Tolley®CPD

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Personal Tax

Employment related benefits: deductions

Summary - The FTT found that business expenses had not been incurred 'in the performance of an employee's duties'.

Mr and Mrs Rockall were the directors and controlling shareholders of two companies, ML and WHL, which had their registered offices at their home. Both companies owned conference centres and hotels which ran residential courses. One of them also owned yachts which were used for chartering and networking purposes.

Mr Rockall purchased jewellery to be worn by his wife at events attended by high net worth individuals, as 'one needs to convey the right image'. Finally, Mr Rockall purchased expensive clocks to showcase at one of the hotels.

The yachts, jewellery and clocks were employment related benefits (ITEPA 2003 s 203(1)) as they were provided by the two companies which were the employers of the Rockalls. They were therefore subject to income tax as earnings. Furthermore, ITEPA 2003 s 205(1)(a)(i) applied when assets were placed at the disposal of employees for their use, whether or not that use was for business purposes. Applying ITEPA 2003 s 365, it was therefore necessary to establish whether any payment for those assets would have been deductible.

Decision:

The FTT accepted that any expenditure by Mr Rockall on the yachts would have been incurred wholly, exclusively and necessarily in the performance of his duties of employment. However, the FTT found that expenditure on the clocks and jewellery (used exclusively for business purposes) would not have been incurred in the performance of his duties. It would rather have been incurred to put him in a position to better perform those duties and so would not have been deductible. No deduction could therefore be allowed in relation to those assets.

Finally, the FTT accepted that the discovery assessments issued by HMRC were valid as a result of the 'careless or deliberate' conduct of the taxpayers (TMA 1970 s 29(4)). £974,000 of work undertaken at their residence had been treated as an asset of ML, rather than in addition to Mr Rockall's loan account. This error had arisen as a result of a failure to meet the standards of a prudent taxpayer, regardless of the fact that professional advice had been sought.

Comments - On the one hand, the FTT was rather generous in finding that expenses incurred on jewellery, worn 'to impress' business connections, were incurred for business purposes. On the other hand, the FTT had to apply the very stringent test which requires employment expenses to be incurred 'wholly exclusively and necessarily' for business purposes.

Gillian Rockall v HMRC TC3767

Relocation benefits (Lecture P846 – 5.54 minutes)

The tax regime – Sections 271 to 289 ITEPA 2003

An individual relocating his main residence due to the needs of his employment can receive tax-free removal expenses from his employer of up to £8,000 per move, provided the expenses consist of:

- reimbursements from his employer in respect of removal costs; or
- costs directly incurred by the employer

Disappointingly the £8,000 limit to the exemption has never increased, and any excess expenses are taxable.

Relocation for this purpose includes the situation where an employee moves in any of the following circumstances:

- to take up a new employment
- as a result of a change in duties within the organisation
- because the location of the current employment changes

The relocation has to be necessitated by the old residence not being within a reasonable daily commute of the workplace.

The new residence must be within commuting distance.

As to what the removal expenses can include, they cover:

- fees in connection with the property sale and purchase
- the cost of moving belongings
- the cost of replacing equipment not suitable for use at the new home
- travel and subsistence, such as viewings
- bridging loan up to the limit of the proceeds from selling the old home

The removal costs have to be incurred by the end of the tax year following that of the relocation, but HMRC have discretion to extend that time limit.

Examples of non-qualifying expenses and benefits are:

- mortgage or housing subsidies for an employee moving to a higher-cost area
- mortgage interest payments for the employee's existing home
- compensation for any financial loss to the employee on the sale of their home
- compensation for other losses, such as penalties for withdrawing a child from school without sufficient notice
- re-direction of mail
- Council Tax bills

Peter Figg v HMRC TC03733

This is an interesting case which involved the issue of whether relocation benefits were deductible or, because the employee did not eventually move, they were taxable in full.

In 2009/10 a company recruited Mr F to work in Berkshire. Since he lived in Sussex the company offered him a relocation package and informed him that this would be exempt from tax under Section 271.

On Mr F's 2009-10 P11D the company declared taxable benefits of £4,498 in respect of temporary accommodation provided under the package. Meanwhile Mr F had formed the opinion that the company had mis-described the nature of the work. In January 2011 they agreed that his employment would terminate by mutual consent on 31 October 2011, and that the company would pay him compensation of £30,000, which was exempt from tax under Section 403 ITEPA 2003. He submitted a repayment claim in respect of the relocation benefits and lodged an appeal to the First-tier Tribunal.

Judge Aleksander found that the appeal was premature, because HMRC had requested further information from Mr F and had not yet reached a formal decision on his claim. However Judge Aleksander observed that HMRC had contended that because Mr F had never actually moved to Berkshire, but had lived in temporary accommodation, the benefits were taxable in full. He expressed the view that *"HMRC's submissions have considerable merit in cases where an employment continues, but the employee never permanently relocates".* In such cases, the relocation benefit would be, in reality, *"a subsidy for long distance commuting".* However, he considered that the exemption should not be denied where an employee was planning to move, but died before doing so.

In this case he expressed the view that the relocation benefits provided by the company to Mr F would be eligible for tax relief from the start of his employment until the date on which it became certain that the employment was no longer permanent. Any relocation benefits provided after that date would not qualify for exemption.

Contributed by Gerry Hart

Forgivable loan to avoid the benefits legislation

Summary – The Tribunal found that the "forgivable loan" had not been properly reported so that a valid penalty for careless behaviour was raised although a reduction was made because of HMRC's flawed procedures

On starting work at Nomura International in 2009, the taxpayer was given a one-off payment of £25,000 in addition to his starting salary. The taxpayer described this as a golden hello but, in his statement of employment, the employer referred to it as a "forgivable loan".

The loan was written off in February 2011. The employer included it as a taxable benefit in his P11D with a note to the taxpayer to include the amount in his tax return for that year. He completed his return but did not include the loan. HMRC amended the return to include the amount and imposed a penalty for carelessness.

The taxpayer appealed, saying he had included the amount in his 2009/10 return.

Decision:

The First-tier Tribunal found that the £25,000 was a loan. This was how the bank described and reported it. On the basis that it was paid in 2009 and written off in 2011, the taxpayer was liable to income tax on the loan written off under ITEPA 2003, s 62 and on the cash equivalent of the loan (that is, the interest forgone) under s 175. The charges arose in 2010/11.

On this basis, the taxpayer should have shown income in his return for 2010/11. The omission was careless and the penalty was due. The taxpayer's excuse that he was unaware of the P11D because his wife had tidied it away did not aid his case because a "prudent and reasonable taxpayer would gather together all relevant papers from his files before starting to prepare his tax return".

The tribunal decided there were no grounds to suspend the penalty but there were special circumstances under FA 2007, Sch 24 para 11 in that the taxpayer had brought the loan to the attention of HMRC in his 2009/10 return. HMRC's decision not to apply a reduction to the penalty was therefore flawed and the tribunal reduced it by 25%.

The taxpayer's appeal was allowed in part.

Comments – It was surprising that this case made its way to the Tribunal. The taxpayer had clearly been informed by his employer, an international bank, of what the correct tax treatment was and what he needed to report. His excuse was hardly acceptable and the judge's comments are self explanatory.

Interest 'rolled over' under a Ponzi scheme

Summary - The FTT held that the taxpayer was liable to tax on interest accrued under a Ponzi scheme.

Mr Rusling ran a building company and owned a portfolio of properties. He was asked to lend funds to an acquaintance, Mr Litt, and made several advances. The loans (together with interest) were intended to be repaid with post-dated cheques. Any interest earned was re-invested and therefore rolled over. Mr Litt's company went into liquidation in May 2008 and he was sentenced to prison for knowingly carrying on the business with the intent to defraud creditors. Monies loaned by unsuspecting investors like Mr Rusling had been used to repay creditors.

Decision:

The FTT found (referring to BMBF [2004] STC 1) that Mr Rusling had received interest (as it arose in the relevant tax year) and that the rate was not excessive given the level of risk involved. Furthermore, a realistic view of the transaction, applying Arrowtown [2003] HKCFA 46, did not change the analysis. Mr Litt's scheme only turned into a Ponzi scheme because he could not find a purchaser for his business and Mr Rusling saw the investment as a means of achieving substantial interest.

The FTT also found that Mr Rusling, a 'substantial businessman', had been careless in not disclosing the expected interest payments to HMRC.

His carelessness also meant that HMRC had no means of finding out about the interest payments at the time the enquiry window had closed. The discovery assessment therefore satisfied both TMA 1970 s 29(1) and s 29(3).

Comments - The result of the decision is undoubtedly harsh. The taxpayer had to pay tax on interest he had not received. Clearly, his carelessness in not disclosing rolled over interest payments weighed heavily against him. As pointed out by the judge, when in doubt, a taxpayer should disclose.

Robert Rusling v HMRC TC3813

Employee remuneration scheme involving genuine loans

Summary - The UT dismissed HMRC's appeal, remitting part of it to the FTT for further determination.

MGM (a company of the Murray Group) had set up an employee remuneration trust, which had in turn set up sub-trusts for some 108 employees (all footballers). The sub-trusts were financed by loans of the company to the head trust. The loans had not been repaid. The question was whether there had been a payment of earnings by MGM to the employees (ITEPA 2003 s 62).

Decision:

The UT first noted that the FTT's approach seemed to have been influenced by Mayes [2009] EWHC 2443 in considering that the steps under consideration 'were genuine legal events with real legal effects', thus constraining the application of the Ramsay doctrine to the case. The UT observed that the relevant provisions in this case were more open to a constructive interpretation than those at issue in Mayes. However, the UT also thought that the FTT had adopted the correct approach and the correct criteria, drawing in particular a distinction 'between enforceable legal structures which were of fundamental practical effect and legal structures which were merely incidental or artificial for tax avoidance purposes only'. The conclusion of the FTT that the payments were loans, not earnings, could therefore not be displaced. The UT pointed in particular to the FTT's findings that the recovery of the loan was not a remote contingency that could be ignored and that the element of 'orchestration' did not entitle employees to obtain anything more than loans. The UT accepted that the setting up of sub-trusts raised questions as to the trustees' power to exercise their discretion. However, it held that the conclusion of the FTT that the trust and sub-trust were not 'ciphers' was open to it. The UT dismissed HMRC's appeal, except in relation to termination payments on which the FTT had not made a final disposal and which were therefore remitted to the FTT.

Comments - Although an element of 'orchestration' was identified, pointing clearly to aggressive tax avoidance, the UT and the FTT were unable to ignore the fact that genuine loans had been granted. The GAAR was adopted in order to curb this type of avoidance.

HMRC v Murray Group and others (FTC/15/2013)

Payment to employee under interim relief order

Summary - The FTT held that a payment received by a 'whistleblower' was not an emolument of theemployment.

Having been informed by email that her employment had been unilaterally terminated, Ms Turullols applied to the Employment Tribunal for interim relief, claiming that the principal reason for her dismissal was that she had made protected disclosures to her employer under ERA 1996 s 43A. The Employment Tribunal granted the relief, ordering the payment of the appellant's salary from the date of her dismissal to the date of the determination of her complaint. The appellant received interim relief for a period of two years until the Employment Tribunal found that she had been unfairly dismissed. She considered that the payments received under the interim order were part of her compensation for loss of employment, so that the first £30,000 should be exempt (ITEPA 2003 s 403).

Decision:

The FTT noted that a key principle was that an emolument is 'from' an employment if it is 'paid … in return for acting as or being an employee'. In this case, the payments would not have arisen but for the appellant's employment and that they were intended to provide income to 'whistleblowers'. Furthermore, under ERA 1996, when an interim order is made, the contract of employment continues in force. However, the true question is not whether the payments arise from the employment contract, but whether they arise from the employment. The effect of the interim relief order was not to reinstate the appellant in employment. The FTT added that if interim relief had not been granted, any payment received as a lump sum would have been considered as compensation for unfair dismissal. There was no reason to treat interim relief differently because it was paid monthly. Similarly, if the appellant had lost her employment tribunal case, the payment would still have been made in consequence of the termination of her employment.

