holdings UK Ltd (TC335). In that instance, HMRC charged a penalty at 5% on a fifth default over a two-year period, which suggested that it would have been proportionate for HMRC to have followed the pattern in that case with the result that the penalty would have been 2% or £52,752.40.

The tribunal concluded that the penalty was disproportionate. However, because there was no provision allowing it to mitigate or reduce the penalty, it had to set it aside.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: "For the argument of proportionality to be successful, a business needs to be able to prove that the surcharge in question was not just 'harsh' but 'plainly unfair'. This point of principle was established in Enersys Holdings UK Ltd a couple of years ago, when a surcharge of nearly £132,000 for paying tax one day late was deemed by the FTT to be excessive and HMRC accepted the decision. The key point with proportionality is that it is an all-or-nothing situation — there is no power to mitigate the penalty to a lower amount — hence the complete withdrawal of the surcharge in this case once the proportionality argument was accepted."

Trinity Mirror plc v HMRCTC3490

Roof is not specified

Summary – To determine the liability the tribunal had to examine carefully the composition of the transaction literally.

A business manufactured and installed polycarbonate roofing panels for conservatory roofs. It said that the panels qualified for the reduced rate of VAT for energy-saving materials (VATA 1994, Sch 7A group 2) because they provided higher levels of insulation than conventional ones.

HMRC disagreed, saying the panels were not insulation for roofs but were the roof itself. The First-tier Tribunal allowed the taxpayer's appeal.

HMRC appealed to the Upper Tribunal.

Decision:

Mr Justice Richards said the First-tier Tribunal was wrong in its interpretation of note 1(a) of group 2. It had misconstrued "insulation for roofs" as extending to the roof. The note made the reduced rate available to certain types as goods or products, not to all types of materials with energy-saving properties that could be installed in homes.

The judge said: "A material which is insulation for a roof is not the same thing as the roof itself. It presupposes that there is a roof to which the insulating material is applied." He added that, if the intention behind the legislation had been to apply the reduced rate of VAT to energy-efficient roofs or walls, it could have easily have done so.

HMRC's appeal was allowed.

Comments – The devil is in the detail with VAT on transactions. This case demonstrates very aptly this concept because of the need to distinguish between the roof and the insulation for the roof.

CRC v Pinevale Ltd v HMRC Upper Tribunal

Dogs' breakfast

Summary – The First-tier Tribunal had been entitled to rule that the goods were aimed at working dogs not pets

The taxpayer sold dog food that had been formulated with working dogs in mind but was also suitable for pets. He claimed that the products should be zero rated for VAT on the basis that they qualified under VATA 1994, Sch 8 group 1 as "animal feedings stuff s".

HMRC disputed the claim, stating the goods were pet food and therefore fell within the exception at item no 6.

The First-tier Tribunal allowed the taxpayer's appeal so HMRC appealed.

Decision:

The Upper Tribunal said the fact that the food was also suitable for pet dogs did not necessarily make the product specifically pet food; this also depended on marketing and the customer base. In light of the evidence, the First-tier Tribunal had been entitled to rule that the goods were aimed at working dogs.

On the particular point that the food was “meal” for dogs — as mentioned in the exception at item no 6 — the judge agreed with the First-tier Tribunal that the meal in this instance was used as a mixer and was not a complete food in itself.

HMRC's appeal was dismissed.

Comments – As with the previous case the devil is in the detail with VAT on transactions. This case demonstrates very aptly this concept because of the need to distinguish between working dogs ane pets.

CRC v R Skinner v HMRC Upper Tribunal

Contingent invoices warning

Summary – The Tribunal held that the raising of contingent invoices led to the loss of bad debt relief because actions were taken too late

The taxpayer, a firm of lawyers, provided legal services to a property developer client.

The firm raised contingent invoices for the work on the understanding that the customer paid them when it realised cash from a development. For invoices raised in 2002 and 2005, because at the time the taxpayer dealt with its VAT on a cash accounting basis, it did not account for VAT because the invoices were not paid.

In 2006, the taxpayer deregistered and, as required by the 1995 VAT Regulations, reg 63, it paid the VAT in respect of the invoices from 2002 and 2005.

In 2013, the taxpayer decided to write off these invoices and claimed bad debt relief. HMRC refused on the basis that reg 165A prevented the claim because it was out of time.

The taxpayer appealed.