Comments - Since Hochstrasser v Mayes [1960] AC 376, the courts have grappled with the concepts of employment and the emoluments thereof. This case sheds some light on the application of these concepts to rather unusual circumstances — the grant of interim relief.

Maria Elisa Turullols v HMRC TC3795

A nicer ISA (Lecture P850 – 4.58 minutes)

The system of encouraging savings through ISAs is being comprehensively overhauled as part of the Government's key objective of looking to support savers, given that well over 20,000,000 adults hold ISAs. The modifications announced by the Chancellor in his Budget Speech on 19 March 2014 are undoubtedly welcome and should, to a significant extent, improve the flexibility of such products.

With effect from 1 July 2014, the following changes have been made. All ISAs become New ISAs (NISAs) – this applies to existing accounts as well as to those opened on or after 1 July 2014. The annual investment limit rises to £15,000 which is a substantial increase on the previous maximum.

In addition, an individual is allowed to split the amount which he invests in a NISA in any proportion which he chooses (up to the new maximum) – in other words, he is able to put the full £15,000 into a Cash NISA or alternatively the same amount into a Stocks and Shares NISA (or any combination of the two). The previous restriction that only 50% of the overall ISA limit could be saved in cash will no longer apply.

Another piece of good news is that, if an amount is subscribed to a Stocks and Shares NISA but remains in cash, the flat rate tax charge of 20% on any interest arising on this temporarily uninvested balance is being removed.

Savers can only pay into a maximum of one Cash NISA and one Stocks and Shares NISA in any tax year.

Contributed by Robert Jamieson

Capital Taxes

Look after the pension fund to avoid a transfer of value

Summary – The FTT found that there was no gratuitous transfer moving pension arrangements but failure to take lifetime benefits constituted a transfer of value

The appellants were the personal representatives of the deceased, Mrs S, two of whom were also her sons and beneficiaries.

In 2000, as part of her divorce settlement, Mrs S gave up her job in her ex-husband's company, Morayford, and received her share of the pension scheme. She was advised that the only option was to have her fund transferred into a FA 1981, s 32 buyout policy. This gave her freedom to invest the fund as she chose but any surplus would be returned to Morayford on her death.

Mrs S was unhappy about this arrangement, wishing to ensure that any surplus would benefit her sons. She was told she had to wait ten years before the fund could be transferred into a personal pension plan. As a result of the changes in pensions law in April 2006, Mrs S's adviser told her she could transfer the whole fund to a personal pension after six years rather than ten. At the time she was terminally ill with cancer, but she made the transfer in October and died in December.

HMRC considered that the transfer to the personal pension was a transfer of value for the purposes of inheritance tax and issued a determination. They made a second determination on the basis that Mrs S had not taken any lifetime benefits between the date the personal pension was created and the date of her death.

The appellants appealed. They said the transfer was a disposition within the meaning of IHTA 1984, s 3(1), but not a transfer of value. They said that s 10(1) applied because the transfer was not intended to confer a gratuitous benefit on anyone and it was made at arm's length.

Decision:

The First-tier Tribunal accepted the appellants' contention that the transfer was a disposition and had been made to ensure no part of the pension fund reverted to the company. The tribunal did not agree with HMRC that she had dual motivation in that she wanted to ensure the death benefits passed to her sons free of inheritance tax, noting that she carried out no other inheritance tax planning.

On HMRC's argument that the transfer conferred a gratuitous benefit on the sons, the tribunal said they were already named beneficiaries in Mrs S's will and had stood to benefit from the s 32 policy. The transfer could not be said to confer a new benefit on them.

The appellants' appeal against the first determination succeeded.

On the second determination, the tribunal said that, under the terms of the s 32 policy and the personal pension, Mrs S had the right to take lifetime benefits from the schemes. She did not. The tribunal agreed with HMRC that this was a deliberate decision by Mrs S at least in part because she wanted to preserve the value of her estate for her sons. The appeal against the second determination was dismissed.

Comments – This case is another example of the provisions of section 3(3) IHTA 1983 and the omission to exercise a right which constitutes a transfer of value. Care always needs to be taken to ensure that one does not fall foul of these provisions – it is not the first time and it won't be the last that come before the Courts

RWJ Parry, HFA Piney and SA Staveley v HMRC TC3548

Appropriate valuation method

Summary – The FTT decided that the taxpayer's method of valuing shares which were gifts to charities was the most appropriate method

A taxpayer made two gift s of 118,750 shares to two charities. He claimed relief under ITA 2007, s 431 of £237,500 based on a market value of £1 a share.

HMRC restricted the relief to £71,250, valuing the shares at 30 pence each. The taxpayer appealed.

Decision:

The First-tier Tribunal had to decide the correct value of the shares. Each party produced expert share valuation reports. HMRC's report produced a discounted cash flow valuation of the company using revenue and earnings projections that would not have been available on the open market. It concluded the shares were worth between 25 pence and 30 pence.

The taxpayer's report used the price/earnings (P/E) technique to value the shares, in that it applied a multiple to the sustainable earnings of the company to produce an adjustable enterprise value. It concluded that each share's value was between 88 pence and 93 pence.

The First-tier Tribunal decided the taxpayer's valuation method was the appropriate one, but that the P/E multiples it used had overvalued the gifted shares. The judge concluded HMRC's share value was more appropriate; he gave the shares a value of 35 pence each, resulting in tax relief for the taxpayer of £83,125. The taxpayer's appeal was allowed in part.

Comments – Valuation of shares particularly in circumstances where there is no arm's length sale to an unconnected third party is always potentially an area of disagreement. It is therefore incumbent on the parties to ensure that valid methods of valuation are utilised and followed through properly. HMRC's method was not appropriate but there were also flaws used in the method applied by the taxpayer.

Green v HMRC TC3525

Avoidance scheme involving conversion of non-QCBs into QCBs

Summary - The FTT found that an avoidance scheme involving the conversion of non-qualifying corporate bonds (NQCBs) into QCBs following a reorganisation 'worked'.

Mr and Mrs Hancock had sold ordinary shares and received loan notes as consideration. As the loan notes could be redeemed in dollars at an exchange rate other than that prevailing at the time of redemption, they were not QCBs for the purposes of TCGA 1992 s 117.

A deed of variation subsequently removed the right to redeem the loan notes in dollars. The loan notes were then exchanged for secured discounted loan notes which were QCBs and which were redeemed in June 2003. The issue was the CGT arising on redemption.

Under TCGA 1992 s 127, the disposal of shares and the acquisition of the loan notes as part of a 'reorganisation' does not trigger a charge to CGT and the gain on disposal of the shares is 'rolled over' into the loan notes. Furthermore, the redemption of a QCB is exempt from CGT (TCGA 1992 s 117). Accordingly, on a reorganisation involving QCBs, the gain accruing on disposal of the shares is 'frozen' until the QCBs are disposed of, when it becomes subject to tax (TCGA 1992 s 116). Mr and Mrs Hancock argued that s 116 did not have effect as the reorganisation had not involved QCBs, so that the redemption of the QCBs did not trigger any tax.

Decision:

The UT found that there had been a single conversion of the loan notes into the secured discounted loan notes for the purpose of s 116, with the effect that the 'original shares' included a QCB and the new holding consisted of a QCB. Section 116 therefore did not apply.

Furthermore, the UT found that the transaction could not be recharacterised under the Ramsay doctrine. 'The fact that the conversion process was intended to give rise to a tax advantage in enabling Mr and Mrs Hancock to make a disposal of a QCB without a charge to tax by virtue of s 116 (10) did not result in the transaction, viewed realistically, being anything other than a redemption of the secured discounted loan notes.'

The UT explained that it was not possible to ignore the conversion of the loan notes into QCBs simply on the basis that the conversion had no commercial purpose. Like the discharge of a debt in MacNiven v Westmoreland [2001] STC 237, the conversion of the loan notes into secured discounted loan notes had the requisite legal effect.

Comments - This case is yet another example of the limits of the Ramsay doctrine. As the tribunal judge so eloquently declared, the gap in the legislation could neither be 'plugged by a process of purposive interpretation', nor by applying a 'broad spectrum antibiotic' (the eponymous expression used by Lord Hoffman in MacNiven). The stated aim of the GAAR is to stop this type of avoidance, which seems immune from attack by the courts.

Anthony and Tracy Hancock v HMRC TC3816

Another main residence case (Lecture P847 – 9.34 minutes)

The recent First-Tier Tribunal decision in *Wagstaff v HMRC (2014)* is yet another case in the seemingly unending line of disputes between taxpayers and HMRC about the meaning and effect of the main residence relief which is set out in Ss222 – 226B TCGA 1992.

The property in question was a flat in Kent which had been purchased in 1990 by the taxpayer's mother (B). In February 1996, B sold the flat to her son (S) and his wife (V) for £45,000. This was subject to an agreement under which B was entitled to live in the flat for the rest of her life at no cost, apart from the payment by her of a one-off lump sum of £5,000. It is understood that the purpose of this arrangement was to release capital to B which she could then invest for her old age.

B continued to occupy the property until 2005 when she unfortunately had a fall down the stairs in the flat, following which she was in hospital for several months. On her release from hospital, B went to live with S and V at their own home, pending the purchase of more suitable (ie. stair-free) accommodation. In the meantime, the flat had remained available for her use with her furniture and belongings still in situ. A replacement property was acquired in June 2006, at which time B moved in and continued to live there on the same terms as she had done with her previous flat (which stayed empty until it was sold – with B's agreement – in March 2007).

The argument here was about the 2006/07 gain on the flat in which B had been living. Did the disposal give rise to a chargeable gain on S and V who owned it or was there a relief which might be available?

S and V contended that the flat was 'settled property'. If this was the case, the flat had been occupied by someone who was entitled to do so under the terms of the settlement, as a result of which the gain was exempt from CGT under S225 TCGA 1992. HMRC did not agree with this analysis.

However, the First-Tier Tribunal held that, in acquiring the flat on terms which included the agreement, S and V had taken on the role of trustees. Their interest in the flat *did* represent 'settled property' so that the agreement had created a trust (despite the fact that the wording in the agreement contained no reference to a trust). The position of the parties was summarised by one commentator as follows:

'The parties intended the agreement to set out legal rights and obligations regulating their relationship during (B's) lifetime: this was the only basis on which she was prepared to part with ownership of the flat.

(B) had effectively placed herself in the hands of her son and daughter-in-law, but only if they accepted particular legal obligations towards her.

Her position in connection with the flat was to be secure against any eventuality and better protected if the taxpayers accepted obligations usually associated with a trust and the role of trustee, as set out in the agreement.'

Accordingly, private residence relief was indeed available to S and V.

This may prove to be a useful way to avoid CGT on the disposal of a 'granny flat'. Note that the alternative relief in S226 TCGA 1992 only applies to properties which have been occupied by a dependent relative since before 6 April 1988.

Contributed by Robert Jamieson

Mansworth v Jelley (2003) – the latest update (Lecture P848 – 22.05 minutes)

The aftermath of the *Mansworth v Jelley (2003)* decision rumbles on. The latest development is the ruling of HMRC's Personal Tax Contentious Issues Panel (PTCIP). This has recently been published by the Tax Faculty as TAXGUIDE 6/14. In overview, the PTCIP conclusion is that, in certain circumstances, taxpayers who claimed loss relief based on HMRC's original interpretation of the case *can* have relief for those losses.

Mansworth v Jelley (2003) involved the tax treatment of share options, but the case itself has almost become of academic interest – the interpretation of the Court of Appeal's decision by HMRC and the subsequent changes to that guidance are of much greater concern. Following the case, HMRC issued guidance which confirmed that the gain or loss on the disposal of shares acquired under unapproved employee share options and EMI share options exercised before 10 April 2003 should be calculated by deducting from the disposal proceeds both of the following amounts:

(i) the market value of the shares at the time when the option was exercised; and
(ii) any amount chargeable to income tax on the exercise of that option.

For many recipients of such share options, this surprising guidance – with, in effect, a double deduction – gave rise to a capital loss.

At this stage, a brief reminder of the computational impact of this interpretation is in order. If Sam, a 40% taxpayer, held an unapproved option to buy 100,000 shares in his company at £1 each and if he exercised this option in 2002/03 when the shares were worth £5 each, he would have to pay income tax at 40% on his 'profit' of £400,000, ie. £160,000. If Sam promptly sold the shares for £5 each, his CGT calculation became:

		£
Sale proceeds		500,000
Less:	Amount subject to income tax	400,000
		100,000
Less:	Market value of shares acquired	500,000
		£(400,000)

In other words, Sam made a capital loss of £400,000 which he could set off against gains in the same or a later tax year and so reduce his CGT bill by what was then £160,000. His net tax liability was zero, despite the fact that he had made a real profit of £400,000.

In 2009, HMRC changed their mind and published revised guidance – see Revenue & Customs Briefs 30/09 and 60/09. This revised guidance stated that, in contrast to their 2003 paper, there was no deduction for any amount chargeable to income tax on exercising an unapproved option before 10 April 2003. HMRC suggested that taxpayers needed to amend their self-assessments to reflect the new stance, but of course many individuals had by then utilised their capital losses. This marked the start of what might be called the 'legitimate expectation' discussions. In other words, if someone had calculated their tax based on official HMRC guidance and could show that they had relied on that guidance, were there not grounds that they should be allowed to do their tax calculation in line with what was then considered to be the law?

Following a number of meetings between HMRC and the main professional bodies, the Tax Faculty published TAXGUIDE 3/13 which comprised the minutes of those meetings. In the speaker's view, the minutes are not that helpful.

The next stage in the saga was the involvement of the PTCIP. The PTCIP is part of HMRC's governance process in that they determine the handling strategy for important issues affecting multiple taxpayers – see the HMRC publication 'How We Resolve Tax Disputes', which was published on 2 July 2013, for more details of the panel's functions. The PTCIP agreed to allow relief for *Mansworth v Jelley (2003)* losses to the extent that taxpayers could show on the balance of probabilities:

(i) that they had relied on the original 2003 guidance;
(ii) that they would suffer detriment if their loss claims were denied by HMRC; and
(iii) that there would have been a legitimate expectation to obtain relief, except that HMRC's delay in dealing with these enquiries has meant that the level of evidence which taxpayers are now able to provide is very limited.

For further information, see TAXGUIDE 6/14.

A typical case in respect of which relief might be obtained would be one where the taxpayer:

(i) claimed loss relief in accordance with the method of computation described in the 2003 guidance;
(ii) disposed of an asset at a profit shortly afterwards in circumstances in which it might reasonably be assumed that the gain was expected to be covered by the loss; and
(iii) could show that both events took place before HMRC had given any indication that they would challenge his loss relief.

Contributed by Robert Jamieson

Plan B for relevant property trusts (Lecture P849 – 28.07 minutes)

On 31 May 2013, HMRC published a consultation document entitled 'Inheritance Tax: Simplifying Charges On Trusts – The Next Stage'. The main purpose of this paper was to outline ways in which 10-year anniversary and exit charge calculations could be made more straightforward. As part of this process, HMRC proposed that the IHT nil rate band should be split equally between all relevant property trusts created by the settlor instead of continuing with the present system under which most settlements are entitled to a full IHT nil rate band of their own.

This did not go down well with most of the parties who commented on the document and so when the notes from last year's Autumn Statement said:

'The Government will consult on proposals to split the IHT nil rate band available to trusts with a view to delivering this change alongside simplification of the trust calculations in 2015.'

It was clear that some sort of rethink was in the offing.

This has now happened with the announcement on 6 June 2014 of a further consultation document called 'Inheritance Tax: A Fairer Way Of Calculating Trust Charges'. In effect, it is HMRC's Plan B.

The details of the latest proposal are as follows:

(i) Each individual will be entitled to a single 'settlement nil rate band' (SNRB) equivalent to the existing IHT nil rate band. When, in future, the IHT nil rate band is amended, this will automatically feed through to the SNRB.

(ii) The revised regime will apply to all new settlements created on or after 7 June 2014 as well as to trust additions made on or after the same date. Thus trusts which were set up before 7 June 2014 will be largely protected from the changes.

(iii) The new IHT rules will affect 10-year anniversary and exit charges arising from 6 April 2015 onwards. For the avoidance of doubt, any IHT charges arising before 6 April 2015 in respect of settlements or additions made on or after 7 June 2014 will be calculated in accordance with existing legislation.

(iv) The individual settlor will be responsible for deciding how his SNRB is to be shared between all the trusts which he creates. A formal election is needed for this purpose. It should be made in writing and on a form prescribed by HMRC.

(v) The election should specify how much SNRB is allocated to each settlement in percentage terms. A copy should be given to the trustees so that they can calculate the IHT due for 10-year anniversary and exit charges.

(vi) The date for making the SNRB election will be flexible. It can be made when a new trust is set up or at any time up to the due date for payment of the first IHT trust charge.

(vii) The allocation of the relevant SNRB to a trust can be amended or withdrawn until the point of the payment date for the first IHT trust charge. However, once the allocated SNRB has been used in the calculation of a 10-year anniversary or exit charge, the allocation to that trust cannot subsequently be reduced.

(viii) If property is added to a trust, a further election can be made (provided, of course, that the settlor has some SNRB available). So, even in cases where a trust may already have incurred a first charge, the relevant SNRB percentage can be increased.

(ix) If no election has been made to allocate SNRB to a trust, the trustees must calculate the charge on the basis that none is available.

(x) On the settlor's death, his personal representatives will have two years in which to make an election either to allocate SNRB to trusts created by the deceased's will or to ensure that the deceased's SNRB has been fully allocated between trusts made by him during his lifetime and on death.

Illustration 1 (exit charge before 10-year anniversary)

Paul settled £850,000 on a discretionary trust for the benefit of his grandchildren on 1 February 2016. He allocated 50% of his SNRB to this trust.

On 14 March 2024, the trustees decide to pay £50,000 to one of the trust beneficiaries who agreed to settle any resulting IHT.

The chargeable amount is:

	£
Initial value settled	850,000
Less: Allocated SNRB (50%)	162,500
	£687,500
IHT @ 6%	£41,250
This gives a settlement rate of: 41,250/850,000 x 100	4.853%
The tax on this absolute capital appointment is: 4.853% x 32/40 = 3.882% x 50,000	£1,941

This is due for payment on 1 October 2024.

Illustration 2 (10-year anniversary charge)

On 3 June 2015, Robert settled £500,000 on a life interest trust for his brother. Robert allocated 35% of his SNRB to this settlement.

The value of the relevant property on 3 June 2025 is £720,000.

The chargeable amount is:

	£
Value of settled property in 2025	720,000
Less: Allocated SNRB (35%)	113,750
	£606,250
IHT @ 6%	£36,375

The tax of £36,375 is payable by the trustees on 1 January 2026.

Illustration 3 (exit charge between 10-year anniversaries)

On 1 August 2015, Alastair settled a portfolio of quoted shares worth £300,000 on a discretionary trust for the benefit of his godchildren. The value of the relevant property in the trust at the time of the first 10-year anniversary (1 August 2025) was £550,000. Alastair allocated 20% of his SNRB to this trust.

The chargeable amount is:

	£
Value of settled property in 2025	550,000
Less: Allocated SNRB (20%)	65,000
	£485,000
IHT @ 6%	£29,100

This gives a settlement rate of:
29,100/550,000 x 100 = 5.291%

Alastair added cash of £100,000 to the trust on 1 July 2027. Subsequently, the trustees made an absolute capital appointment of quoted shares worth £45,000 to one of Alastair's godsons on 1 September 2030. The godson agreed to pay any tax due.

The effective rate of an exit charge which follows a 10-year anniversary is governed by S69 IHTA 1984 and is based on the rate which applied at that 10-year anniversary (and adjusted for the number of complete successive quarters which have elapsed since then). Any addition of relevant property to the trust fund between the 10-year anniversary and the exit charge has to be included in a recalculation of the tax rate and is valued at the date of the addition. This gives the revised settlement rate.

Thus:

	£
Value of settled property in 2025	550,000
Add: Addition to trust in 2027	100,000
	650,000
Less: Allocated SNRB (20%)	65,000
	£585,000
IHT @ 6%	£35,100

The revised settlement rate is:

35,100/650,000 x 100	=	5.4%

The tax on the absolute capital appointment to the godson (which is assumed to come out of the originally settled property) is:

5.4% x 20/40 = 2.7% x 45,000	=	£1,215

This is due for payment on 1 April 2031. Not the most straightforward of IHT calculations!

Apart from the nil rate band change, it seems clear that the other proposals dealing with the calculation of IHT on relevant property trusts, which were included in last year's consultation document, are going ahead. The main ones are that:

(i) the settlor's cumulative total of chargeable transfers effected in the seven years prior to the making of any settlement will be disregarded;

(ii) it will not be necessary to take into account the initial value of any property in a related settlement (ie. other property which was settled on the same date but in another trust); and

(iii) a flat tax rate of 6% will be used for all 10-year anniversary and exit charges.

Contributed by Robert Jamieson

Administration

Cataclysmic decline and clarity of TTP agreement

Summary – The FTT agreed with the taxpayer’s contention that a valid TTP arrangement existed

The taxpayer was a 50% partner in a commercial estate agency that suffered financial difficulties because of the fall in the property market. On 20 January 2010, his adviser called HMRC to say the taxpayer could not pay the tax due on 31 January. He suggested that a time-to-pay arrangement be made allowing the taxpayer to pay the sum in £2,000 instalments over 28 months. HMRC said an inspector would have to agree the plan because it exceeded one year, but said the taxpayer should make the initial payment on account. The taxpayer continued to make monthly payments but HMRC said the arrangement was never formally agreed. The department issued late payment surcharges against which the taxpayer appealed.

Decision:

The First-tier Tribunal noted that a conversation about the taxpayer's inability to pay the tax in full had taken place in January 2010 as a result of which HMRC allowed an informal time-to-pay arrangement to operate. The department did not formally review the taxpayer's case until October 2011, when the taxpayer was selling his house to clear the debt. The tribunal decided that this supported the contention that HMRC were “broadly happy” with the plan on the basis that regular payments were better than none. The judge concluded the taxpayer had taken these steps with the expectation that he would not then be subject to surcharges on his tax liability. The judge concluded in addition that the taxpayer had reasonable excuse for the late payment because there had been a “cataclysmic fall-off” in his trade. This fell in the category of “exceptional”.

The taxpayer's appeal was allowed.

Comments – A TTP arrangement is very important as it gives the taxpayer more time to make payments in circumstances which require it. It is essential that the terms of the arrangement are clear and agreed between the parties. It is also another useful example of what will be regarded as exceptional by the Tribunals.

R Campbell v HMRC TC3628

Interdepartmental confusion over advice gives reasonable excuse

Summary – The Tribunal found in favour of the taxpayer who had been misinformed by another Government department over the tax status of a payment and therefore had a reasonable excuse

The taxpayer received a state pension lump sum from the Department for Work and Pensions. She said the department told her it was paid net of tax. She included the payment on her 2011/12 tax return which she filed in September 2012.

HMRC took the view that the sum was gross and assessed the taxpayer to tax on it. She appealed against the assessment believing no further tax was due. In April 2013, HMRC contacted the DWP and told the taxpayer that they could not settle the matter until the DWP confirmed the tax status of the payment.