Decision:

The First-tier Tribunal noted that bad debt relief must be claimed by the later of two dates: either within four years and six months of the date the goods or services were made to the customer, or the due date

of the sales invoice. In this instance, there was no payable date for the invoice so the relevant time could not start. Therefore no claim could be made.

The judge agreed that this was "unfair and one that could not have been intended by the legislation", but said reg 165A could be interpreted no other way.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, said: "A key message here is that the raising of contingent sales invoices, albeit for sound commercial reasons (to establish a liability with the customer and a value to that liability), can have unfortunate VAT consequences. The tribunal was sympathetic to the taxpayer but had no option but to dismiss the appeal."

Hurndalls v HMRC TC3533

Fleming: extension of a claim was a new claim

Summary - The FTT held that the amendment of a claim to extend it to different supplies and a different period of time was a new claim.

Following the Fleming case, on 19 March 2009, the taxpayer had submitted a claim for repayment of overpaid VAT under VATA 1994 s 80 in respect of 'amusement machines'. HMRC authorised repayment in respect of bingo machines but not in respect of other machines. Grand Entertainments appealed to the FTT on 16 September 2009. It then sought to amend its claim on 9 November 2009 and on 12 January 2010 by adding claims for overpaid VAT in respect of other machines and an additional period. HMRC rejected the claims on the grounds that they were new claims and that they were out of time. Grand Entertainments' appeal was stayed pending the outcome of the Rank [2013] EWCA Civ 1289 and Reed Employment [2013] UKUT 0109 litigations.

Decision:

Applying Reed Employment, the FTT found that the November 2009 and January 2010 claims were new claims, regardless of the fact that they were described as amendments to the original claims. The original claim clearly stated the categories of supplies and the period of time to which it related. It therefore implicitly excluded any claim in respect of other categories of supplies and other periods of time. The FTT added that the original claims had not been submitted on a provisional basis, with the later claims providing the missing material.

Comments - The case is a practical example of the way the FTT will apply the principles established in Reed Employment . Clearly, the concept of 'amendment to an existing claim' will be interpreted extremely narrowly.

Grand Entertainments v HMRC TC3735

Holding companies and input tax recovery

Summary - The FTT held that the taxpayer was not entitled to recover input tax as it had not charged for its supplies.

HMRC had denied claims for the recovery of input tax on the ground that the taxpayer was not carrying out an economic activity. In the alternative, HMRC argued that the input tax claimed was not attributable to any taxable supplies.

Norseman Gold (NG) is a UK registered company listed on AIM. It is a holding company for subsidiaries which carry on mining activities in Australia. It is registered for VAT with the trade classification 'management consultancy'.

Decision:

Referring to BAA [2013] STC 752, the FTT observed that NG's directors played an active part in the direction of the subsidiaries, spending 'material amounts of time on the subsidiaries' activities'. Consequently, the 'direct and indirect involvement' referred to by Mummery LJ in BAA was established. NG was therefore providing a taxable supply. However, the issue was that NG did not impose a charge for the services it provided. The fact that it had formed the vague intention to do so at some later stage was not sufficient. Commission v Finland (C-246/08) was authority for the proposition that failure to stipulate any price or consideration 'can lead only to the conclusion that there was no obligation to pay for the supplies at the time they are made'. The agreement of a price after the assessed periods did not rectify the position.

Comments - This case is a reminder that holding companies providing management services must document the legal framework of the arrangements they have with their subsidiaries to cover not only the duties performed but also the fee payable for such duties.

Norseman Gold v HMRC TC 3698

Changing plans – payback and clawback rules **(Lecture B845 – 14.41 minutes)**

There are occasions when a business changes its mind as far as a project is concerned – an easy example would be where a developer buys a plot of land with a view to building a new house and selling it (zero-rated sale) but then decides at the end of the project to rent out the property instead (exempt income). He would have been correct to reclaim all of the input tax when his intention was to sell – but the change of intention means he might have to repay all of the input tax initially claimed – because the actual supply has a different VAT liability. The developer needs to consider the 'payback and clawback rules'.

Note – many house builders had the above challenge back in 2008/2009 when the housing market took a downturn and they were forced to rent out dwellings for cash flow purposes.

HMRC introduced concessions that in most cases meant the builders did not need to repay the input tax by basing the property life on a ten-year period (so one year rental intention would produce a 10% clawback of input tax) and using the partial exemption de minimis rules – see R&C Brief 44/08 and VAT Information Sheet 07/08.