It was not until August 2013 that the DWP replied, saying it had not deducted tax from the payment, despite having told the taxpayer that it had. She accepted that tax was therefore due on the sum, but not the penalties HMRC had, in the meantime, imposed for late payment.

The dispute proceeded to the First-tier Tribunal.

Decision:

The judge said it was reasonable for the taxpayer to believe that the tax was not payable until the DWP confirmed whether the payment had been made gross or net. Having been told that the tax was correctly assessed, she paid it within a short time.

The tribunal decided the taxpayer had a reasonable excuse for the late payment and discharged the penalty.

Comments – Although it might seem obvious to tax practitioners determining whether a payment is paid gross or net is fundamental to the tax liability arising from a particular payment. In this case the taxpayer sought advice from the Government department paying and they got it wrong. Quite rightly the tribunal decided the taxpayer had a reasonable excuse for the late payment and discharged the penalty.

P D Spink v HMRC TC3651

Facts, facts, facts

Summary - It may be an obvious statement, but the importance of getting the facts right came to fore in Wragg.

The taxpayer worked as an employee of various firms specialising in digging tunnels. He lived in Liverpool but between 2006/07 and 2008/09 he worked in the south east, on separate projects each of which was for a year or less. The taxpayer claimed relief under ITEPA 2003, s 338 for his travel and accommodation costs because he was working on different main sites for periods of less than two years.

HMRC did not allow the claim because, the taxpayer's then representative confused the facts by rolling together the assignments to the effect that he had worked more than two years on the same project.

During an adjournment for lunch, the taxpayer provided clear information to confirm that the assignments were unconnected. HMRC immediately conceded that the appeal should be allowed.

Decision:

The tribunal judge applauded HMRC for making the concession and confirmed that “no fault of any sort” attached to the department.

Comments – One of the statements which oft repeated amongst tax professionals is the importance of the case before the FTT as a finding of facts cannot be overturned in superior levels of the Court system of appeal. Establishing the correct facts is integral to this. Often in cases recently HMRC have been found wanting and therefore the tribunal judge applauded HMRC for making the concession and confirmed that “no fault of any sort” attached to the department.

C Wragg v HMRC TC3679

Penalties for late filing and posting

Summary - The FTT allowed the taxpayer's appeal against penalties for late filing of CIS returns.

Mr Oddy was registered under the CIS and had been issued a penalty for late filing. He disputed the penalty, arguing that the return had been posted in good time. He was then issued several more penalties for late return. He demanded the production by HMRC of date stamped returns, but never obtained them. In its review letter, HMRC explained that returns were logged on the day of receipt and suggested that the issue may be caused by Royal Mail. No reason was given for not providing date stamped copies.

Decision:

The FTT noted that, in the absence of evidence of the date of receipt of the returns, HMRC's assertions must be weighed against the appellant's assertions. The FTT also found Mr Oddy to be an honest and credible witness with an excellent record of filing on time.

Comments - The FTT refused to accept HMRC's log-in date as evidence of the date of receipt and was prepared to rely on the taxpayer's excellent track record as evidence that he must have posted the returns on time.

Christopher Michael Oddy v HMRC TC3796

Negligent conduct and legitimate expectation

Summary - The FTT found that the taxpayer's accountant had been negligent and that a reassurance given by HMRC had not given rise to a legitimate expectation.

Mrs Rotberg had made disposals of shares on which she had claimed rollover relief. HMRC amended her return on the basis that the relief was not available. However, her accountant had a file note evidencing a conversation with HMRC, during which he had received confirmation that rollover relief would be available.

Decision:

The first issue was whether HMRC had been entitled to make a discovery assessment under TMA 1970 s 36(1) on the basis that Mrs Rotberg (or her accountant Mr Michell) had been negligent. The FTT found that Mrs Rotberg's reliance on Mr Michell had been reasonable, as there had been no indication that he was unable to advise her appropriately. However, Mr Michell had been negligent. The FTT pointed out in particular that shares are 'conspicuous by their absence' from the rollover provisions (TCGA 1992 s 155). Furthermore, nothing in the guidance notes accompanying tax returns suggested that a disposal of shares which may be subject to a rollover relief claim should not be included. Mr Michell had therefore not met the standard of the ordinarily competent tax adviser which he purported to be.

The second issue was whether Mrs Rotberg had a legitimate expectation as a result of the conversation between Mr Michell and HMRC. Referring to Aspin [1987] STC 723, the FTT held that the jurisdiction of the FTT in direct tax cases is limited to considering the application of the tax provisions themselves. There is therefore no jurisdiction for the FTT to apply the public law principle of legitimate expectation, 'even in a case where a relevant degree of assurance is provided before the event and the taxpayer has done something to his detriment' (in this case not claiming EIS) in reliance on that assurance. The FTT added that, in any event, the confirmation provided by HMRC to Mr Michell fell 'well short of the threshold at which a legitimate expectation could be regarded as having been created'.

Comments - The FTT admitted reaching its conclusion 'without enthusiasm'. Mrs Rotberg was faced with a considerable tax liability, which she could have avoided had she been advised to claim EIS within the deadline. It was also regrettable that her accountant was given such blatantly wrong advice by HMRC.

Karen Rotberg v HMRC TC3780

Jurisdiction of the UT

Summary - The UT held that it had no jurisdiction to hear an appeal from the FTT.

Mr Tindale had appealed against an assessment treating him as self-employed, rather than employed, with the effect that he had lost any credit for tax deducted (or which should have been deducted) under PAYE.

The FTT had found against the taxpayer on the mere basis that the tax paid under PAYE far exceeded any tax due under the assessment and so it was 'just and reasonable' to dismiss the appeal to prevent such a windfall.

Decision:

Referring to Carrimore (1944) 26 TC 301 and Arranmore Investment (1973) STC 195, the UT stressed that it would only have jurisdiction (under TMA 1970 s 33(4)) if the dispute related to the proper method of calculation of pro fits or income.

The FTT's decision was not based on the quantification of Mr Tindale's income, and so there could have been no error of law by the FTT 'in connection with the computation of pro fits'.

Comments - Although the UT concluded that it did not have the jurisdiction to hear an appeal which was not concerned with the computation of pro fits, it did recommend the avenue of judicial review.

Philip Graham Tindale v HMRC (FTC/113/2013)

Obligation of HMRC to disclose employment records

Summary - The High Court ordered HMRC to provide employment history in relation to an asbestos claim.

HMRC had taken the view that it could not lawfully disclose HMRC employment schedules, outside the scope of issued court proceedings, in respect of persons who had died of asbestos diseases. This meant that intending claimants could not obtain the employment histories needed to be able to identify and sue the correct tortfeasors. The High Court listed this hearing as a sample case. HMRC contended, relying on CRCA 2005 s 18, that it could not disclose any employment history, as such information was held in connection with its function.

HMRC also argued that the Data Protection Act 1998 ss 7 and 8 did not assist, as either the data did not constitute 'personal data' since it related to a deceased individual, or the purpose for which the data was sought was not covered by the Act.

Decision:

The court noted that the Deregulation Bill due to come into effect at the end of 2014 should allow HMRC to disclose employment schedules in relation to at least some asbestos claims and decided to order HMRC to disclose in the meantime.

Comments - This is yet another case (following Privacy International [2014] EWHC 1475) in which HMRC struggled with the requirement to disclose to third parties. Hopefully, in the confined realm of asbestos cases, the Deregulation Bill will clarify the position, but this will leave everything else in a haze of uncertainty.

Christine Yates v HMRC (HQ14X00565)

Business Taxation

IR35 developments (Lecture B846 – 10.14 minutes)

Any hopes of a major relaxation of the implementation of IR35 have surely now disappeared. All HMRC has done in response to criticism from the House of Lords Select Committee is to amend their guidance in a revised version published on 17 June 2014 .

Select committee's findings

The key initial concerns, the findings and other points made by the select committee were:

- Compliance with the IR35 rules demanded a great deal of time and effort.
- HMRC were trying to apply an outdated method of taxation to a new, emerging way of working.
- The abolition of IR35, although attractive, would be unwise providing the amounts of tax that HMRC stated were at risk were accurate. The claim is that the at risk amounts total £550m but that was suspect as it is based on estimates and needed more robust work to establish their veracity.
- The current structure and rates of income tax and NICs provided an incentive for taxpayers to arrange their financial affairs in order to minimise the amount of tax and NICs paid which has led to complex legislation such as IR35. In the committee's view, the government should "re-examine the longer-term case for combining taxes on income and NICs".
- The questions asked about PSCs on the self-assessment form (SA100) were a missed opportunity to "raise awareness of the potential tax consequences of operating through a personal service company" and in many cases were not answered by taxpayers.
- HMRC were not allocating enough resources "sufficient to ensure compliance with the IR35 legislation". This meant that IR35 was not operating as a sufficient and effective deterrent and many taxpayers were taking a risk and ignoring the legislation.
- There was insufficient guidance provided by HMRC for those operating through PSCs, although the introduction of the business entity tests and the IR35 forum had improved matters.

HMRC guidance published 17 June 2014: INTERMEDIAIRIES LEGISLATION (IR35) – WORKING THROUGH AN INTERMEDIARY, SUCH AS A PERSONAL SERVICE COMPANY

Much of the 19 page guide covers how to calculate and pay the liabilities when IR35 does apply. However there are some new aspects covered as follows:

1. HMRC operate a free and confidential IR35 Helpline and Contract Review Service. Conversations are confidential and your identity can be kept secret.

2. Any information received is not shared with HMRC compliance teams. The Contract Review Service can look at existing contracts only. HMRC provide a unique reference number if they decide the contract is outside IR35 via a risk-based approach and that is valid for 3 years subject to any changes in circumstances that may take place.

3. Before seeing whether IR35 applies to a contract, consider the agency legislation and managed service company legislation as they take precedence.

4. Consider using the Business Entity Tests which should indicate whether risk-assessed as low risk; medium risk; or high risk.

5. If those tests indicates that the low-risk band applies this can help in the event of any HMRC enquiry. You should retain your evidence of that test result as it is not automatically searchable.

The 12 tests and their scores

1. **Business premises test** - Does the business own or rent business premises separately from the contractor's home or end client's premises? (10 points if yes)
2. **PII test** - Does the contractor need professional indemnity insurance? (2 points if yes)
3. **Efficiency test** - Has the business had the opportunity in the past two years to increase its revenue by working more efficiently? (10 points if yes)
4. **Assistance test** - Does the business employ any workers who bring in at least 25% of the yearly turnover? (35 points if yes)
5. **Advertising test** - Has the business spent over £1,200 on advertising in the past year? - entertainment does not count as advertising (2 points if yes)
6. **Previous PAYE test** - During the past year, has the end client engaged you with no major changes to your working arrangements? (Minus 15 points if yes)
7. **Business plan test** - Does your business have a business plan with a regularly updated cash flow forecast, and does it have a business bank account, identified by the bank as such and separate from your personal account? (1 point if yes to both parts of the question)
8. **Repair at own expense test** - Would the business have to bear the cost of rectifying any mistakes? (4 points if yes)
9. **Client risk test** - During the past two years, has the business been unable to recover payment amounting to more than 10% of yearly turnover? (10 points if yes)
10. **Billing test** - Does the business invoice for work carried out before being paid and negotiate payment terms? (2 points if yes)
11. **Right of substitution test** - Does business have the right to send a substitute? (2 points if yes)
12. **Actual substitution test** - Has the business hired anyone in the previous two years to do the work it has taken on? (20 points if yes)

Risk assessment

The scores used to assess risk profiles are:

Less than 10 points = ***High risk***
10-20 points = ***Medium risk***
More than 20 points = ***Low risk***

Contributed by Gerry Hart

Tax relief on sponsorship costs (Lecture B847 – 7.28 minutes)

The Court of Appeal found for HMRC in the duality of purpose case of ***Interfish Limited v HMRC*** (decision published 27 June 2014). They rejected the taxpayer's appeal in a unanimous decision, and clearly the interpretation of the wholly and exclusively rule in Section 54 CTA2009 is as strict as ever with no account taken of the changes in the business world since this basic tax rule was introduced.

Where there is duality the entire expenditure is disallowed unless any of the following applies:

1. the private aspect is merely incidental to the main business purpose: or
2. the expense can be properly apportioned between private and business (e.g. motor expenses); or
3. statutory tax rules allow a deduction for part of the expense; or
4. HMRC practice allows a deduction for part of the expense (subject of course to a possible and successful attempt by HMRC to subsequently overturn that)

Interfish Limited v HMRC UKUT 0336

Sponsorship is usually categorised as advertising and promotion in the company's accounts. In addition, as long as the sponsorship payments do not also benefit the managing director's personal hobby, or those of his family, it has generally been regarded as tax deductible.

Interfish is a successful seafood supplier based in Plymouth that donated over £1m to its local rugby club Plymouth Albion. The company gave cash to the club at different times, with the money being used to prop up the club financially and later to buy better players.

It was held by the FTT that Interfish should not be allowed to deduct its sponsorship payments for tax purposes as its intention to help the club buy players did not meet the requirement of "wholly and exclusively... for the purposes of the trade".

The company failed in its appeal to the Upper Tax Tribunal with the main points being:

- Cash was donated by Interfish to the Club at different times - initially it was used to prop up the club financially and then specifically to purchase higher quality players. Mr Colam, its managing director, had already acquired shares in the Club and was able to assert influence at board level. This also assisted the Club.
- Mr Colam in giving evidence at the original hearing before the First Tier Tribunal said that making the payments to Plymouth Albion was beneficial to Interfish in various ways. As well as providing visible promotion he also described the Club as 'one of the most, if not the most, influential business meeting place in Plymouth'.
- Mr Colam got to know, amongst other people "on the best table" at events and functions there, a NatWest bank manager who served on the club's board. NatWest subsequently lent funds to Interfish, when other banks had already turned the company down. Mr Colam said that he felt that his company's involvement with the club had "opened doors' within NatWest and the Plymouth business community.

- The essential issue was that Interfish accrued significant but immeasurable benefits as a sponsor - but were these a commensurate return on expenditure of £1.2 million?
- The FTT thought that it was "unrealistic to assume that the NatWest credit committee were influenced to fund an unduly risky venture because Interfish was the benefactor of Plymouth Albion Rugby Club."
- They found that advertising could have been obtained at the Club's published rates for about £10,000, although they noted the argument based on the dictum of Lord Reid in ***Ransom v Higgs 50 TC 1*** that "if a trader is actuated by none but commercial motives, the Crown cannot merely say he has paid too much".
- The competing purposes of the payments appeared to be achieving benefits for Interfish and furthering Mr Colam's private interest in the Club. However, the FTT and UTT focused on who really benefited from certain payments made by Interfish which were applied directly by the club to purchase players. They considered that these specific payments did not meet the requirement of 'wholly and exclusively ... for the purposes of the trade' as required by Section 54 CTA 2009. The payments benefitted the club, so there was duality of purpose.

Court of Appeal comments

There were two purposes found in this case, and one of those was not the purpose of the taxpayer's trade. There is no authority for distinguishing between the two purposes by assessing one as being intermediate or subordinate to the other. The purpose of meeting the financial needs of Plymouth Albion Rugby Club could not be described as incidental, so could not be ignored.

They approved of the comment made by the FTT Judge:

> *"The outcome will be different only if there was a rule that a purpose that is pursued with a view to an ulterior purpose somehow drops out of the picture, but such an approach would be inconsistent with the nature of the exercise prescribed by the authorities, namely, that of identifying the purpose or purposes being pursued".*

The way ahead for success?

Whilst clearly a worrying case at the all-important Court of Appeal level, presumably if Interfish had just made smaller payments and had no influence on the way that the Club used them there may well have been no duality of purpose. Splitting the payments appropriately may also have helped their case, so as to avoid duality on some of the payments made.

Leaving that aside, the decision must cast doubt on the tax deductibility of sponsorship payments as there will often be an element of dual purpose.

Contributed by Gerry Hart

And there goes McLaren – a fine imposed by governing body

Summary – The UT found that a penalty paid by McLaren was not deductible

McLaren, the Formula One motor racing team, had, by entering the 2007 world championship (and the Concorde Agreement), expressly agreed to be bound by the regulations of the Federation International de l'Automobile and the International Sporting Code. The World Motor Sport Council found McLaren guilty of spying on Ferrari, a rival Formula One team, and had imposed a £32m penalty for breach of the code. The key issue was whether the penalty had been incurred 'wholly and exclusively' for the purpose of McLaren's trade (ICTA 1988 s 74), which in turn depended on whether cheating was part of its trade. By casting vote of the judge, the FTT had allowed McLaren's appeal against HMRC's decision not to allow the deduction of the penalty.

Decision:

The UT overturned the FTT's decision, noting that although obtaining information on competitors was part of McLaren's trade, cheating was not. Any competitive advantage resulting from the obtaining of the information was liable to be (and indeed was) cancelled by the loss of points and the penalty. Although the tribunal accepted that the penalty was paid to allow McLaren to remain in the world championship, the main reason for the penalty was the satisfaction of a legal obligation arising as a result of activities which were not in the course of McLaren's trade.

Comments - The decision may be relevant to any business liable to a fine imposed by a professional body. It suggests that a breach of the rules imposed by such a body is intrinsically outside the trade, so that any resulting penalty is not deductible.

McLaren Racing Ltd v CRC, Upper Tribunal

Set-off of trading losses

Summary - The FTT found that a loss-making chartering business was carried on with a view to profit.

The main activity of the company was the construction and management of property. However, its director decided to branch out into the boat chartering business and, after an 18 month search, purchased a 92 foot yacht aptly called Supertoy.

Although the chartering rates were high, an expensive refurbishment programme meant that the business only became profitable after three years, in 2001. Unfortunately, in 2003 Supertoy suffered a 'catastrophic engine failure' leading to huge repair and legal costs.

The issue was the allowability of the losses of the chartering business. This, in turn, depended on whether the chartering business had been carried on with a view to profit (ICTA 1988 s 393A and CTA 2010 s 44).

Decision:

The UT, referring to Glapwell [2013] UKFTT 516, observed that this was an objective test requiring 'a realistic possibility' of profit. The FTT added that the legislation does not impose any time limit.

The UT pointed out that the business had been carried out on a commercial basis. The significant losses could be explained by the need to re fit the yacht and the engine issues. More importantly, the FTT noted that charters had been agreed for 2014 and that the yacht was marketed and managed through professional charter agents.

Comments - When deciding whether the yacht had any prospect of bringing in profits, the FTT allowed itself the benefit of hindsight by noting that in 2014 profits seemed a real possibility.

Beacon Estates (Chepstow) v HMRC TC3808

Preparing your practice for Auto Enrolment (Lecture B848 – 10.47 minutes)

Key steps for employers

The Pensions Regulator http://www.thepensionsregulator.gov.uk lists the following key events for employers preparing for auto enrolment, in the "Action Plan for Auto Enrolment" tool.

These auto enrolment online seminars will look at each stage in more detail, but in thinking about service provision you will need to consider the work needed in the context of very small employers, and particularly those with under 30 employees. This will help you plan the level of service you intend to provide for your clients.

- Know your staging date
- Nominate a contact
- Develop initial plans
- Know your workforce
- Check processes and software
- Review pension arrangements
- Communicate to your staff
- Things to do on the staging date
- Enrolling eligible jobholders
- Registration
- Keep records
- Ongoing responsibilities

Issues for practices

Research by the Pensions Regulator indicates that around 75% of very small businesses intend to rely wholly on their accountant for help with auto enrolment. CEBR estimates that the cost for an employer with 1 – 4 employees of setting up the necessary systems to operate auto enrolment is £9,100.

This is the cost to get the business into a position of being able to start deducting contributions. In addition, even if all of the employees opt out, these costs must be borne, as employees are auto enrolled and then permitted to opt out.

Financial advice

Helping a client to choose the right pension product for his business and workers **does not** come within the definition of financial advice, as FCA regulation covers only advice to individuals. However, the liability issues associated with helping a client to choose a pension scheme are very significant indeed, and most firms will not wish to advise outside their competence. If this is your firm's decision, you will need the services of an IFA.

One of the early decisions to take is whether your firm will provide advice about an appropriate product, or will link with an IFA to provides a seamless service to your clients, or whether you will ask clients to source their own financial adviser. In deciding whether to undertake financial advice about pension arrangements you will need to check whether your PII cover extends to giving advice of this nature, and also whether you believe that you have staff with the required skills and training to deliver such advice.

If you are linking with an IFA, your firm will need to contact the financial adviser early to agree how much lead time they will need to dovetail advice about appropriate schemes into the whole preparation plan. The IFA will also be able to advise how much notice the various pension providers may need to implement a scheme. Current estimates are around six months, so those clients staging early in 2015 will need to start making preparations in the autumn of 2014.

You should also be aware that some pension providers are not prepared to deal with much smaller schemes, with one provider limiting business to schemes generating £6,000 per month in contributions, and others unwilling to accept business below £2,000 per month in contributions. At the level of contributions required initially, this equates to gross pay in the payroll of between £100,000 and £300,000 per month.

The role of NEST

NEST (National Employment Savings Trust) is the Government backed scheme provider aimed at the small business sector. Their website is www.nestpensions.org.uk

NEST provides a simple and easy system which will be administratively simple for small employers to operate, and for members to understand. However, if you are concerned not to provide financial advice for professional reasons, then you should not recommend NEST to your client businesses, as this represents investment advice.

If your client has already selected NEST as their pensions provider, it is a good idea to include a statement of this in the letter of engagement that you prepare for advice on auto enrolment, so that it is clear that your advice is based on their previous decision to use NEST as a provider.

Engagement letters

Because this area is so complex, it is advisable to issue a separate letter of engagement , setting out the services you intend to provide to your client in helping them with auto enrolment. If any of these services rely on information coming from your client, setting deadlines for these responses is also advisable, so that clients understand how their tardy responses may impact on the business readiness for the start of auto enrolment.

Workload volumes

The Pensions Regulator has published data to indicate how many employers in the medium sized down to micro categories will be staging over 2015 to 2018. The latest information (based on data provided by HMRC regarding employer numbers on 1 April 2012) is as follows.

Employer size	Quarter (financial year)	Forecast volumes
Medium employers, 50-249 people	Q1 2014/15	15,900
	Q2 2014/15	11,500
	Q3 2014/15	1,200
	Q4 2014/15	3,400
Small and micro employers, < 50 people	Q1 2015/16	17,100
	Q2 2015/16	9,700
	Q3 2015/16	16,100
	Q4 2015/16	110,000
	Q1 2016/17	101,000
	Q2 2016/17	133,000
	Q3 2016/17	168,000
	Q4 2016/17	215,000
New employers	Q1 2017/18	178,000
	Q2 2017/18	137,000
	Q3 2017/18	131,000
	Q4 2017/18	87,000
Total		1,334,900

Planning service provision

Apart from ensuring that staff is adequately trained to observe the requirements of money laundering reporting (many of the offences under the auto enrolment legislation will require a report) it is up to each firm to decide how they wish to provide services to clients. The following broad areas might be considered:

- Minimal service only : processing deductions through payroll and onward transmission of data to pension provider
- Support to staging date : covering all steps necessary to get the client ready to stage, including advise about which staff are affected by AE, helping with classifying staff and calculating pay for this purpose, support with communication to both Pensions Regulator and staff.
- Support with choice of pensions provider, with or without the help of an IFA
- Ongoing support after staging : helping client monitor changes in the status of staff, dealing with opt in and opt out, re-enrolling opt out, processes for joiners, communications with staff and pension provider.