Note – the opposite situation would work in favour of a developer if he didn't claim input tax on the original expenses because of an intention to rent out a dwelling. If he then changed his mind and decided to sell it upon completion, then he would be entitled to go back up to six years and claim input tax on the basis that he is making a taxable sale (rather than exempt).

Case study

To analyse this topic, and to also introduce some thoughts on the option to tax, we will create a case study:

- John buys a plot of land in February 2009 for £70,000 plus £10,500 VAT and reclaimed input tax because he was hoping to get planning permission to build a new house on the land and sell it

- The intention never materialised and he now (in 2014) intends to sell the land to a car valeting business for £70,000 ie breakeven figure. The car valeting business is not VAT registered so would not be able to claim input tax if VAT was added to the £70,000 proceeds.

- John has never opted to tax the land

What are the VAT issues?

Solution

If there was a genuine intention to make a taxable supply (or taxable supplies) when the land was purchased in 2009, then the initial input tax claimed by John was correct. So there has been no error in the original input tax claim – VAT errors are capped at four years but that is not relevant in this particular situation.

The relevant issue is the 'payback and clawback' regulations (1995 VAT Regulations, SI1995/2518, reg 108). The 'clawback' rules require any input tax claimed on the basis of 'intended' taxable supplies to be repaid to HMRC if within a period of six years following the claim, an actual exempt supply is made by the business (or mixed supplies both taxable and exempt in which case the input tax becomes residual and partly claimable under the rules of partial exemption). The relevant date is when there is a change in intention (which might not necessarily occur in the same VAT period as the actual sale takes place).

Note – the six year cap for the payback and clawback regulations is often forgotten because advisers think of a four-year period as being relevant ie as we have with the time period relevant to the correction of errors on previous VAT returns.

Note – the 'payback' rules apply when eg a business did not claim input tax on the basis of making an intended exempt supply but then makes an actual taxable supply (or both taxable and exempt supplies). So there is an input tax windfall (payback by HMRC) when the change in intention takes place.

What are the options?

Client A could opt to tax the land and charge £70,000 plus £14,000 VAT to the car valeting business owner to avoid a problem with the 'clawback' rules – but this would not help the new owner because he cannot reclaim input tax. So a better option as an initial starting point would be to sacrifice the £10,500 input tax claim on the basis that this will be based on the 15% VAT rate we had in 2009 rather than the current rate of 20%.

As an alternative suggestion, is there scope for the car valeting business owner to buy the land (plus VAT) in a connected business (say a partnership with his wife rather than a sole trader activity); the connected business opts to tax the land and becomes VAT registered (to claim input tax on the land purchase from Client A) and then charges a commercial rent to the trading business? The commercial rent (say £70,000 x 5% + VAT on an annual basis) would produce irrecoverable input tax of £700 a year for the trading business but this is better than an initial VAT loss of £14,000 at a time when cash flow is likely to be tight. In effect, this outcome gives a £14,000 interest free loan to the new owner, repayable over 20 years.

The starting point is to consider anti-avoidance legislation because the trading business is associated with the landowner and is not occupying the land for 'eligible' purposes ie because the trading business is not VAT registered and accounting for output tax on its sales. The legislation (VATA1994, Sch 10, para 12) allows up to 20% of total sales made by the connected trading business to be exempt or not subject to output tax but in the case of a non-registered entity, this figure will be 100%. In effect, the anti-avoidance legislation blocks the option to tax election made by the land/property owning entity so that rental income is still VAT exempt ie to prevent an input tax claim on the initial purchase of the land. However, the good news is that the anti-avoidance legislation only applies if the property/land in question comes within the capital goods scheme ie £250,000 or above excluding VAT – a figure of £70,000 is well below this figure.

The end result

Option 1

- Client A to repay £10,500 of input tax to HMRC under 'clawback' rules at the time when an intention is made to sell the land to the car valeting business.

Option 2

- Client A opts to tax the land and sells it to a connected business of the car valeting entity (plus VAT at 20%) – the connected entity becomes VAT registered and makes an option to tax election as well with HMRC (VAT1614A) and charges VAT on a commercial rent to the trading entity.
  This process is not blocked by anti-avoidance legislation because the land value is less than £250,000 ie the capital goods scheme threshold which is relevant to the anti-avoidance rules.

Contributed by Neil Warren