Once you have established the level of service you wish to provide to clients, you will then be able to plan the resources that you will need in terms of both staff and software. Products are presently available, but there are likely to be more AE products coming to the market soon, many of which will be designed for the smaller employer market.

There is also a group called "Friends of Auto Enrolment" which is a subgroup of CIPP (Chartered Institute of Payroll Professionals). This group is working with pension providers and software houses to develop a single data standard for the transfer of data between payroll and employers to pension providers. This will allow standard payroll products to be used with any pension provider rather than needing to use "middleware" of a variety of types for a range of pension providers. Their website is www.friendsofae.org.uk and membership is free of charge.

Professional Indemnity Insurance

If your firm is to provide advice about the choice of pensions provider, you will also need to check the position regarding insurance cover. Your current insurance may not cover such advice, and you will need to ensure that your insurers are aware of the extra range of services and duties you will be providing to your clients.

Key action points

- Decide within your firm whether you are to offer a service to clients to help them prepare for auto enrolment
- Discuss and decide about the advice regarding choice of pension adviser. Is an external IFA to be involved? Is the client to be asked to source this advice separately? Check your insurance position regarding your chosen route.

- Start thinking about staffing resource depending on how many clients are likely to seek your support. Think about staff training and whether you may wish to recruit additional staff.
- In particular, even if you are not supporting clients with auto enrolment, you will need to consider the impact on any payroll services that you provide. It is likely that the start of auto enrolment will entail more work in running payroll in both handling deductions and passing information over to pension providers. It will also be necessary to advise employer clients of the amounts they need to pay over to the pension provider and by what date.

Contributed by Rebecca Benneyworth

Making a start with your client - Staging dates (Lecture B849 – 8.26 minutes)

Main staging dates

The main staging dates for employers are determined by reference to the number of employees in the PAYE scheme as at **1 April 2012**. Employers who registered their PAYE scheme after that count as new employers and will not stage until May 2017 at the earliest.

Table 1: List of staging dates by PAYE scheme size or reference; employee numbers as at 1 April 2012

PAYE scheme size or reference	Staging date
61	1 August 2014
60	1 October 2014
59	1 November 2014
58	1 January 2015
54-57	1 March 2015
50-53	1 April 2015
40-49	1 August 2015
30-39	1 October 2015
Fewer than 30 with the last 2 characters in their PAYE reference numbers	
92, A1-A9, B1-B9, AA-AZ, BA-BW, M1-M9, MA-MZ, Z1-Z9, ZA-ZZ , 0A-0Z, 1A-1Z or 2A-2Z	1 June 2015
BX	1 July 2015
BY	1 September 2015
BZ	1 November 2015
02-04, C1-C9, D1-D9, CA-CZ or DA-DZ	1 January 2016
00 05-07, E1-E9 or EA-EZ	1 February 2016
01, 08-11, F1-F9, G1-G9, FA-FZ or GA-GZ	1 March 2016
12-16, 3A-3Z, H1-H9 or HA-HZ	1 April 2016
I1-I9 or IA-IZ	1 May 2016
17-22, 4A-4Z, J1-J9 or JA-JZ	1 June 2016
23-29, 5A-5Z, K1-K9 or KA-KZ	1 July 2016
30-37, 6A-6Z, L1-L9 or LA-LZ	1 August 2016

N1-N9 or NA-NZ	1 September 2016
38-46, 7A-7Z, O1-O9 or OA-OZ	1 October 2016
47-57, 8A-8Z, Q1-Q9, R1-R9, S1-S9, T1-T9, QA-QZ, RA-RZ, SA-SZ or TA-TZ	1 November 2016
58-69, 9A-9Z, U1-U9, V1-V9, W1-W9, UA-UZ, VA-VZ or WA-WZ	1 January 2017
70-83, X1-X9, Y1-Y9, XA-XZ or YA-YZ	1 February 2017
P1-P9 or PA-PZ	1 March 2017
84-91, 93-99	1 April 2017
Fewer than 30 unless otherwise described	1 April 2017
Employer who does not have a PAYE scheme	1 April 2017

Table 2 : Staging dates for employers who started their PAYE scheme after 1 April 2012

Date PAYE income first payable	**Staging date**
Between 1 April 2012 and 31 March 2013	1 May 2017
Between 1 April 2013 and 31 March 2014	1 July 2017
Between 1 April 2014 and 31 March 2015	1 August 2017
Between 1 April 2015 and 31 December 2015	1 October 2017
Between 1 January 2016 and 30 September 2016	1 November 2017
Between 1 October 2016 and 30 June 2017	1 January 2018
Between 1 July 2017 and 30 September 2017	1 February 2018

Staging date tool

If employers are not sure of their staging date, the Pensions Regulator site provides a staging date look up tool at

http://www.thepensionsregulator.gov.uk/employers/tools/staging-date.aspx

The employer will need to enter the PAYE scheme reference and the staging date will be displayed.

Bringing forward a staging date

If an employer wishes to bring forward their staging date to tie in with a financial year end or for other reasons, this can be done online, through the same portal as is used for registration with the Pensions Regulator. The employer must select one of the available staging dates, and not all dates are available.

Conditions for bringing the staging date forward

To bring the staging date forward, the employer must:

- have an existing staging date.
- have contacted a pension scheme that is to be used to comply with the employer duties and secured the agreement of the trustees or managers, provider, or administrator of the scheme, that the scheme will be used to comply with those duties from the new (earlier) staging date.*

- notify The Pensions Regulator in writing (online, or by letter, fax or email) at least one calendar month before the new (earlier) staging date providing the following information:
  - Employer name.
  - Employer PAYE scheme reference(s) e.g. 123/4AB.
  - The new (earlier) staging date chosen and the original staging date.
  - Employer's address (including postcode) and email address.
  - The name of the owner or most senior accountable person at the employer (optional).
  - Companies House registration number or equivalent, e.g. registered charity number, VAT registration number or industrial provident society number.
  - A declaration from the employer that they have contacted a pension scheme and have obtained the agreement of the trustees or managers, provider, or administrator, that the scheme can be used to comply with the employer duties from the new (earlier) staging date.
  - Your name (applicant), job title within the organisation and contact telephone number, email address and business address.
  - A declaration that the applicant is authorised to apply for a change of staging date.

* It should therefore be clear that a decision to bring forward the staging date can only be made after the scheme provider has been selected, otherwise the necessary confirmation cannot be secured. So although clients may de3cide to bring forward their staging date, the notification cannot be made until they have chosen a pension provider and indicated that they will be seeking an earlier staging date. At the initial contact, the provider will not be aware of the required staging date, so it will simply be a matter of advising the staging date that has been selected and asking for confirmation from the provider that this is appropriate.

Available dates for staging

The dates which can be selected are:

2014	2015	2016	2017
1 August	1 January	1 January	1 January
1 October	1 March	1 February	1 February
1 November	1 April	1 March	1 March
	1 June	1 April	1 April
	1 July	1 May	1 May
	1 August	1 June	1 June
	1 September	1 July	1 July
	1 October	1 August	1 August
	1 November	1 September	1 September
		1 October	1 October
		1 November	1 November

Plus 1 January 2018.

Postponing auto enrolment

Employers are permitted to postpone auto enrolment start date by up to three months for some or all of their employees. However, **this does not alter the employer staging date**; it does delay the date that employees are actually enrolled in a scheme. Postponement can be used after staging to delay enrolling staff in a scheme who are going to leave the employment in under three months.

Dates from which the employer can use postponement

The employer is only permitted to postpone auto enrolment with effect from certain dates. These are:

- The staging date
- A staff member's first day of employment
- The date a staff member first becomes eligible for automatic enrolment.

How to postpone

The employer must write to tell the staff whose automatic enrolment has been postponed, within six weeks from the date postponement starts. It is possible to postpone only for selected staff, and it is acceptable to have different postponement periods for different staff. The Pensions Regulator provides a selection of standard letters to advise employees about postponement, and recommend the use of letter template 6 if the employer is postponing from the staging date for all staff.

http://www.thepensionsregulator.gov.uk/docs/Template_for_Letter_6_-_postponement_-_all_workers.doc

Note that using the template from the Regulator website will ensure that the financial limits are updated as appropriate, so you should not download the template too far in advance. The financial limits change whenever the tax or NIC thresholds change, so this will normally be on 6 April each year.

There is no need to inform the Pensions Regulator of postponement, but employer must be aware that postponing from the staging date does not alter the staging date.

What happens next?

Employees who have been postponed can opt into the pension scheme during the postponement period. If they give notice of opting in, the employer must enrol them in the scheme.

At the end of the postponement period the employer must enrol those employees who remain eligible for auto enrolment immediately. It is not possible to have a further postponement, even if the original postponement was for less than the three months permitted.

Further guidance on postponement

There is an A4 booklet (32 pages) giving more information for professional advisors. It is http://www.thepensionsregulator.gov.uk/docs/detailed-guidance-3a.pdf

Key action points

- As you assume responsibility for each client, it is worth discussing postponement in respect of seasonal staff. Arriving at a strategic decision for clients who take on extra staff on a seasonal basis may make auto enrolment much easier for those clients.
- Discuss with each client whether it is appropriate to bring forward a staging date to avoid staging at a particularly busy time for the business. For larger clients, bear in mind the time constraints associated with uploading data to pension provider systems around the staging date.
- Ensure that you have considered the staffing implications for your firm of clients staging at particularly busy times in the year, such as 1 February, when staff may be dealing with tax return clients in the run up to staging.
- If you are providing a full service to clients, you will need to start managing the workload, either by using specialist software or through the use of spreadsheets. You should start collating a list of clients and staging dates, adding notes about bringing forward or postponement so that those in charge of resourcing can identify what needs to be done.

Contributed by Rebecca Benneyworth

Getting started – nominate a contact and initial plans (Lecture B850 – 10.06 minutes)

Nominate a contact

Once an employer is within 12 months of their staging date, they will receive a letter from the Pension Regulator advising them to commence preparations. There will be a reference on this letter and employers can then nominate the contact for the Pensions Regulator.

Nominating a contact early means that the contact will receive emails periodically from the Regulator, advising them of the necessary state of preparations, and the next jobs they should be starting.

The link for nominating a contact is:

https://forms.thepensionsregulator.gov.uk/workplacepensionsreform/nominate.aspx

The primary contact

The employer is required to name the primary contact. This must be the most senior person within the employing organisation, for instance, CEO, managing director etc. This person will receive letters and also emails if no secondary contact is provided.

The secondary contact

It is also possible to nominate a Secondary contact. This is the person who will manage or implement enrolment, for instance, HR manager, pensions manager, accountant, IFS etc. This person will receive emails to help with the implementation, and will therefore be reminded of what needs doing and when.

External professional advisers may decide to nominate a member of their auto enrolment staff as the secondary contact so that they can keep track of the various employer responsibilities. However, it might also be useful to have a secondary contact at the business (for employers with several staff) so that the client is aware of what is happening.

The auto enrolment implementation team

Where the client has an HR professional in place, they will need to be involved in the initial planning, as must any member of payroll staff who will be dealing with the basic deductions. Other staff may need to be involved, including the management who may wish to make a decision about pension providers, and accounts staff who will handle the payment of contributions to the pension provider.

In practice, for a very small client, the adviser will probably assume most of these roles.

The resourcing of ongoing work after implementation should also be considered at this early stage. For example, is the client wishing to rely on the external adviser for follow up work such as repeated assessment of workers after staging, dealing with opt in and opt out and re-enrolling periodically those who have opted out and similar tasks.

Choosing a pensions provider and scheme

These early discussions will also involve identifying the route to choosing a pension provider – whether this is to be advice provided by your firm, an IFA or another adviser, or indeed whether the client has already made a decision about which pension provider to go with. The initial plans will need to allow around six months to get the pension arrangements set up.

Starting the process with the Pensions Regulator

As part of the preparations, the employer (or someone on his behalf) should log in to automatic enrolment registration online and start providing some of the information required. Information such as the employer address and PAYE reference can be recorded at the start, and other information added as it becomes available. The time to start this process is early, so that the ball is rolling and the registration date (three months after the staging date) is not missed.

When the pension scheme has been set up, the scheme information, including the employer pension scheme reference and the address can be added.

Payroll software

You will need to ensure that the payroll software used can handle deductions from employees pay, and also calculate and record the employer contributions for members of the pension scheme. It is likely that almost all payroll software will be able to do this successfully, but if you are offering a bureau service you may wish to check what your provider is doing about auto enrolment.

Software interface with pensions provider

The information that the pensions provider will need in order to run the scheme effectively is more detailed that (and probably in a different format to) that naturally provided as outputs by standard payroll software.

This means that either the payroll software will need to be upgraded to deal with appropriate outputs for auto enrolment – these outputs being pension provider facing, or the employer will need to invest in some additional software.

Some pension providers insist that the employer purchases and use specialist software provided by them for this purpose. This software is frequently known as "middleware", and this can be very expensive to purchase. Some pension providers charge £2,000 for this software.

Auto enrolment "management" software

The larger the employer is, the more challenging the job will be to monitor changes in worker status after staging, and ensure that the right actions are taken at the right time – such as re-enrolling those who have opted out, and monitoring employees who move through the various age limits.

You will therefore need to consider whether your firm (or indeed your clients separately) will purchase appropriate software to help manage this aspect of auto enrolment.

Questions to ask software providers

The Pensions Regulator guidance includes the following useful advice.

"You need to find out if your software can identify whether you have staff that you will need to automatically enrol. If you don't have access to the necessary software, you will need to get it. When speaking to your software provider or selecting new software, you should ask whether the system:

- assesses your workforce
- allows the use of postponement
- calculates pension contributions
- handles opt-in and joining
- handles opt outs and refunds
- supports you in generating and issuing letters to your staff
- keeps records and provide reports
- interoperates with some or all pension scheme provider systems."

Testing and data cleansing

The software and processes will need to be tested, but if as an adviser you are using the same systems for all clients, this can obviously be done once only. However, in addition, you will need to ensure that the client data is fully cleansed and accurate. Employers staging early have found this to be a particular issue, even where data had been cleansed for RTI.

The initial phase of this is scheduled for around 10 months before staging, with testing running around two months before staging.

Planning the employee assessment process

Strictly, assessment of workers is done at the staging date (or the deferral date if auto enrolment is postponed for some or all employees). However, the early planning can identify a suitable advance date to carry out a preliminary assessment, which can be reviewed as the staging date approaches. The final assessment must be made at the staging date, so planning for this work and the timing of it is important at this early stage.

More guidance

The detailed guidance for employers covering this area is in Guidance booklet #2 – "Getting ready", which is 37 pages long. The administrative preparations and processes information starts at page 22.

http://www.thepensionsregulator.gov.uk/docs/detailed-guidance-2.pdf

Key action points

Decide who within your firm will take responsibility for scheduling work on auto enrolment for the clients you are acting for

Decide whether a member of your firm's staff will be the secondary contact for some or all clients and advise clients accordingly, gathering contact details for clients (primary and optionally secondary) early, but not before 12 month point.

For each client, draw up a list of those who need to be involved in auto enrolment planning. As noted above, for very small employers it is likely that your firm will assume most roles.

Think about the purchase of management software to cover all of the auto enrolment responsibilities. Check with your own software providers to see what changes they are making to deal with auto enrolment.

Where clients do their own payroll work, you may need to ask them to check with their software provider that the changes needed to implement auto enrolment can easily be made.

Bear in mind that when the HMRC free Basic PAYE Tools software is in use for payroll, it is extremely unlikely that this will perform any AE functions at all, other than handling deductions through the payroll, so you will probably need to move to a commercial system before staging.

As soon as you have made progress in choosing a provider, you will need to establish what data the provider will need and in what form. It is worth checking which providers specialise in small employer AE schemes and whether they require the employer to purchase additional software. The Friends of AE project to establish a common data standard may mean that this task is simpler as time moves on.

Contributed by Rebecca Benneyworth

Status of distributions subject to an earn-out

Summary - The UT held that distributions subject to an earn-out remained in the beneficial entitlement of their holder.

Under a share purchase agreement, Bupa (the purchaser) was obliged to pay to Tawa (the vendor) an amount equal to any distribution as 'earn-out consideration'. The issue was therefore whether Bupa was beneficially entitled to the distributions for consortium relief purposes (ICTA 1988 s 403C).

Decision:

The UT observed that the beneficial entitlement referred to in s 403C could be held both directly and indirectly via another body corporate. This showed that 'beneficial entitlement' was a wider concept than 'equitable ownership'. The 'more than a mere legal shell' test applied to ascertain whether there was a 'beneficial' right of ownership. Bupa did not hold the distributions as constructive trustee and had more than a 'mere legal shell'. It was open to it to fund the earn-out by other means than the distributions it received. Furthermore, it was not realistic to treat the beneficial entitlement as being 'in suspense' or as resting with any other party.

Comments - This was an unusual case in that the issue was not whether shares were beneficially owned, but rather whether distributions were the result of a beneficial entitlement. The FTT confirmed that 'beneficial entitlement' is a wide concept which convers anything beyond a 'mere legal shell'.

Bupa Insurance v HMRC (FTC/27/2013)

VAT

Wrong category of FRS?

Summary – The Tribunal found that the taxpayer's choice under the FRS was incorrect

The taxpayer was a mechanical engineering company. The director decided to use the VAT flat rate scheme and, because there was no category appropriate to the company's range of services, decided to class it under "any other activity not listed elsewhere". HMRC said this was incorrect and deemed the right category to be "architects, civil and structural engineers, and surveyors". The taxpayer appealed.

Decision:

The First-tier Tribunal found that the company was involved in the field of mechanical engineering. The director was not a chartered engineer and did not have a university degree. He was a trained mechanical engineer which was distinct from a civil or structural one. The judge said there was an "obvious defining line between mechanical engineering and the other two categories of engineering activity mentioned". The flat rate scheme chosen by the taxpayer was appropriate.

The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: "This case is very worrying — HMRC have always tried to encourage taxpayers to join the flat rate scheme as a way of simplifying their VAT accounting records, and state in their guidance that they won't challenge a taxpayer's chosen category as long as a 'reasonable' choice was made.

"To make matters worse, HMRC originally charged the company a 35% penalty for a 'deliberate error not concealed' but this was reduced to 15% as a 'careless error' after an internal review by a different HMRC officer. The approach to adopt with the choice of category is clear: a business owner should consider how he would describe his business in everyday terms to someone he had just met at a party and this should form the basis of the relevant category. The company director would never have described himself as a civil engineer and, because there was no specific category for 'mechanical engineering', he was right to choose the default category of 'any other activity'."

Idess Ltd v HMRC TC3638

Fantastic VAT

Summary – The Tribunal found partly in favour of the taxpayer that there is a direct and immediate link to certain supplies

The Roald Dahl Museum paid VAT on certain costs incurred in refurbishing and maintaining exhibits. It said that the VAT should be treated as residual input tax for the partial exemption calculation because

the expenditure had a direct and immediate link to exempt supplies of admissions to the museum and taxable supplies made in the shop.

HMRC disagreed saying the VAT paid on the exhibition costs was linked solely to exempt admission sales.

Decision:

The First-tier Tribunal noted that it was common ground that the exhibit costs were linked to admissions. On the disputed link to the shop, the tribunal said the items in the shop could be sold anywhere, regardless of whether the museum exhibits existed. It agreed with HMRC that there was no link between the costs of maintaining the exhibits and the shop.

However, it did agree with the taxpayer that input tax on the cost of designing The Hut Book, which was sold in the museum shop, was allowable. The book was, the tribunal decided, an "integral part of the gallery display" because it explained to the visitors what they were looking at. This constituted a direct and immediate link to taxable sales.

The taxpayer's appeal was allowed in part.

Comments - Neil Warren, independent VAT consultant, said: "The outcome of this case shows that, even if a small link can be established between expenditure and taxable sales, the input tax will be at least partly recoverable. The link must be 'direct and immediate', a phrase that was first established in the world of partial exemption nearly 20 years ago, rather than indirect."

The Roald Dahl Museum and Story Centre v HMRC TC3445

Availability of partial exemption special calculation method

Summary - The UT dismissed HMRC's appeal against the decision of the FTT to allow a partial exemption special method (PESM).

The issue was whether Lok'nStore should have applied the standard method (based on turnover) to apportion its residual input tax, i.e. the input tax incurred on goods and services used to make both taxable and exempt supplies. The standard method must be used unless HMRC either approves or directs the use of a different method (VAT Regulations, SI 1995/2518, reg 102). A PESM must produce a fair and reasonable apportionment.

Lok'nStore provides self-storage facilities which are subject to the standard rate of VAT. It also provides insurance services which are exempt. Lok'nStore had appealed HMRC's rejection of its proposed PESM and the FTT had found in its favour.

HMRC argued that the FTT had used the 'direct link' test at the apportionment stage when it should have been used only at the attribution stage.

Decision:

The UT held that the FTT had been wrong, but that its application of the 'direct link' test made no material difference to its application of the correct economic test. This was because considerations which are relevant at the attribution stage may also be relevant when examining the economic use made of particular overheads at the apportionment stage. The UT also agreed with the FTT's finding that the overheads were used 'almost exclusively for the purpose of making supplies of storage'.

Finally, the UT rejected HMRC's 'attractive' proposition that the FTT had been wrong to adopt a method based on the physical use of the premises, which did not reflect their economic use. HMRC argued that the storage space had a dual function, including the generation of insurance income. The UT noted however that the insurance charged bore no relation to the volume of the goods stored and concluded that it was more accurate to concentrate on the part of the premises in which the insurance was sold.

Comments - Convincing HMRC that a PESM is appropriate is not always easy and the concept of 'economic use' is at times elusive. Yet it is this concept which was the guiding principle of the UT, leading it to accept a reference to the 'direct link' test at the apportionment stage. Unfortunately, there is not a 'one size fits all' approach.

HMRC v Lok'nStore Group (FTC/05/2013)

Are snowballs cakes?

Summary - The FTT found that snowballs were cakes.

Both appellants manufactured and sold snowballs. The issue was whether snowballs were 'food of any kind used for human consumption' within the scope of VATA 1994 Sch 8 Group 1 or whether they fell within the 'confectionery' exception (item no. 2), which itself excludes cakes.

The FTT observed that the question was whether a snowball had sufficient characteristics of a cake to be considered as such by an ordinary person. Based on the authorities, the FTT listed the following factors as relevant: ingredients, process of manufacture, unpackaged appearance, taste and texture, circumstances of consumption, packaging and marketing. The manufacturing process for Lees' snowballs and teacakes was very similar and that they were made on the same production line.

As for the Tunnock's snowballs, HMRC accepted that the only difference between them and teacakes was the grade of chocolate used in the coatings. Furthermore, the snowballs were sold by supermarkets in the cake section and never in the confectionery section.

Decision:

The FTT found that a snowball looks like a cake, is not out of place on a plate full of cakes and has the mouth feel of a cake. Additionally, most people would enjoy a snowball in the same way as a cake, with a drink, preferably seated with a plate and napkin (although this may depend on age and gender). The FTT concluded that a snowball had sufficient characteristics to be characterised as a cake.

Comments - The FTT observed that this was a 'fine balancing act' which turned mainly on questions of facts on the basis of factors extracted from the various authorities. In the absence of an objective test, food manufacturers are likely to be faced with continuing uncertainty.

Lees of Scotland & Thomas Tunnock v HMRC TC3754

Taxable supplies by statutory body

Summary - The UT partially set aside the decision of the FTT that the statutory body did not make taxable supplies.

The South African Tourist Board (SATB) promotes South Africa as a tourist destination. It is funded by the South African government under a performance agreement (PA). The issue was whether SATB made taxable supplies of marketing services or whether it was a statutory body receiving grant funding.

Decision:

The UT noted that Apple and Pear [1988] STC 221 was authority for the proposition that a statutory body can act in accordance with given objectives and discharge its duties by making supplies for consideration. However, the nature of SATB's obligations under the PA was also relevant. The UT concluded that the PA fell 'far short of demonstrating the nature of reciprocity required to constitute the payments' received by SATB as consideration for supplies.

The UT found however that incidental activities such as marketing initiatives with the airline Emirates and services to the Tourism Business Council of South Africa (TBSCA) were taxable supplies. TBSCA's payments, in particular, were aimed at obtaining certain privileges.

Comments - The decision is a reminder that a statutory body funded by a government can make taxable supplies, provided that a relationship of reciprocity exists.

South African Tourist Board v HMRC (FTC/46/2013)

Exercise of option to tax

Summary - The FTT found that a property was subject to an option to tax.

Mr and Mrs Hills were the buyers of a freehold property and the issue was whether VAT should have been charged on the sale. Mr and Mrs Patel had used a self-invested personal pension plan (SIPP) to purchase the property in 2003. Mr Patel died in September 2010 and the sale by the trustees of the SIPP to the appellants was agreed shortly thereafter in December 2011. In July 2010, the trustees of the SIPP had written to HMRC to make a 'belated notification of option to tax' (VATA 1994 Sch 10).

The Hills argued that the election had no application as it had not been made by Mrs Patel who was the beneficiary (Sch 10 para 40).

The FTT found that the benefit of the consideration accrued to the trustees and not to Mrs Patel, relying in particular on the fact that a number of calls existed on the sale proceeds before her entitlement.

Decision:

The FTT also held that the decision to opt to tax had been made on 30 March 2004, at the time the property was acquired — as the use of a SIPP suggested that tax implications were considered at the outset. Additionally, the FTT rejected contentions that the anti-avoidance provisions (Sch 10 paras 12–17) disapplied the option as Mrs Patel had not been a 'development financier'.

Finally, it held that no exempt grant — which would have required prior permission from HMRC (Sch 10 para 10) — had taken place before the exercise of the option. This was because, although the rent invoices stated 30 March as the beginning of the lease, the lease itself gave 31 March as the rent commencement date.

Comments - This is a useful example of the pragmatic approach a tribunal will adopt when ascertaining whether a property is subject to an option to tax.

Darren and Lynn Hills v HMRC TC3770

The cost sharing exemption and the 'exact reimbursement condition'

Summary - The FTT found that the cost sharing exemption did not apply.

The West of Scotland Colleges Partnership (WOSCOP) had been established as the colleges' collective representative to access grant funding from the EU. The issue was whether the conditions for the VAT cost sharing exemption were satisfied (VATA 1994 Sch 9 Group 16). The VAT cost sharing exemption applies where two or more VAT exempt organisations join together to form a separate independent entity, to supply themselves with services at cost price. Without the exemption, there would be an irrecoverable VAT charge on those services.

The dispute related to the 'exact reimbursement' by members of their shares of joint expenditure. This was a condition for the exemption.

Decision:

The FTT observed that the exact reimbursement rule could be met over a period of time and that some attempt had been made by the colleges to differentiate the interests and benefits accruing to each of them. However, it also noted that no written record supporting a calculation of exact reimbursement had been produced and that the oral evidence did not even seem to support an awareness at the material time of the true nature of the test.

Comments - Although the colleges were clearly within the 'spirit' of the exemption, the FTT applied the rules strictly and denied the exemption.

West of Scotland Colleges Partnership v HMRC TC3746

Supplies of holiday accommodation are subject to UK VAT

Summary - The FTT dismissed the taxpayers' appeal for the second time.

The taxpayers ran a hotel on the Isle of Wight. Some visitors made direct bookings but others booked through a travel agent. Until autumn 2011, the taxpayers' VAT returns were completed on the basis that all the accommodation supplies were standard rated.

In October 2011, the taxpayer claimed a refund of the VAT accounted for on supplies to foreign travel agents. HMRC made the repayment but then reclaimed it saying it had been wrongly repaid. The taxpayers appealed, saying the legislation was complex and that even some HMRC officers seemed confused about the correct treatment of supplies to agents based outside the EU.

Decision:

The First-tier Tribunal said that the supply of hotel accommodation had to be treated as taking place in the UK, regardless of whether it was supplied to an individual, a UK-based business or one outside the UK. Therefore, the supply was liable to standard-rated VAT.

There was no requirement for the taxpayers to complete an EU sales list, or for the travel agent in the other country to make a reverse charge calculation on its own VAT return because there was a charge to UK VAT.

The taxpayers' appeal was dismissed. The decision in TC3755 replaced TC3615 because the first one did not take account of a letter from the taxpayers that the tribunal decided should be allowed in evidence. The tribunal reached the same conclusion.

Comments - The taxpayers had clearly been misled by conflicting statements by HMRC staff. This was however not enough to establish a legitimate expectation in the absence of a clear and unqualified statement.

Neil Warren, independent VAT consultant, said:

> “This case was complicated by the fact that the taxpayers assumed that, because they had been sent an EU sales list by HMRC, their supplies to EU travel agents outside the UK would not attract VAT. However, the issuing of the sales list was likely to have been caused by the fact that they made an incorrect entry in box 8 of one of their VAT returns — this box should always be left blank in relation to EU sales of services, as it is only relevant to the sale of goods.”

Mr and Mrs Baldwin trading as Ventnor Towers Hotel TC3615/TC3755

Were services rendered in course of a business?

Summary - The FTT found that the taxpayer had rendered services in the course of a business.

Mr Spencer-Churchill (SC) was having dinner with Mr Lyons, who was the vendor of an extremely valuable property, and a second gentleman referred to as 'Jean Luc' (JL). JL had been introduced to SC by Aylesford, a firm of international estate agents. As it happened, a Mr Goncharenko, who was known to be looking to buy a high-end property, was having dinner in the same restaurant. JL, who knew Mr Goncharenko, made the necessary introduction and the contracts for sale of the property were exchanged within two days.

Although, no fee had been formally agreed for the introduction, Mr Lyons agreed to pay £500,000 to be shared by whoever had been involved. A series of acrimonious emails followed as SC, JL, Aylesford and Knight Frank (who originally had been involved with both the vendor and the purchaser), each fought for a share of the fee. It was finally agreed between them that SC would receive £125,000 — although he was eventually paid only £108,000. HMRC contended that VAT should have been paid in relation to the service rendered by SC.

Decision:

The FTT accepted that there was no contract between Mr Lyons and SC; nor was there any informal undertaking for the payment of a sale commission at a particular level. However, the FTT observed that there must have been some 'handshake deal', as a result of which Aylesford had become involved in the sale of the property. Under this 'deal', it was implicit that SC would perform some introductory service and that he would be entitled to a substantial payment in the event of a sale. The FTT concluded that SC had performed a service for consideration. The absence of a business structure may be a factor that 'derogates from the conclusion that the supplies are business-like', but the FTT rejected any suggestion that a 'one-off business-like supply' cannot be a supply in the course of a business. The FTT concluded

that SC's activity was not some activity in the course of a 'social engagement', but a business venture conducted alongside other participants who all expected to pay VAT.

Comments - The fact that the taxpayer expected to be paid was fatal to his argument that he was not engaged in a business venture. This may be relevant in very different circumstances.

Alexander Spencer-Churchill v HMRC TC3763

Totel Distribution Ltd v CRC, Upper Tribunal

Supplies of accommodation to the homeless

Summary - The FTT held that supplies of accommodation to the homeless were exempt.

Atlas property owned a number of basically furnished homes which local authorities rented to provide temporary accommodation to homeless people. The properties were neither available nor marketed to the general public. Once a lease (or licence) had been granted to the local authority, the only services provided by Atlas Property were the emptying of bins, the cleaning of the common parts and gardening. Although occupancy was always intended to be temporary, pending the finding of longer term accommodation by the local authority, the average period of occupancy was eight months.

Decision:

The grant of an interest in land is exempt from VAT, unless it is the provision of hotel accommodation or 'similar establishment' suitable for use by travellers (VATA 1994 Sch 9 Group 1). The FTT observed that the properties were not used by travellers; the question was therefore whether they were 'similar' to a hotel by reference to other characteristics. It noted that periods of long stay are highly unusual features of the use of accommodation in hotels and pointed to the 'home-like' nature of the accommodation. The FTT added that Atlas Property provided very few 'hotel-like' services. In particular, no food, cleaning or reception desk services were provided. Finally, it noted that the accommodation could not even be likened to 'serviced flats', as it was not cleaned daily.

Comments - In deciding whether Atlas Property was supplying hotel accommodation, the FTT referred extensively to HMRC's own guidance (VATLP11400), focusing in particular on the absence of even 'minimal' 'hotel-like' services. Also worth noting is the fact that although it was clear that the intention of the parties was always that the letting would be for a short time, the fact that it nearly always ended up lasting a few months made the accommodation less 'hotel-like' in the eyes of the FTT.

Atlas Property London v HMRC TC3797

Exercise of discretion by HMRC

Summary - The UT ordered HMRC to exercise its discretion to accept evidence for the deduction of input tax.

The taxpayer had failed to supply self-billed invoices in relation to the purchase of scrap metal from four suppliers. HMRC had not allowed the recovery of input tax, despite having a discretion to do so (VAT Regulations, SI 1995/2518, reg 29).

Decision:

Having reviewed the extensive correspondence between the parties, the UT concluded that HMRC had made no attempt to consider the exercise of the discretion.

Furthermore, even if HMRC had considered the exercise of the discretion, the refusal to exercise it in Housley's favour was based entirely on the absence of a self-billing agreement between the taxpayer and his suppliers. This was giving too much weight to such an agreement, to the detriment of other evidence. In particular, self-billed invoices had been consistently used and Housley had obtained VAT registration numbers and certificates for the relevant suppliers.

The UT concluded that HMRC should now exercise (or re-exercise) its discretion in the light of the totality of the evidence.

Comments - The UT directed that HMRC exercise its discretion and suggested that the taxpayer should accept that HMRC would not be out of time for making a further assessment. This pragmatic approach would have the advantage of making a further hearing unnecessary.

HMRC v GB Housley (FTC/65/2013)

Extension or independent annexe?

Summary - A new structure was held to be an extension subject to standard rated VAT.

Gateshead ran a nursery. It had built additional accommodation and appealed against HMRC's decision to treat the construction services for the new structure as standard rated.

Under VATA 1994 Sch 8 Group 5, the construction services could only be zero rated if the new structure was not an extension but an annexe capable of functioning independently, with its own main access. It was accepted that the building was to be used 'solely for relevant charitable purposes'.

Decision:

The FTT observed that the test was objective and that the way the building was actually used or accessed might guide the answer but was not determinative.

The FTT found that the new structure was simply an additional room which was fully integrated with the existing building both externally (architecturally) and internally (in terms of layout). It therefore constituted an extension rather than an annexe.

The FTT added that even if the new structure had been an annexe, it would have failed the test as it did not have its own independent main access.

Comments - This is yet another case showing the difficulty of establishing the difference between an extension and an independent annexe. Interestingly, the new structure was capable of functioning independently as an annexe, but it would have failed the test as an annexe because it did not have its own main access — although it could be accessed directly.

Gateshead Jewish Nursery v HMRC TC3807